**HB 1020**

# Department of Legislative Services

Maryland General Assembly
2003 Session

## FISCAL AND POLICY NOTE

House Bill 1020 (Delegate Hixson, *et al.*)
Ways and Means

**Transportation - Tax Revenues**

This bill imposes a sales and use tax on the sale of motor fuel and alters the distribution of existing tax revenues between the general fund and the Transportation Trust Fund (TTF).

The bill takes effect July 1, 2003.

## Fiscal Summary

**State Effect:** General fund revenues could increase by approximately $128.3 million in FY 2004 from the transfer to the general fund of distributions of the corporate income tax and rental vehicle sales tax that are currently distributed to the TTF. TTF special fund revenues would increase by approximately $104.3 million in FY 2004 from imposition of the sales tax on motor fuel and from increasing the motor carrier tax. The projected revenue from the sales tax on motor fuel is based on economic projections of motor fuel prices. Such prices, however, are extremely volatile. A 20% change in fuel prices would not be unusual in a given year, resulting in revenue changes of as much as $40 million (positive or negative) in the current or subsequent fiscal year.

The Comptroller's Office would incur one-time and ongoing administrative expenses to administer the sales tax on motor fuel and motor carriers.

| ($ in millions) | FY 2003 | FY 2004 | FY 2005 | FY 2006 | FY 2007 |
|---|---|---|---|---|---|
| GF Revenue | $0 | $128.3 | $131.9 | $135.5 | $139.3 |
| SF Revenue | 0 | 104.3 | 105.1 | 108.4 | 112.1 |
| GF Expenditure | .5 | .2 | .2 | .2 | .2 |
| Net Effect | ($.5) | $232.4 | $236.8 | $243.8 | $251.2 |

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

**Local Effect:** Local transportation revenues from TTF revenue sharing could increase by approximately $32.7 million in FY 2004.

**Small Business Effect:** Meaningful.

## Analysis

**Bill Summary:** The bill's major provisions are as follows:

- the sales and use tax is applied to the sale of motor fuel (except motor fuel that is already exempt from the motor fuel tax);

- sellers of motor fuel will prepay the sales tax at a rate of 7 cents per gallon for fiscal 2004, which will be adjusted annually (rounded to the nearest half-cent) by the Comptroller's Office based on the average retail price of fuel for the prior calendar year (or more frequently if significant changes in the price of fuel);

- the sales and use tax would also be reflected in the motor carrier tax rate, and would be adjusted quarterly based on the average selling price for the preceding quarter;

- the additional sales tax and motor carrier tax revenues would be dedicated to the Gasoline and Motor Vehicle Revenue Account of the TTF, 30% of which is shared with local governments;

- the corporate income tax and the vehicle rental tax would remain pledged to existing transportation bonds but would not be pledged to any future transportation bonds;

- after expiration of existing transportation bonds, the distribution of State tax revenues from the corporate income tax is altered so that 100% of those revenues are distributed to the general fund (versus current distribution of 24% of net revenues to the TTF and 76% to the general fund), and the distribution of State tax revenues from the sales tax on short-term vehicle rentals is altered so that 100% of those revenues are distributed to the general fund (versus distribution of 45% of net revenues to the TTF and 55% to the general fund); and

- prior to expiration of the bonds, the TTF would annually transfer unpledged TTF revenues to the general fund an amount equal to the TTF's share of the corporate income tax and the sales tax on short-term vehicle rentals.

**Current Law:** See discussion above.

**Background:** Some states, including Maryland, impose only a motor fuel excise tax, expressed for example as 23.5 cents per gallon for gasoline in Maryland. Other states impose both an excise tax and a sales tax. A sales tax is expressed as a percentage of the selling price but for various purposes, it is often translated into cents per gallon based on a periodically-updated average retail fuel price. The motor fuel tax rates for gasoline in neighboring jurisdictions are as follows: Delaware (23 cents per gallon), the District of Columbia (20 cents per gallon), Pennsylvania (12 cents per gallon plus an oil franchise tax for an effective rate of 26.6 cents per gallon), Virginia (17.5 cents per gallon plus a local option tax), and West Virginia (20.5 cents per gallon plus sales tax for an effective 25.35 cents per gallon).

**State Revenues:** The impact of the bill comes from three components: the transfer of corporate income taxes and rental vehicle sales taxes to the general fund, and the addition of a sales tax on motor fuel and motor carriers dedicated to the TTF. **Exhibit 1** below illustrates the fiscal impact of all the components of the bill.

**Exhibit 1**
**HB 1020 - Transportation Revenues**
**Estimated Revenue Impact**
**($ in Millions)**

| | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 |
|---|---|---|---|---|---|
| TTF share of corporate income tax to GF | $105.6 | $108.8 | $112.0 | $115.4 | $118.9 |
| from MDOT share | 73.9 | 76.2 | 78.4 | 80.8 | 83.2 |
| from local share | 31.7 | 32.6 | 33.6 | 34.6 | 35.7 |
| TTF share of rental vehicle sales tax to GF | 22.7 | 23.1 | 23.5 | 23.9 | 24.3 |
| from MDOT share | 17.3 | 17.6 | 17.9 | 18.2 | 18.5 |
| from local share | 5.5 | 5.5 | 5.6 | 5.7 | 5.8 |
| New sales tax/motor carrier tax to TTF | 232.6 | 237.0 | 243.9 | 251.5 | 256.5 |
| to MDOT share | 162.8 | 165.9 | 170.7 | 176.0 | 179.5 |
| to local share | 69.8 | 71.1 | 73.2 | 75.4 | 76.9 |
| | | | | | |
| Net GF increase | 128.3 | 131.9 | 135.5 | 139.3 | 143.2 |
| Net TTF increase | 104.3 | 105.1 | 108.4 | 112.1 | 113.3 |
| to MDOT share | 71.6 | 72.2 | 74.5 | 77.1 | 77.8 |
| to local share | $32.7 | $32.9 | $33.9 | $35.1 | $35.4 |

For the sales tax on motor fuel, the estimate is based on projected growth in the gallonage of all motor fuel and in the price of gasoline, as illustrated below in **Exhibit 2**. The estimate assumes a 1% decrease in the taxable sales base as a result of the imposition of the sales tax due to price elasticity. This price elasticity reflects factors such as consumers purchasing fuel in neighboring states with lower rates, shifting to lower-grade gasoline, or ultimately shifting to more fuel efficient vehicles and away from fuel-inefficient vehicles such as sport utility vehicles (SUVs). To the extent that actual elasticity is greater than assumed, then actual revenues could be lower than projected.

**Exhibit 2**
**HB 1020 – Estimated Increase in Motor Fuel Sales Tax Revenue**
**($ in Millions)**

| | FY 2004 | FY 2005 | FY 2006 | FY 2007 | FY 2008 |
|---|---|---|---|---|---|
| Total gallons – all fuel (millions of gallons) | 3,076.2 | 3,106.4 | 3,136.8 | 3,167.6 | 3,198.6 |
| Base projected gallonage growth | 2.10% | 0.98% | 0.98% | 0.98% | 0.98% |
| Projected average gasoline price per gallon | $1.53 | $ 1.54 | $1.57 | $1.60 | $1.62 |
| Base projected price growth for prior calendar year | -4.00% | 0.90% | 1.90% | 2.10% | 1.00% |
| Base total taxable sales | $4,699.5 | $ 4,788.3 | $4,927.0 | $5,079.8 | $5,180.9 |
| Taxable sales assuming 1% decline due to elasticity | $4,652.5 | $ 4,740.4 | $4,877.8 | $5,029.0 | $5,129.1 |
| **Sales tax revenues** | **$232.6** | **$ 237.0** | **$243.9** | **$251.5** | **$256.5** |
| Sales tax expressed as cents/gallon | 7.6 | 7.7 | 7.9 | 8.0 | 8.1 |

It should be noted that the projected revenues from the sales tax on motor fuel are based on economic projections of motor fuel prices. Such prices, however, are extremely volatile. A 20% change in fuel prices would not be unusual in a given year, resulting in revenue changes of as much as $40 million (positive or negative) in the current or subsequent fiscal year.

**State Expenditures:** The Comptroller's Office would incur approximately $500,000 in fiscal 2003 in one-time programming costs, and approximately $150,000 in annual ongoing costs to administer the sales tax on motor fuel. Unlike the current sales tax, which has a relatively constant rate and is collected in arrears, this tax would be collected in advance based on a prepayment rate that is adjusted at least annually (and possibly more often depending on the volatility of gasoline prices). The necessary data processing system would be very different from the current tracking system for sales taxes and associated programming costs could total $500,000 or more in fiscal 2003.

On an ongoing basis, the Comptroller's Office must annually (or more often) calculate the prepayment rate as an effective cents per gallon and notify fuel vendors of the change in that rate, incurring postage and printing costs. For the motor carrier tax, there would be a quarterly calculation and notification. The advance collection from the fuel wholesalers, with subsequent payment and reconciliation with the retailers, would require significant administrative efforts both by these parties, and by the Comptroller's Office, which would be responsible for auditing tax payments and reconciling differences in statements between the wholesalers and the retailers, requiring additional agency staff work. In addition, the bill provides that organizations that are currently exempt from the sales tax (such as churches, governmental units, etc.) would be required to pay the sales tax at the pump and then apply for a refund, resulting in substantial administrative work by the agency. These additional costs could total $150,000 or more annually.

**Local Revenues:** Local governments currently receive TTF revenue sharing for transportation purposes, based on (after certain deductions) 30% of the TTF's corporate income tax revenues and 30% of 80% of the TTF's short-term vehicle rental sales tax revenues. Under the bill, the local governments would receive 30% of revenues from the sales tax on motor fuel and the increased motor carrier tax. The net increase is estimated to be $32.7 million in fiscal 2004; the out-years are shown in Exhibit 1. Based on the changes in distribution described above, the local share of TTF revenues increases slightly.

**Small Business Effect:** Small businesses for which fuel costs constitute a significant portion of their costs (transportation firms, delivery companies, taxicabs, etc.) could be meaningfully and negatively affected by a 5% increase in their costs.

There are approximately 2,200 service stations in Maryland, most of which are small businesses. These businesses would be required to collect and remit the sales tax, and reconcile these collections against the amount of their prepayments, which is likely to require significant administrative effort. Currently, the excise tax is paid by the wholesalers and is transparent to the retailer. Service stations that sell other items such as snacks, however, are currently required to collect and remit the sales tax.

## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Department of Transportation, Department of Legislative Services

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