

Department of Legislative Services
 Maryland General Assembly
 2015 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 589 (The President, *et al.*) (By Request - Administration)
 Budget and Taxation

**Motorist Tax Relief - Motor Fuel Tax - Consumer Price Index and Sales and Use
 Tax Equivalent Rate Adjustments - Repeal**

This Administration bill repeals (1) the indexing of specified motor fuel tax rates and (2) the future increases in the sales and use tax equivalent rate imposed on the specified price of motor fuel. The bill also repeals a contingency enacted by Chapter 429 of 2013 that requires the Comptroller to distribute 4% of total sales and use tax revenues to the Transportation Trust Fund (TTF) if federal remote sales tax legislation is enacted by December 1, 2015; otherwise the sales and use tax rate will increase under Chapter 429 in several steps to 5% in fiscal 2017. These changes are effective beginning with fiscal 2016. As a result, the bill repeals any future changes in these taxes, and motor fuel taxes will remain equal to the rates in effect as of January 1, 2015.

The bill takes effect June 1, 2015.

Fiscal Summary

State Effect: TTF revenues decrease by \$141.9 million in FY 2016 due to a reduction in motor fuel taxes. Future year estimates reflect projected fuel consumption, prices, and inflation. Expenditures are not directly affected.

| (\$ in millions) | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 |
|------------------|-----------|-----------|-----------|-----------|-----------|
| SF Revenue | (\$141.9) | (\$260.4) | (\$328.9) | (\$390.5) | (\$438.1) |
| Expenditure | 0 | 0 | 0 | 0 | 0 |
| Net Effect | (\$141.9) | (\$260.4) | (\$328.9) | (\$390.5) | (\$438.1) |

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: The Administration has determined that the bill has minimal or no impact on small business (attached). Legislative Services disagrees with this assessment as discussed below.

Analysis

Current Law:

Motor Fuel Tax – Rate Indexing

Beginning July 1, 2013, motor fuel tax rates are indexed for all fuels, except for aviation or turbine fuel, to the annual change in the Consumer Price Index (CPI). Motor fuel tax rates will increase annually if the Comptroller's Office determines that CPI has increased over a specified 12-month period. The increase is equal to the percentage growth in CPI multiplied by the motor fuel tax rates, rounded to the nearest one-tenth of 1 cent. Motor fuel tax rates will remain unchanged if there is no increase (or a decrease) in CPI. In addition, the tax rates may not increase by more than 8% of the tax rates imposed in the previous year.

Motor Fuel – Sales and Use Tax Equivalent Rate

A sales and use tax equivalent rate is imposed on motor fuel based on the retail price of regular unleaded gasoline, excluding federal and State taxes, as determined by the Comptroller's Office. The tax is determined by multiplying the applicable percentage rate times the annual average retail price, less federal and State taxes, rounded to the nearest tenth of 1 cent. The Comptroller's Office is required to calculate the average retail price of regular gasoline (excluding federal and State taxes) over a specified 12-month period and determine the tax to be imposed.

The rate is equal to (1) 1% beginning July 1, 2013; (2) 2% beginning January 1, 2015; and (3) 3% beginning July 1, 2015. Unless federal legislation is enacted by December 1, 2015, authorizing the State to require the collection of the sales and use tax on sales made by out-of-state sellers to Maryland consumers, the rate will increase from 3% to 4% beginning January 1, 2016, and increase to 5% beginning July 1, 2016.

If federal legislation on sales tax collection is enacted and takes effect before December 1, 2015, the sales and use tax equivalent rate remains at 3% and the Comptroller is then required to distribute 4% of State sales and use tax revenues to TTF.

Exhibit 1 shows the sales and use equivalent tax rate imposed in each fiscal year and the additional tax rate (contingent rate) that will be imposed unless the federal legislation

described previously is enacted by December 1, 2015. The sales and use tax equivalent rate is increased in several steps and will equal 5% in fiscal 2017 and beyond.

Exhibit 1
Sales and Use Tax Equivalent Rates
Fiscal 2014-2017

| | <u>FY 14</u> | <u>FY 15</u> | | <u>FY 16</u> | | <u>FY 17+</u> |
|-------------------------------|--------------|-----------------|-----------------|-----------------|-----------------|---------------|
| | | <u>July-Dec</u> | <u>Jan-June</u> | <u>July-Dec</u> | <u>Jan-June</u> | |
| Sales and Use Equivalent Rate | 1% | 1% | 2% | 3% | 3% | 3% |
| Contingent Rate | <u>0%</u> | <u>0%</u> | <u>0%</u> | <u>0%</u> | <u>1%</u> | <u>2%</u> |
| Total Rate | 1% | 1% | 2% | 3% | 4% | 5% |

A floor tax is imposed on any person possessing tax-paid motor fuel for sale at the start of business on the date that the tax rate is increased. Individuals are required to compile and file an inventory held at the close of business on the date preceding an increase and remit within 30 days any additional tax that is due.

The revenue generated as a result of the motor fuel tax rate indexing and sales and use tax equivalent rate is distributed to TTF and is retained by the Maryland Department of Transportation (MDOT). As of January 1, 2015, the per gallon motor fuel tax rate is equal to 30.3 cents (gasoline and clean-burning fuel), 31.05 cents (special fuel/diesel), and 7 cents (aviation and turbine fuel).

Background: The Transportation Infrastructure Investment Act of 2013 (Chapter 429) was enacted to substantially increase the amount of transportation revenues by increasing motor fuel taxes and requiring the Maryland Transit Administration to increase base fare prices beginning in fiscal 2015.

Chapter 429 alters motor fuel taxes specifically by:

- indexing motor fuel tax rates, except for aviation and turbine fuel, to inflation beginning in fiscal 2014;
- imposing a 1% sales and use tax equivalent rate on all motor fuel, except for aviation and turbine fuel, beginning in fiscal 2014, increasing to 2% beginning on January 1, 2015, and to 3% beginning in fiscal 2016;

- unless federal remote sales tax legislation is enacted by December 1, 2015, the sales and use tax equivalent rate increases from 3% to 4% beginning January 1, 2016, and then increases to 5% beginning in fiscal 2017; and
- if federal remote sales tax legislation is enacted and takes effect by December 1, 2015, the sales and use tax equivalent rate remains at 3% and the Comptroller is then required to distribute 4% of total State sales and use tax revenues to TTF.

Chapter 429 also increases the vehicle registration fee surcharge, requires the Governor to include in the operating or capital budget specified appropriations to the State Highway Administration, and places procedural restrictions on transfers from TTF and use of TTF monies.

Chapter 429 also prohibits transfers from TTF unless legislation is approved by a three-fifths vote of the appropriate standing committees of the General Assembly and is enacted into law, or the Governor declares a state of emergency and declares that revenues are needed for defense or relief purposes. Any transfer must be repaid within five years.

In addition, Chapter 422 of 2013 proposed to amend the Maryland Constitution to (1) require TTF funds to be used only to pay the principal of and interest on transportation bonds and for any lawful purpose related to construction and maintenance of an adequate highway system or any other transportation-related purpose and (2) prevent TTF funds from being transferred to the general fund or a special fund. An exception to the prohibition on TTF transfers is authorized only if the Governor, by executive order, declares that a fiscal emergency exists and the General Assembly, by a three-fifths vote of both houses, approves legislation concurring with the use or transfer of the funds. The allocation of highway user revenues to local governments and the allocation of TTF revenues to the Maryland Transportation Authority are not affected. The constitutional amendment was approved by the voters at the November 2014 general election.

Exhibit 2 shows the estimated increases in transportation revenues and motor fuel tax rates as enacted by Chapter 429. Exhibit 2 also shows the impact of the increased motor fuel taxes for a typical driver.

Exhibit 2
Transportation Revenues Resulting from Chapter 429 of 2013

| | <u>FY 2014</u> | <u>FY 2015</u> | <u>FY 2016</u> | <u>FY 2017</u> | <u>FY 2018</u> | <u>FY 2019</u> | <u>FY 2020</u> |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Total Rate Increase¹ | 3.5¢ | 5.4¢ | 11.4¢ | 15.3¢ | 17.5¢ | 19.5¢ | 21.0¢ |
| Typical Driver Impact² | \$20 | \$29 | \$59 | \$76 | \$82 | \$87 | \$89 |
| <u>Revenues (\$ in Millions)</u> | | | | | | | |
| Sales and Use Tax Equivalent Rate | \$100 | \$138 | \$266 | \$249 | \$282 | \$309 | \$329 |
| Contingent Rate ³ | 0 | 0 | 44 | 166 | 188 | 206 | 219 |
| CPI Indexing | 13 | 24 | 40 | 52 | 67 | 83 | 98 |
| Farebox Recovery | <u>0</u> | <u>10</u> | <u>22</u> | <u>23</u> | <u>32</u> | <u>33</u> | <u>33</u> |
| Total Increase – MDOT | \$113 | \$172 | \$371 | \$490 | \$569 | \$631 | \$680 |
| WIP – GO Bond⁴ | \$0 | \$45 | \$65 | \$85 | \$100 | \$100 | \$0 |
| Total Transportation Funding | \$113 | \$217 | \$436 | \$575 | \$669 | \$731 | \$680 |

MDOT: Maryland Department of Transportation

GO: general obligation

WIP: Watershed Improvement Plan

¹ Average rate in effect during the fiscal year.

² Expressed in constant 2015 dollars and based on average annual light duty fleet economy and 12,000 annual miles.

³ Unless federal remote sales tax legislation is enacted by December 1, 2015, the sales and use tax equivalent rate increases from 3% to 4% beginning January 1, 2016, and increases to 5% beginning in fiscal 2017.

⁴ The Budget Reconciliation and Financing Act of 2015 (Senate Bill 57/House Bill 72) requires that the required appropriations for Watershed Improvement Plan appropriations come from the Transportation Trust Fund, eliminating the requirement that the Governor include an appropriation from general funds or bond funds to the State Highway Administration for these purposes.

Source: Maryland Department of Transportation; Department of Legislative Services

The total State motor fuel tax rates for gasoline in neighboring jurisdictions are shown in **Exhibit 3**. These rates are in addition to a federal motor fuel tax of 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel fuel. Maryland’s motor fuel tax rates are slightly higher than the average national rate of 30 cents per gallon for gasoline and diesel, but lower than the average rate of 36.7 cents per gallon (gasoline) and 44.0 cents per gallon (diesel) imposed in the Mid Atlantic region. Most neighboring jurisdictions impose an additional price-based motor fuel tax, most typically calculated based on the wholesale price of gasoline, while Maryland is the only jurisdiction that adjusts the tax rate based on the change in inflation.

Exhibit 3
Total State Motor Fuel Tax Rates in Neighboring Jurisdictions
(Cents per Gallon)

| | <u>Price-based</u> | <u>CPI Adjustment</u> | <u>Gasoline</u> | <u>Diesel</u> |
|----------------------|--------------------|-----------------------|-----------------|---------------|
| Delaware | | | 23.0¢ | 22.0¢ |
| District of Columbia | | | 23.5 | 23.5 |
| Pennsylvania | Yes | | 50.5 | 64.2 |
| Virginia | Yes | | 22.4 | 26.1 |
| West Virginia | Yes | | 34.6 | 34.6 |
| Maryland | Yes | Yes | 30.3¢ | 31.05¢ |

Note: The tax rates for other states include additional state taxes and fees.

Source: American Petroleum Institute

State Fiscal Effect: The bill repeals (1) the indexing of specified motor fuel tax rates and (2) future increases in the sales and use tax equivalent rate imposed on the specified price of motor fuel. The bill also repeals a contingency enacted by Chapter 429 of 2013 that requires the Comptroller to distribute 4% of total sales and use tax revenues to TTF if federal remote sales tax legislation is enacted by December 1, 2015; otherwise the sales and use tax rate will increase under Chapter 429 in several steps to 5% in fiscal 2017. These changes are effective beginning with fiscal 2016. As a result, motor fuel taxes will remain equal to the rates effective as of January 1, 2015 – 30.3 cents (gasoline and clean burning fuel), 31.05 cents (special fuel/diesel), and 7 cents (aviation and turbine fuel).

Exhibit 4 shows the estimated reduction in motor fuel tax rates, revenues, and motor fuel taxes paid by a typical driver as a result of the bill based on the current forecast of inflation and motor fuel prices. It is assumed under current law that the federal government does

not enact specified online sales tax legislation, thereby requiring additional increases in the sales and use tax equivalent rate.

**Exhibit 4
Net Impact of Bill
Fiscal 2016-2020**

| | <u>FY 2016</u> | <u>FY 2017</u> | <u>FY 2018</u> | <u>FY 2019</u> | <u>FY 2020</u> |
|---|------------------|------------------|------------------|------------------|------------------|
| <u>Gasoline Tax (cents per gallon)</u> | | | | | |
| Current Law | 34.9¢ | 38.8¢ | 41.0¢ | 43.0¢ | 44.5¢ |
| Proposed | <u>30.3</u> | <u>30.3</u> | <u>30.3</u> | <u>30.3</u> | <u>30.3</u> |
| Total Rate Decrease | 4.6¢ | 8.5¢ | 10.7¢ | 12.7¢ | 14.2¢ |
| | | | | | |
| Typical Driver Savings | \$24 | \$42 | \$50 | \$57 | \$60 |
| | | | | | |
| <u>Revenues (\$ in Millions)</u> | | | | | |
| Sales and Use Tax Equivalent Rate | (\$82.4) | (\$66.8) | (\$98.0) | (\$125.6) | (\$144.5) |
| Contingent Rate | (44.3) | (166.0) | (187.8) | (206.2) | (219.3) |
| CPI Indexing | <u>(15.3)</u> | <u>(27.6)</u> | <u>(43.1)</u> | <u>(58.7)</u> | <u>(74.3)</u> |
| Total | (\$141.9) | (\$260.4) | (\$328.9) | (\$390.5) | (\$438.1) |

Source: Department of Legislative Services

Appendix 1 and **Appendix 2** provide a more detailed comparison of gasoline tax rates and revenues under current law and under the bill.

MDOT Capital Program

MDOT is authorized to issue revenue bonds, called Consolidated Transportation Bonds (CTBs), for its capital program. These bonds are not backed by the full faith and credit of the State. There are specific limits on the amount of CTBs that can be issued. Currently there is a statutory limit of \$4.5 billion for CTBs. Further, MDOT uses two different debt service coverage ratios, the net income test and the pledged taxes test, with the net income test the limiting factor. MDOT has agreed to maintain a 2.0 coverage ratio with bond holders, whereby the pledged taxes or net income has to be 2.0 times greater than the maximum debt service. Currently MDOT uses a 2.5 coverage ratio to be conservative. MDOT's debt also counts toward State debt measures. Currently, the State's ability to issue debt is constrained by the debt service as a percentage of revenues measure. In fiscal 2017 and 2018, the State is approaching the current 8% limit.

If TTF revenues decrease, MDOT's capacity to issue debt decreases due to the debt service requirements. As a result, capital program spending could decrease by between \$2.64 billion and \$3.02 billion over the six-year period.

Small Business Effect: Small businesses for which motor fuel constitutes a significant portion of their costs (transportation firms, delivery companies, taxicabs, etc.) will have decreased tax burdens as a result of the bill. The tax savings may also be passed along to customers (including other businesses) through lower product prices. Small businesses may potentially be negatively impacted to the extent that decreased funding prevents improvements to the State's transportation infrastructure.

The bill will also result in a significant reallocation of income, and spending, within the State. Small businesses within or dependent on the construction industry will be negatively impacted by the reduction in State transportation spending. Depending on the types of projects MDOT cancels, this could also include a reduction in additional federal and local government spending. Conversely, some small businesses in other industries may benefit from the additional consumer spending resulting from the reduction in motor fuel taxes.

Additional Information

Prior Introductions: None.

Cross File: HB 483 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

Information Source(s): Maryland Department of Transportation, Department of Legislative Services

Fiscal Note History: First Reader - March 4, 2015
md/jrb Revised - Clarification - March 5, 2015

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Appendix 1
Fiscal 2013- 2020 Gasoline Tax Rates
(cents per gallon)

| | <u>FY 2013</u> | <u>FY 2014</u> | <u>FY 2015</u> | <u>FY 2016</u> | <u>FY 2017</u> | <u>FY 2018</u> | <u>FY 2019</u> | <u>FY 2020</u> |
|---------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| <u>Current Law</u> | | | | | | | | |
| Base Rate | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 |
| Sales and Use Equivalent | 0 | 3.1 | 4.6 | 8.7 | 8.2 | 9.2 | 10.1 | 10.7 |
| Contingent Rate | 0 | 0.0 | 0.0 | 1.4 | 5.4 | 6.1 | 6.7 | 7.1 |
| CPI Indexing | <u>0</u> | <u>0.4</u> | <u>0.8</u> | <u>1.3</u> | <u>1.7</u> | <u>2.2</u> | <u>2.7</u> | <u>3.2</u> |
| Total Rate | 23.5 | 27.0 | 28.9 | 34.9 | 38.8 | 41.0 | 43.0 | 44.5 |
| <u>Proposed</u> | | | | | | | | |
| Base Rate | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 | 23.5 |
| Sales and Use Equivalent | 0.0 | 3.1 | 4.6 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| Contingent Rate | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| CPI Indexing | <u>0.0</u> | <u>0.4</u> | <u>0.8</u> | <u>0.8</u> | <u>0.8</u> | <u>0.8</u> | <u>0.8</u> | <u>0.8</u> |
| Total Rate | 23.5 | 27.0 | 28.9 | 30.3 | 30.3 | 30.3 | 30.3 | 30.3 |
| <u>Net Effect</u> | | | | | | | | |
| Sales and Use Equivalent | 0 | 0 | 0 | (2.7) | (2.2) | (3.2) | (4.1) | (4.7) |
| Contingent Rate | 0 | 0 | 0 | (1.4) | (5.4) | (6.1) | (6.7) | (7.1) |
| CPI Indexing | <u>0</u> | <u>0</u> | <u>0</u> | <u>(0.5)</u> | <u>(0.9)</u> | <u>(1.4)</u> | <u>(1.9)</u> | <u>(2.4)</u> |
| Total Rate | 0 | 0 | 0 | (4.6) | (8.5) | (10.7) | (12.7) | (14.2) |

Note: Estimated gasoline taxes are the average rate in effect during the fiscal year.
Source: Department of Legislative Services

Appendix 2
Motor Fuel Tax Revenues
Fiscal 2016-2020
(\$ in Millions)

| | <u>FY 2016</u> | <u>FY 2017</u> | <u>FY 2018</u> | <u>FY 2019</u> | <u>FY 2020</u> | <u>Total</u> |
|---------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|---------------------|
| <u>Current Law</u> | | | | | | |
| Sales and Use Equivalent | \$265.5 | \$248.9 | \$281.7 | \$309.4 | \$329.0 | \$1,434.5 |
| Contingent Rate | 44.3 | 166.0 | 187.8 | 206.2 | 219.3 | 823.6 |
| CPI Indexing | <u>39.7</u> | <u>51.9</u> | <u>67.3</u> | <u>82.8</u> | <u>98.5</u> | <u>340.2</u> |
| Total | \$349.5 | \$466.7 | \$536.8 | \$598.5 | \$646.8 | \$2,598.3 |
| <u>Proposed</u> | | | | | | |
| Sales and Use Equivalent | \$183.1 | \$182.2 | \$183.7 | \$183.8 | \$184.5 | \$917.3 |
| Contingent Rate | 0 | 0 | 0 | 0 | 0 | 0 |
| CPI Indexing | <u>24.4</u> | <u>24.2</u> | <u>24.2</u> | <u>24.2</u> | <u>24.2</u> | <u>121.2</u> |
| Total | \$207.6 | \$206.4 | \$207.9 | \$208.0 | \$208.6 | \$1,038.5 |
| <u>Net Effect</u> | | | | | | |
| Sales and Use Equivalent | (\$82.4) | (\$66.8) | (\$98.0) | (\$125.6) | (\$144.5) | (\$517.3) |
| Contingent Rate | (44.3) | (166.0) | (187.8) | (206.2) | (219.3) | (823.6) |
| CPI Indexing | <u>(15.3)</u> | <u>(27.6)</u> | <u>(43.1)</u> | <u>(58.7)</u> | <u>(74.3)</u> | <u>(219.0)</u> |
| Total | (\$141.9) | (\$260.4) | (\$328.9) | (\$390.5) | (\$438.1) | (\$1,559.8) |

Source: Department of Legislative Services

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Motorist Tax Relief – Motor Fuel Tax – Consumer Price Index and Sales and Use Tax Equivalent Rate Adjustments – Repeal

BILL NUMBER: SB589/HB483

PREPARED BY: Governor’s Legislative Office

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS