November 12, 2009

To: TRAC
From: Rick Todd, President, South Carolina Trucking Association
Re: Highway-Use & Business Taxes on Motor Carriers

<u>TRAC's Purpose</u> - The Title of TRAC's enabling legislation reads: "...TO FURTHER THE GOAL OF MAINTAINING AND ENHANCING THE STATE AS AN OPTIMUM COMPETITOR IN THE EFFORT TO ATTRACT BUSINESS AND INDIVIDUALS TO LOCATE, LIVE, WORK, AND INVEST IN THE STATE..."

One of the documents distributed after the first meeting said: ***"The <u>ultimate</u> goal of the TRAC Commission is to enhance the state's reputation as a competitive, pro-business environment that supports the expansion of existing business and industry and encourages new business and individuals to locate, live, work and invest in SC."***

SC is a small trucking market. This goal cannot be accomplished if the *Rolling Stock* of SC's motor carriers cannot be competitively purchased, registered and domiciled here. Sales and property taxes are critical components of a successful state strategy.

<u>Background on the "trucking industry"</u> - By law, **practically every entity – regardless of type of business or size of operation – that operates a commercial motor vehicle over 10,000 lbs. is classified as a "motor carrier."** There are almost 500,000 *inter*-state for-hire and private (business that owns it own trucks and hauls for itself – i.e., "corporate trucking") motor carriers in the US. Two-thirds of all medium and heavy-duty trucks in the US are operated by private, Main Street-type businesses, not for-hire trucking companies. The average motor carrier has fewer than 6 trucks. SC has over 27,000 *intra*-state motor carriers.

The average retail price of a road tractor is now $105,000-110,000; $165,000 – 175,000 for the average dump truck. SC sales will average 1,500-2,000 of these types of heavy-duty trucks in a normal year. The average retail price of a commercial freight-hauling trailer will cost at least $15,000 and increase exponentially, depending on the type of specialization of equipment needed for the commodity being transported. **SC should encourage these commercial vehicle sales through *SC dealers.***

In addition to the federal taxes levied by the U.S. Government, interstate motor carriers are also subject to state and local taxes in each of the states. There is little direct coordination or uniformity among state tax systems, although most show a certain similarity to one another. To its credit, SC is fairly consistent – something we **should strive to maintain so our SC-based carriers are competitive with their out-of-state counterparts.**

The state and local taxes to which motor carriers are subject fall fairly neatly into two classes – general Business Taxes and Highway (or Operating) Taxes. When comparing states' tax burdens, **TRAC should take into account all of the various SC taxes and their impact on motor carrier's equipment purchases and registrations – and the cost burden of the SC-based truck fleet owner in comparison to their competitors.** (See **Exhibit B)**

<u>General Business Taxes</u>

The Federal Excise Tax **(FET) on heavy-duty trucks is 12%.** This revenue is deposited into the federal Highway Trust Fund and is returned to the states for highway purposes.

State and local governments levy a variety of taxes and fees on businesses, including interstate businesses, operating within their borders. The situation of the interstate trucking industry with respect to these classes of tax may be summarized as follows.

<u>Sales Taxes.</u> **SC's sales tax on trucks and trailers ("Rolling Stock") is capped at $300.** (See **Exhibit A) (See Exhibit C,** letter by *The Strom Thurmond Institute* at Clemson, declaring them **"an important class of vehicles that deserve some special treatment.")**

However, over half the states exempt interstate motor carriers' purchase of vehicles. This is done partly from equitable considerations, since, because sales taxes are not generally apportioned, it makes little sense for a state to collect a full tax on property that will be used both inside and outside the jurisdiction. Exemptions stem from an effort to protect local fleets from their low-cost interstate competitors, local truck sellers, and to cause interstate fleets to purchase in their respective state. It is recognized that carriers will purchase trucks where they are not subject to tax. Also, **commercial vehicles are not luxury vehicles, and are used to produce, distribute or deliver items which are subject - or will after further processing – become subject to the sales tax.** A smaller but still substantial number of states exempt truck parts, tires, and repair services. A small number of the states without full exemptions allow carriers who will use their purchases partly within and partly without the state to pro-rate the sales tax they pay.

All states that levy sales taxes also levy a corresponding "use tax" (not to be confused with a fuel use tax) on property brought untaxed into the state which would have been subject to the sales tax if it had been purchased in the state. It has been a nearly universal practice among states to grant sales and use tax reciprocity to vehicles registered in other jurisdictions.

Property Taxes. Taxes on real and personal property are the largest and, in many instances, the only significant source of tax revenue for the 63,000 units of local government in the states. Business as a whole pays more in property taxes any other tax.

A particular jurisdiction may impose different rates on different types of property, and the general level of rates can vary widely among jurisdictions, even within a single state. Federal law prohibits a jurisdiction from taxing motor carriers' real and personal property at a rate higher than that applied to other business property in the locality. Trucking companies are almost universally subject to property taxation on their holdings of real property – terminals, staging areas, and other pieces of land. **Exemptions are common for business personal property and *for property used in interstate commerce.*** (See **Exhibit B)**

More than half the states exempt the vehicles of interstate carriers, frequently in return for the payment of higher vehicle registration fees*. A few others allow carriers based within their borders an apportioned exemption, based on miles traveled within and without the state (SC). Most states allow property tax reciprocity for vehicles registered elsewhere, but a few require the payment of an apportioned tax on both in-state and out-of-state based trucks. (SC- if have real property in SC.) In many cases, considering the low tax liabilities involved, these taxes can be extraordinarily burdensome for motor carriers to comply with.

In SC, intra-state vehicles are taxed locally. Interstate vehicles pay apportioned property taxes, based upon their fleet's SC miles as opposed to 100%. Out-of-state fleets that operate through their SC warehousing and distribution facilities pay an apportioned fleet tax too. This system is fair, but it levies a 9.5% assessment ratio, which should more fairly be set at 6%. *A growing number of states which do not exempt interstate trucks from property tax are collecting this tax, usually in the form of an apportioned in-lieu fee, through the IRP.*

Business License Taxes. At the local level, most towns and cities require local businesses to buy business licenses, usually at a rate of so much per location. Truck terminals may be expected to do this as well, and certainly locally-headquartered for-hire trucking companies must do so – and the license must be fairly apportioned. In a few places, however, a local government will attempt to collect this or other types of fees from motor carriers simply making deliveries or picking up freight in the locality. These fees can be burdensome nuisances to interstate carriers, and there is reason to doubt their constitutionality.

Income Taxes. Forty-five states levy corporate net income taxes and forty-one levy personal income taxes. Recent federal legislation, however, has prohibited a state taxing the personal income of a trucking employee (which includes an individual owner of an operation) who is engaged in interstate operations in the state and who does not live there. **SC has a threshold/nexus for corporate income tax liability**.

Highway Taxes

Highway or operating taxes may be defined as "user fees." Primarily they include vehicle registration fees, fuel taxes, and tolls.

State highway taxes (and returned federal use taxes) provide by far the largest part of the funds used by state governments for roads. Local streets and roads are generally funded in large measure through property taxes.

Fuel Taxes. Fuel taxes are imposed, at a rate of so many *cents per gallon*, by every state and by a few local governments, if specially authorized. **The average state tax rate is 24.78 (25.67 – diesel) cents a gallon, and has more than doubled over the last twenty years. (SC's has remained at 16.75 - for 22 years.)**

Some states impose sales tax on motor fuel. (A word of caution: state agencies and the education establishment jealously guard sales tax revenues – and it will be a hard fought battle to secure motor fuel sales tax revenues exclusively for DOT.) Often, the proceeds from this tax are designated for highway purposes; and since the tax is also in cents per gallon, these levies are merely a part of the motor fuel tax. (Some states claim this is a "diversified source" of revenue for their DOT - as if it were actually a non-related subsidy from their General Fund.)

Non-highway fuel and heating oil are exempt from fuel tax. The "gas tax" is applied on the wholesale level and collected by the wholesaler from the service station operator and by the latter from the highway user. Practically no heavy trucks now use gasoline. A growing number of fleets are using propane, compressed natural gas, or some other "clean" fuel, and pay a fuel tax on that. Some heavy vehicles operating with electricity may soon be here. The effect on the traditional diesel fuel tax is unknown, but it will take a long time.

Collection: The collection point of the tax on **diesel fuel** varies by state, but it is **at the "rack" in SC**. More than half the states (SC) **collect it at the wholesale or terminal levels (rack)**, and the others collect it at the service station level.

Trucking fleets, depending on the nature of their operations, buy fuel either in bulk directly from a wholesaler, or at retail at a truckstop along the highway. Ordinarily, they pay tax to the seller at the time they get the fuel. But that is not the end of the matter for those operating heavy commercial vehicles (commonly defined as those weighing over 26,000 pounds gross weight) *inter*state. **Such users are also subject to what is variously called a fuel-use tax, road tax, or motor carrier fuel tax.**

History: Practically all of the states (but no local governments) impose this sort of tax, which *used* to work like this: At the end of every quarter, each company filed a report detailing the miles it had traveled and the fuel it had purchased in each state in which its vehicles had operated, computing, on the basis of miles traveled, the fuel used in each jurisdiction, and crediting the taxes which may have been paid during the quarter on fuel purchased in that state. If more fuel was used by the company than tax was paid, it paid the state the additional tax due; if more fuel was purchased than used, the company filed its report and got a refund of the difference from the state.

In this way, each state received its share of the tax on fuel actually used by heavy trucks on its roads. The system is inherently somewhat cumbersome, but was until recently made much worse by differing administrative requirements in each state. What was really just a redistributive mechanism for taxes already paid on the purchase of fuel became very expensive for the states and even more so for the trucking industry.

Now: Working together on this problem, state officials and the industry developed a **multi-state agreement, the International Fuel Tax Agreement (IFTA)**, bringing a high degree of uniformity to the area of state fuel use taxation and eases the industry's administrative burden. Under IFTA, a carrier chooses a member state (usually its home state) as its base, registers with that state for fuel use tax on behalf of all the other IFTA states, files a consolidated report and pays a net tax to its base for all the other states, and is audited by its base on behalf of all the IFTA members. **The base state in turn is responsible for distributing the carrier's tax payments among the other member states in which the carrier traveled.** In precedent-setting legislation enacted in 1992, Congress in effect required all the states that levy fuel use taxes to join IFTA before the end of 1996. All of the Canadian provinces have also joined IFTA.

<u>Vehicle Registration Fees</u>. Before any vehicle travels on the highway, it must be registered; that is, its operator must pay a flat fee to the state in which it is based and receive a license plate which evidences the payment and serves to identify the vehicle. All states levy annual registration fees. The fees charged are roughly proportional to the gross weight of a vehicle, and vary greatly from state to state. The average fee is about $1,600* per power unit (truck tractor) registered to haul 80,000 pounds combined gross weight. (SC is $800 – plus - a relatively high property tax.) Truck trailers are also registered, but only for nominal sums and often for a period of more than a single year. A growing number of states offer the option of a permanent trailer plate. (SC adopted a one-time fee-in-lieu and permanent trailer tag, as part of a change in the way it levies interstate power-unit property taxes.)

Light-duty vehicles (<26,000 lbs gross weight) commonly operate interstate on a system of reciprocity; that is, each state recognizes the validity of another state's license plate to the extent the second state recognizes the license of the first. (Just like cars have universal reciprocity.)

For medium and heavy-duty trucks, however, all of the contiguous 48 states and the ten Canadian provinces belong to the International Registration Plan (IRP), a base-state agreement much like IFTA and similarly mandated in the United States by federal statute. Under IRP, a carrier chooses a base state for its fleet of vehicles, applies for its license plates to that one state, and reports the proportion of miles its fleet traveled during the preceding year in each state. The base state calculates the fees for the fleet vehicles for all the member states in which the carrier intends to operate in the coming year on the basis of the percentages of fleet miles traveled in each, bills the carrier, and distributes the revenues to the other member states. The carrier is furnished by its base with a single IRP license plate for each of its power units and is then registered in each IRP state for which it has paid.

<u>Tolls</u>. Toll roads exist in about a third of the states, and toll bridges or tunnels in half. Tolls are commonly imposed as a means of paying for the specific facility concerned, whose construction will probably have been funded by the selling of state bonds. Tolls are usually set at so much per mile, and are often calculated according to the number of a vehicle's axles.

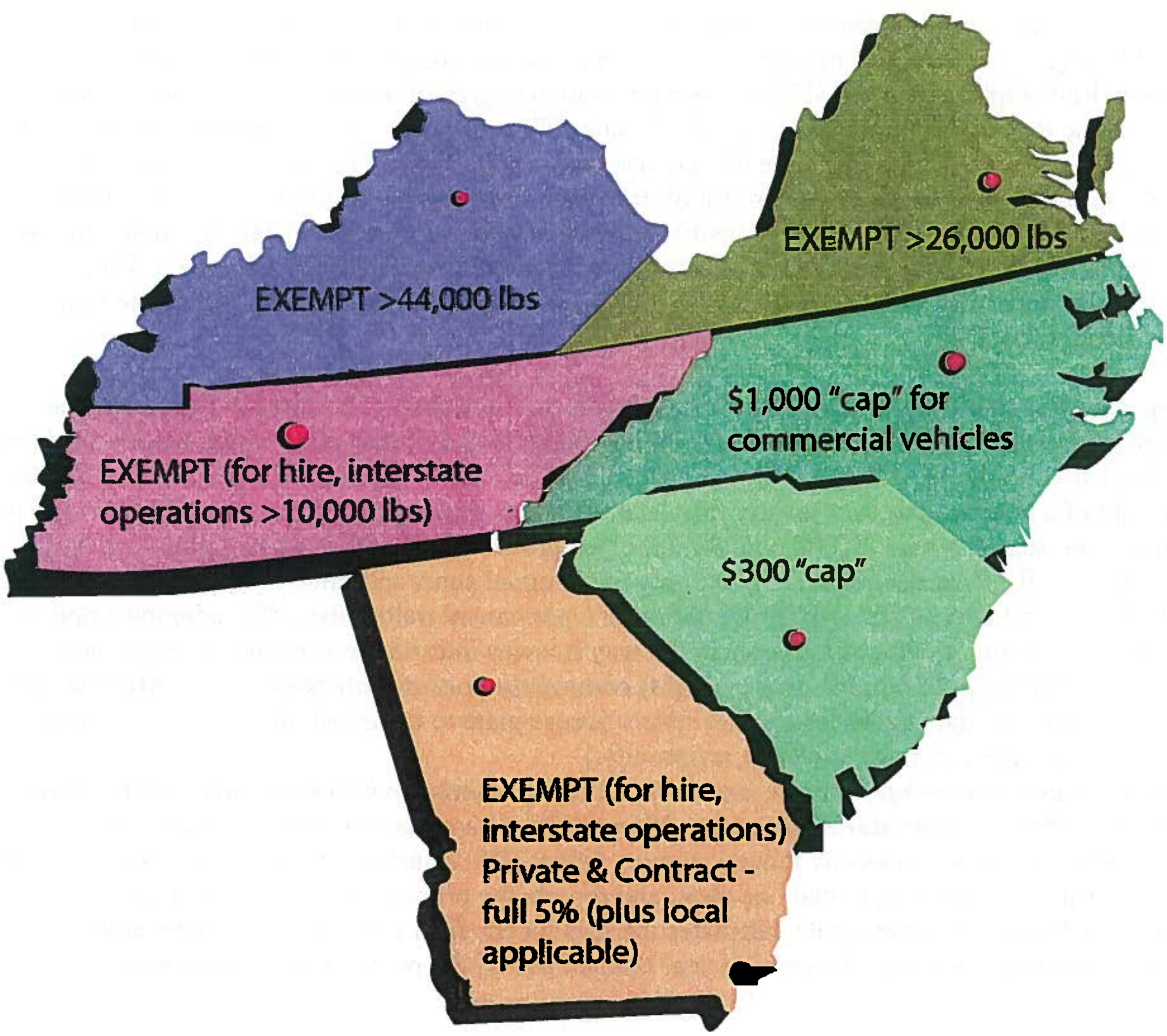
Tolls are generally considered an inefficient and inequitable means of funding a road, since highway users will be paying taxes twice for the use of it – first the tolls and second the fuel and registration fees they pay anyway. An exemption for fuel taxes can reduce one inequity, but this is rarely provided. In addition, toll roads are often administered inefficiently, since cash flow from the facility is assured. Finally, tolls are often set by a state at a level that will bring in more money than is actually needed by the toll road alone, so that toll-road users are actually subsidizing the maintenance of other roads as well.

Having said this, however, it must also be said that many bridges and tunnels could not have been built without the assurance of toll funding, and, as roads become more and more expensive to build, tolls may be resorted to rather more for highway funding than they have been in the past. Recent federal legislation has sought to encourage this, but traffic counts must be sufficient to cost-justify. **In SC, it is hard to imagine toll revenue being sufficient to pay anywhere near 100% of the cost of a new facility.**

EXHIBIT A

Sister-States Sales Tax on Trucking Equipment

(States "compete" for sales & registrations of rolling stock)



State Sales & Property Taxes on Trucking *Rolling* Stock

SC competes directly with our sister states for commercial trucking equipment purchases, registrations and the taxes that go with them. The Legislature has worked with us to adjust our truck tax structure so that it is fair and reflects the realities of interstate commerce - understanding the nature and importance of interstate "rolling stock."

Competing States[1]: Sales and Property Taxes on MOTOR CARRIER ROLLING STOCK - Annual

	Sales Tax (trucks, trailers):		Sales Tax on Parts:		Total Sales Tax Paid	Property Tax Paid	Total
State	Sales Tax Rate	Sales Tax Paid	Sales Tax Rate	Sales Tax Paid			
Florida	6%	$1,575	6%	$300	$1,875	Exempt	$1,875
Georgia	For-hire with interstate operations EXEMPT	-	Exempt	-	-	$1,932	$1,932
North Carolina	3% ($1000 cap)	$363	4% - apply for refund - EXEMPT	$200	$563	$771 *	$1,334
South Carolina	6% ($300 cap)	$150	6%	$300	$450	$1,682	$2,132
Tennessee	F-hire >10,000 lbs, interstate operations EXEMPT	-	3.75%	$188	$188	$683	$871
Virginia	Exempt over 26,000 lbs	-	5%	$250		$2,146 *	$2,396

Notes: These figures represent sales and property taxes paid in each state for a tractor-semitrailer combination operated by a regulated for-hire interstate motor carrier. For purposes of this comparison, the vehicle is assumed to operate all of its miles in the state in which it is based. The italicized figures represent amounts that are apportioned according to mileage traveled in the state.

The combination has a manufacturer's suggested retail price of $125,000, its purchase price was $105,000 (the tractor $90,000, the trailer $15,000), has a useful life of 4 years, and is in its first year of operation. It is assumed to be worth $75,000 on the retail market and $58,000 as a trade-in. It requires $5,000 worth of parts per year, including tires.

The sales taxes on the purchase of equipment, which are amortized over the useful life of the tractor and trailer, do not in each instance correspond to the tax rate, since some states cap the amount of tax due on a single transaction involving rolling stock. The extent of state sales tax exemptions for rolling stock vary greatly. Local sales taxes are not included here.

Property taxes, which tend to vary widely depending on locality, are calculated here for the capital city of each taxing state.
*NC - NC property tax is based on retail value, and NC has not changed that this year (although they should have reduced it).
*VA - VA property tax is based on trade-in value (although it should have fallen).

*27 states *exempt* truck rolling stock from *property* taxes.

*34 states either *levy no sales tax* - or - *exempt* motor carrier rolling stock from *sales* tax.

EXHIBIT C

THE STROM THURMOND INSTITUTE

October 10, 1994

MEMORANDUM

TO: Staff, Joint Ad-Hoc Committee on Tax Restructuring

FROM: Jim Hite

SUBJECT: Sales Tax Cap on Vehicles and Exemption for Commercial Vehicles

In my zeal to see the inequity removed that results from the present sales tax cap on auto vehicles, I overlooked an important class of vehicles that deserve some special treatment. I am referring to commercial vehicles used in producing, distributing, or deliverying items which are subject, or will after further processing become subject, to the sales tax.

If we are to be even-handed in providing exemptions for various types of inputs used in further production, we must also extent a similar exemption to transportation inputs. Assuming the present cap is removed, it will take a little work to determine precisely how this exemption might best be effected. But as long as the other exemptions on inputs are in the law, such an exemption needs to be preserved.

cc: Holley Ulbrich

THE STROM THURMOND INSTITUTE OF GOVERNMENT AND PUBLIC AFFAIRS
Clemson University • Box 345130 • Clemson, South Carolina 29634-5130 USA • 803/656-4700 • FAX 803/656-4780