Fuel Tax Subcommittee of the South Carolina Taxation Realignment Commission (TRAC)

Draft Report and Recommendations to Full TRAC

August 10, 2010

Members of the Fuel Tax Subcommittee of the South Carolina Taxation Realignment Commission (TRAC) are: Kenneth Cosgrove (Chair), Ben Kochenower and Don Weaver.

The Subcommittee finds it within its prevue to study issues related to the State's road funding pertaining to the adequacy of both the amount of revenue currently generated and specifically related to the adequacy and effectiveness of the State's current motor fuel excise tax (in terms of both its rate and structure) and how that tax and/or structure impacts the amount of revenue generated.

As such, the Subcommittee finds that:

- Adequate/sufficient funding by the State for road and/or transportation related infrastructure projects is of paramount importance for both the mobility and safety of the State's citizens and is an important aspect of the State's long term economic development.

- The majority of State road funding for the Department of Transportation to construct or maintain the State's transportation related infrastructure is the motor fuel excise tax, referred to by statute as a "user fee", which generates approximately $500 Million annually.[1]

- An excise tax is a "fixed rate tax" which remains unchanged regardless of changes in the price of motor fuel and/or changes in the price of oil.

- The current motor fuel excise tax rate is 16 cents per gallon of gasoline or diesel fuel sold, excluding 0.75 cents per gallon for inspection and/or environmental fees. Including those additional fees, the total motor fuel user fee is 16.75 cents/gallon "at the pump".[2]

- This rate of tax (16 cents/gallon) has remained unchanged since 1987.[3]

- SC's current rate of tax is the lowest of the 12 states that comprise the Southeast[4] and is the 3rd lowest in the entire country.[5]

- Compared to our neighbors, SC's excise tax rate is 7.25 cents per gallon lower (or 30 percent less) than Georgia's (approximately 24 cents/gallon) and is 13.15 cents per gallon lower (or 45 percent less) than North Carolina's (29.9 cents/gallon).

- Due to the current structure of SC's tax (fixed rate excise), road funding is, in essence, completely tied to consumption, which has been trending flat or downward as a result of several factors including increasing fuel efficiency and a gradual switch to hybrid and/or alternative fueled vehicles.

- As a result, and absent a fuel tax increase or structural change, the only significant way to increase motor fuel revenues is to increase the number of vehicles on the state's roads and/or burn more gallons of motor fuel within our state. However, this actually puts more strain on the State's roadways, requiring more maintenance and therefore seemingly compounding the issue(s) at hand.

- As evidence of this trend, over the last 13 years (FY97 to FY09), motor fuel revenue has grown at a rate of 2 percent per year.[6]

- In contrast, the growth of population plus inflation[7] has averaged approximately 4 percent/year during that period and the growth of a price of a barrel of oil[8] (a primary "ingredient" in road construction cost) has grown at 10 percent per year (Note: In 1987, it cost approximately $26,000 to pave 1 mile of 2 lane roadway. Today that same cost is $180,000 (a 9 percent/year increase)).[9]

- Taking a more near term snapshot (FY05 to FY09) motor fuel revenue has grown at just 0.58 percent per year and revenues declined by 3.6% in FY09.[10]

- As a result of these and other factors, South Carolina road funding/support from state sources (as measured by "net state funds per mile" (excluding SIB* funds)) ranks 49th, at $20,000 per mile. The US average of net state support is $89,000 per mile.[11] *Note: If SIB funds were included, SC's per mile total would increase by approximately $3,000/mile, potentially improving the State's ranking by roughly 3 to 4 spots.

- As such, and based in part on the findings above and other factors, the Subcommittee finds the current level of road funding invested by the State to be inadequate.

And while the Subcommittee further finds that the State may be overly reliant on one primary source of road funding (motor fuel excise tax), as evidenced by the fact that a relatively small portion of DOT's funding comes from any source other than the motor fuel excise tax, the Subcommittee believes it is outside of its authority to make budgetary/appropriation recommendations to the General Assembly.

As such, TRAC cannot make a recommendation that the General Assembly simply increase General Fund appropriations for road funding which would have the effect of necessitating a shift of funding from one functional area of state government to another. That is the prerogative of the General Assembly, not TRAC.

Instead, as TRAC's primary purpose is an examination of the state's tax rates and structures, a component of which is certainly the motor fuel excise tax or "user fee", the Subcommittee has limited its principal recommendation(s) to issues surrounding the State's current motor fuel excise tax.

Therefore, based on the findings above, the Subcommittee recommends that the Full TRAC committee forward **BOTH** of the following proposals (in their entirety) to the General Assembly so that it may determine which proposal is best to implement in South Carolina. Note: The Subcommittee finds that both proposals have merit and therefore determines that the General Assembly should have the opportunity to study each.

1) Current Structure:

- Increase the current 16 cent/gallon motor fuel excise tax on gasoline and diesel fuel by 5.5 cents/gallon, bringing the total state excise tax including fees to 22.25 cents/gallon.*Note: The half cent increase over and above the base 5 cent increase proposed will be temporary, with proceeds dedicated to the SUPERB fund, and will be repealed immediately upon the fund returning to solvency.

- The Subcommittee approximates that this would generate an additional $150 Million in revenue for the Department of Transportation annually, depending on consumption and related issues (as discussed above). Note: This estimate requires verification (or correction) by the Board of Economic Advisors and/or the Department of Transportation and as such is for informational purposes only.

- This increase would provide needed revenue for roads while keeping the tax rate competitive with Georgia and North Carolina.

2) Structural Modification:

The Subcommittee reviewed, and wishes to advance, a proposal to modify the current fixed rate excise tax to a "hybrid" tax based on a combination of a price component[12] and flat excise tax component. Similar structures currently exist in both Georgia and North Carolina.[13]

Specifically, the proposal:

- Ensures that the price component is an excise tax, rather than a sales tax, to ensure the money continues to be dedicated to roads and is not unintentionally diverted to the General Fund for other uses.

- So as to ensure no burden or cost to retailers and distributors in implementing this new structure, continue the tax collection and remittance point at the terminal rack level.

- Recommends adjusting the price component at least annually, or semi-annually (every 6 months) to capture a tax rate that more accurately reflects fuel prices in a timely manner.

- Ensures a "floor", or minimum tax rate regarding the variable rate so that road funding is stabilized to the extent possible.

- Recommends a "ceiling", or maximum tax rate, that cannot be exceeded. An appropriate ceiling to consider would be NC's "floor" (that is, the total tax rate could not exceed 29.9 cents/gallon as that is NC's current "floor").

- Ensures that any fuel structure change should account for the current distribution of portions of the gas tax revenue as required under current law, so that those distributions are not unintentionally and adversely affected (this is a technical/mathematical exercise that can easily be incorporated into any final recommendation as necessary).

- Recommends that in the transition to the hybrid tax structure, that the DOR has adequate resources to properly and timely implement the new structure.

- This recommendation is "revenue neutral" the first year when the current 16 cent/gallon excise tax is reduced by 9-cents (to 7 cents/gallon) and it is combined with a price component of 4.65% (x the current weighted average wholesale price ($1.935 x 4.65% = 9-cents/gallon)). *Note: In addition to the 7 cents/gallon referenced above, the recommendation adds an additional half cent increase and will be temporary, with proceeds dedicated to the SUPERB fund, and will be repealed immediately upon the fund returning to solvency.

<u>Additional Recommendation(s):</u>

- The Subcommittee further recommends that the General Assembly consider adoption of a modified version of Arkansas's innovative approach regarding ad valorem taxation of out of state trucks based on the amount miles driven by those trucks in state and other factors. This new revenue stream would help to diversify the State's funding portfolio without putting additional burden on our State's drivers or our in-state trucking companies. Such a diversification is important as South Carolina has an inordinate amount of State maintained roads compared to the average state (see attached for the Arkansas statute referenced above).

- Alternative Fuel Vehicles. As noted above, the nation and state is experiencing a gradual trend to use of not only more fossil fuel vehicles which are more fuel efficient, but a shift towards vehicles that do not use fossil fuels (gasoline/diesel) at all. Because State funding for roads comes almost exclusively from taxes imposed on gasoline/diesel consumption, as this trend continues, it will naturally lead to less road revenue as drivers of such vehicles have no mechanism by which to contribute to road maintenance under the current system/structure. Simply put, alternative fuel vehicles, and the normal wear and tear that results from them, as with any vehicle, needs to be accounted for. As such, the Subcommittee recommends that the General Assembly accept with foresight this gradual but long term trend and begin planning accordingly.

Note: The Subcommittee also reviewed other recommendations that could increase road funding, including removal of the sales tax exemption on motor fuel and elimination of the $300 car tax cap, and possibly using the resulting revenues for roads, but such recommendations would be in conflict with the TRAC recommendation that any revenue generated by changes to the current sales and use tax exemptions should be used to lower the overall sales tax rate ("broad base / low rate").

Notes:

1 Source: "Highway Funding 2008 - Ranked by Net State Funds per Mile", a 50-state comparison compiled by the South Carolina Department of Transportation from various federal and other sources. In 2008, total State funding for State roads (excluding SIB) was $839.9 Million, of which approximately $521.2 Million (62%) was from motor fuel revenue. Note: A small percentage of road funding from motor fuel revenue is made available to counties to fund locally maintained roads.

2 "South Carolina Revenue Sources and Fiscal Impacts", South Carolina Budget and Control Board, Division of Research and Statistical Services, Office of Economic Research (October 21, 2009).

3 "South Carolina Revenue Sources and Fiscal Impacts", South Carolina Budget and Control Board, Division of Research and Statistical Services, Office of Economic Research (October 21, 2009).

4 www.scstatehouse.gov/citizensinterestpage/TRAC/093009Meeting/TableofGasolineTaxesintheSoutheast.pdf

5 www.taxadmin.org/fta/rate/mf.pdf. Of the "lower 48" states, South Carolina has the 3rd lowest motor fuel tax behind New Jersey (14.5 cents/gallon - gasoline only) and Wyoming at 14 cents/gallon. Florida has a base state rate of 16 cents/gallon, but consumers must pay at least 12.6 cents/gallon more in county level fuel tax. When factoring in Alaska at 8 cents/gallon, South Carolina ranks as the 4th lowest motor fuel (gasoline and diesel) tax levy in the country.

6 "South Carolina Gasoline, Special Fuel, and Highway Use Fee Revenue by Type and Allocation", a report compiled by the South Carolina Board of Economic Advisors from State Treasurer and Department of Transportation year-end reports and reported in the "South Carolina Revenue Sources and Fiscal Impacts", South Carolina Budget and Control Board, Division of Research and Statistical Services, Office of Economic Research (October 21, 2009).

7 Between calendar year 1997 and 2009, the State's population increased at an average annual rate of approximately 1.4% per year, while the CPI increased at approximately 2.45% per year, for a total annual average increase of approximately 3.85% per year. Source: Unofficial staff estimate based on data from the U.S. Department of Commerce's Bureau of Economic Analysis and from the U.S. Department of Labor and the Census Bureau.

8 According to the U.S. Energy Information Administration, the 1997 "Weekly All Countries Spot Price FOB Weighted by Estimated Export Volume" annual average cost for a barrel of oil was $18.28. By 2009, that figure was $60.07, a 10% per year increase in the price of a barrel of oil.

9www.scstatehouse.gov/citizensinterestpage/TRAC/DOT%20Presentation%20Materials%20to%20TRAC%20Fuel%20Tax%20Subcommittee.pdf (see Page 1 of link).

10 "South Carolina Gasoline, Special Fuel, and Highway Use Fee Revenue by Type and Allocation", a report compiled by the South Carolina Board of Economic Advisors from State Treasurer and Department of Transportation year-end reports and reported in the "South Carolina Revenue Sources and Fiscal Impacts", South Carolina Budget and Control Board, Division of Research and Statistical Services, Office of Economic Research (October 21, 2009).

11 "Highway Funding 2008 - Ranked by Net State Funds per Mile", a 50-state comparison compiled by the South Carolina Department of Transportation from various federal and other sources.

12 TRAC recommends that the General Assembly use as its "price component" an "average wholesale price component" published on a timely basis by the U.S. Department of Energy. Using an average "wholesale" component is advantageous because it ensures the State does not inadvertently "tax a tax", which could happen if a "retail" price component was used.

13 Both NC and GA base their motor fuel tax rates on a combination, or a "hybrid" of: 1) a fixed rate/flat "per gallon" excise tax and a 2) variable rate based on some price component (similar to a sales tax) of fuel (either wholesale or retail). The two rates are summed to a final "cents per gallon" figure, providing a total tax rate for a period as described below. These rates are recomputed every 6 months based on a retrospective look at fuel prices over the previous period and are implemented prospectively during the following 6 months. Neither tax structure places additional cost or burden on the states' retailers and/or gas station operators by requiring them to collect, remit, or re-compute the tax. Instead, the tax is collected and remitted as it is here, at the terminal rack level (In NC; in GA it is at the distributor level).