Tax Plan Needs Course Correction

House Transportation Package Leaves out New Revenues, Could Harm Key Services

By Wesley Tharpe, Policy Analyst

Georgia needs a sustained commitment to transportation that includes new revenues or it will struggle to thrive in the 21st century. A funding proposal unveiled by House legislative leaders in January 2015 includes some reasonable reforms of Georgia's gas tax system but could cause undue harm to other critical state investments. Rather than raising new revenues above what Georgia now collects, it diverts funds from existing pots of tax money. It moves money from the state's general budget and its local governments, which will require immediate cuts to other state services and limit the ability of cities and counties to pay for schools, road maintenance and other public needs. State lawmakers can address these shortcomings by including some common sense tax reforms in the plan to raise new revenues.

This Georgia Budget and Policy Institute report is a brief analysis of the transportation funding package unveiled as House Bill 170 by Georgia House leaders. Key points include:

- **Proposed reform of Georgia's motor fuel levy keeps overall gas taxes about the same but local governments could push them higher.** The House proposal replaces Georgia's current mix of excise and sales taxes on gasoline with a single excise tax of 29.2 cents per gallon statewide.[1] Drivers paid about 28 cents per gallon in 2014 under the current system once all state and local taxes on gas are included. The new plan allows cities and counties to each add optional gas taxes of up to six cents per gallon, raising the possible total rate as high as 41.2 cents per gallon in some parts of the state. The plan also creates a new annual road-usage fee for drivers of electric cars, which would establish a state funding source for local transit systems for the first time in Georgia history.
- **Most new transportation funds are diverted from state and local budgets, rather than raised through new revenues.** Simplifying Georgia's complex method of taxing gasoline is a reasonable policy goal. But the House plan would harm other essential state and local services as a side effect. To generate the $1 billion in transportation funds state lawmakers say is needed, the plan diverts about $700 million from other sources. It moves $180 million from the state's General Fund, Georgia's main account for funding schools, hospitals and other services. That will require cuts in the state's pending 2016 budget. About another $520 million is diverted from city and county budgets, with most of the impact phased-in gradually.
- **Some common sense revenue options could address the plan's shortcomings**. Any package that redirects existing revenue from the state General Fund or local governments to transportation should also replace that money. Lawmakers could replace the lost state revenue by boosting cigarette taxes, for example. Extending Georgia's sales taxes to some household services now exempt is a viable option to compensate local governments. Rejecting new revenue options will likely lead to cuts in key state and local services.

Georgia can't compete in the 21st century without raising more money to support the state's aging roads, bridges, ports and transit systems. But lawmakers should rethink simply moving money from one pot to another. That will create as many problems as it solves. Paying for transportation by cutting funds for schools, hospitals and other public needs is not a viable roadmap for success.

How Georgia Pays for Transportation

Georgia now funds its transportation network with a complex mix of sales and excise taxes:

- A flat **state excise tax** of 7.5 cents per gallon is dedicated entirely to roads and bridges.
- A **state sales tax** of 4 percent, calculated twice a year based on the statewide average price of gas. Three of the four pennies of this sales tax pay for transportation, while the so-called "fourth penny" is deposited into Georgia's General Fund. Because this sales tax portion fluctuates with the price of gas, Georgia's overall motor fuel tax varies over time.
- **Local sales taxes** on gas of 3 percent in most counties.[2] Some of the resulting revenues pay for local transportation projects, while others support schools, jails, fire safety and other services.

Georgia's combined state tax on gasoline is 19.3 cents per gallon as this report goes to press. The national average for state gas taxes is 27 cents per gallon.[3] Georgia's combined state and local tax on gasoline was 28 cents per gallon in 2014.[4] The national average for state and local gas taxes is 30.1 cents per gallon.[5]

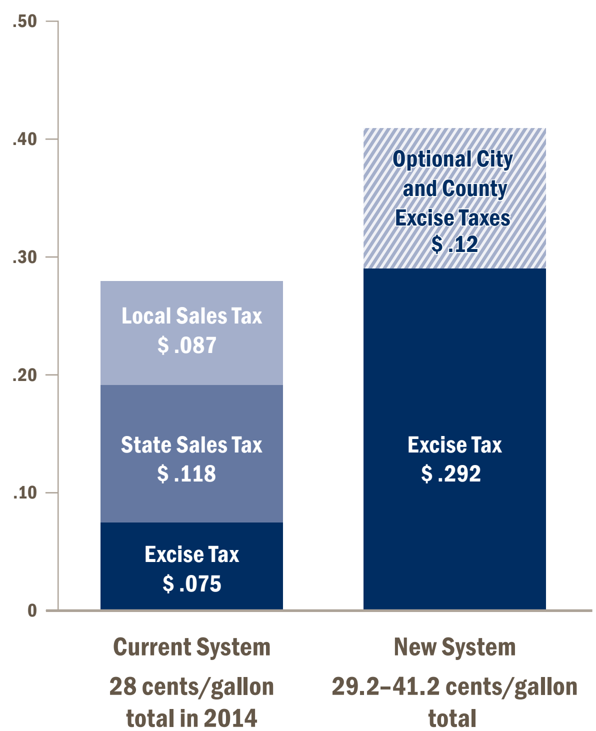
Funding Plan Swaps Multi-tax System for Excise Taxes

The proposed system changes Georgia's system of taxing motor fuel in several ways, as illustrated in the related chart:

- It eliminates both the state and local sales tax on gas and replaces them with a higher excise tax, set at a uniform rate of 29.2 cents statewide.[6] This represents an increase of about 1 cent per gallon in the state and local tax from what Georgia drivers paid in 2014.
- The new excise rate would rise in future years because lawmakers propose to tie the rate to both inflation and federal fuel efficiency rules, known as CAFÉ standards. This is a reasonable plan to ensure stable future transportation revenues.[7]
- Cities and counties can each add up to an additional 3 cents per gallon. Local governments could add an extra 3 cents per gallon, or 6 cents total, if voters approve a local referendum. If a city and its respective county each added a gas tax of 6 cents per gallon, the combined local tax would equal 12 cents per gallon. All resulting revenues must go to transportation. This tax would generate an estimated $180 million for counties statewide if all 159 of them choose the 3 cent option.[8] The potential revenue gain for cities is unknown.[9]
- Drivers of electric or natural gas vehicles will pay an annual road usage fee of $200 for personal cars and $300 for commercial vehicles.[10] Drivers of alternative-fuel vehicles now cause wear and tear on Georgia's roads but don't pay gas taxes for upkeep.[11] Lawmakers say they intend to earmark these usage fees for transit, but the money won't be constitutionally dedicated.

Plan Combines Existing Gas Taxes

Cents per gallon, by type of gas tax



Source: GBPI calculations based on estimates in the Joint Study Committee on Critical Transportation Infrastructure Funding.
Notes: Figures assume average statewide gas price of $2.95 per gallon and local sales tax rate of 2.97 percent. Cities and counties could levy up to 6 cents per gallon each. City or county rates above 3 cents per gallon would require approval from local voters.

New Transportation Funding Could Come at Expense of Schools and Other Services

State lawmakers estimate Georgia needs a minimum of $1 to $1.5 billion in additional investment each year to maintain its current transportation infrastructure.[12] The initial House package calls for about $850 million[13] in additional state annual transportation funding, plus a promised one-time bond package of $100 million.

The new plan keeps Georgia's statewide gas tax roughly flat, however, as noted earlier. So it doesn't raise much new money in the short-term. Gas tax revenues under the proposal would rise by about $69 million next year over what Georgia's state and local governments typically collect. That total gradually rises in future years if lawmakers choose to index gas taxes to inflation and fuel efficiency standards.

Since the new excise tax would not raise much new revenue, the additional transportation money must come from somewhere else. The plan gains around $700 million by shifting existing revenues from a combination of the state General Fund and local governments.

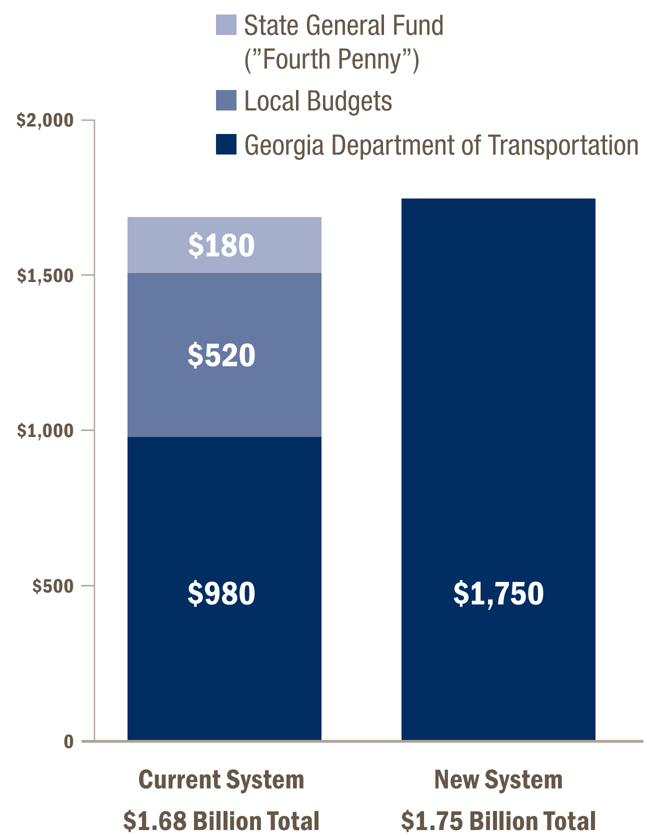
The new legislation proposes to move an estimated $180 million to the state's Department of Transportation from its General Fund. About $520 million more is diverted from city and county budgets, which support a wide range of local programs and services. The shift of local funds is phased-in gradually. The associated chart illustrates the dynamics of this shift.

Eliminating "Fourth Penny" Deprives Other State Services
The proposal moves an estimated $180 million from the state's General Fund and dedicates it to the Department of Transportation. That happens because the proposed reform eliminates the so-called "fourth penny" of Georgia's current state sales tax on motor fuel. As noted earlier, three of the four pennies from Georgia's 4 percent sales tax on gas go to transportation, while the fourth penny pays for schools, public safety and other general state needs. If Georgia eliminates the sales tax portion of the gas tax in favor of a larger excise tax, the fourth penny ceases to exist. So it no longer supports general state spending.

Stopping the flow of $180 million in gas tax revenue to the General Fund shrinks the funds available for the pending 2016 budget. It also removes that source of money from the tax base in future years. Many state services still reel from cuts imposed during the Great Recession and shifting money away from them could worsen existing shortfalls.

Transportation Proposal Shifts Existing Funds

Approximate annual revenue from Georgia motor fuel taxes, by recipient, in millions



Source: GBPI calculations based on estimates in the final report of the Joint Study Committee on Critical Transportation Funding. Figures assume average statewide gas price of $2.95 per gallon, local sales tax rate of 2.97 percent and revenue gain of $60 million per each cent of motor fuel tax.

Local Services Also at Risk

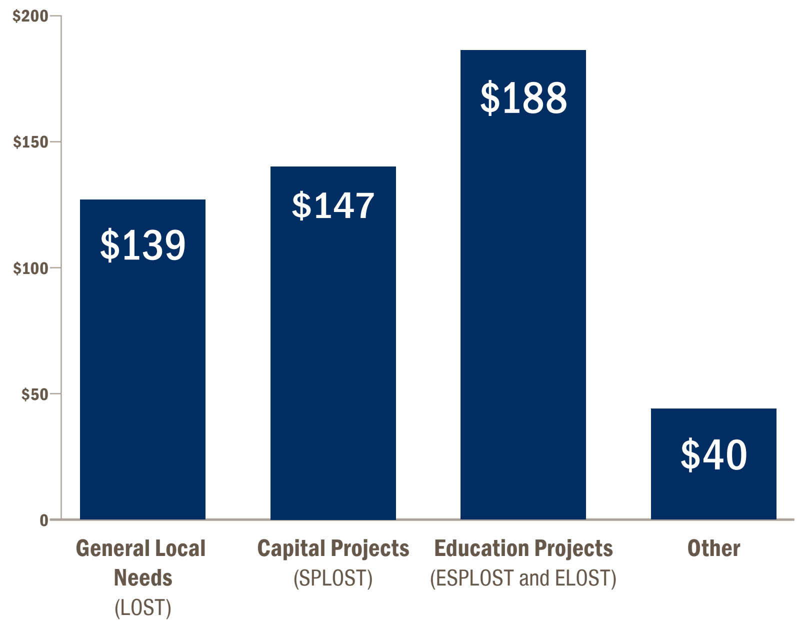
House Bill 170 proposes a phase-out of the ability of Georgia's cities and counties to apply local sales taxes to gasoline. Georgia is one of only five states that allow local governments to levy additional sales taxes on gasoline.[14] Even though the change brings Georgia more in line with other states, it poses practical concerns because ending local sales taxes on gas will likely harm other local services.

Cities and counties generate around $520 million annually from local option sales taxes on gas.[15] That money supports a mix of schools, general local services and voter-approved capital projects. Most counties levy three different 1 percent local-option sales taxes, one to raise unrestricted revenue for general local needs (LOST), one to fund specific voter-approved capital projects like new roads and government buildings (SPLOST) and another to raise money for K-12 schools (ESPLOST or ELOST).[16] Annual revenue from these different local tax streams is illustrated in the related chart.

The changes to the local-option sales tax for general needs would take effect immediately, so those funds would be unavailable in the fiscal year that starts July 1, 2015. The changes to local SPLOST and education sales taxes would be phased-in, so local governments could still apply their sales taxes to gas until their expiration.[17]

Local Sales Taxes on Gas Generate Sizable Funds

Estimated county revenue from local-option sales taxes on gas, by tax, in millions, FY 2014 data



Source: Department of Revenue, Association of County Commissioners of Georgia. County sales taxes on gasoline collected $514 million in the 2014 fiscal year as shown above. This figure differs slightly from the $520 million estimate elsewhere in the report for technical reasons.

Local governments already reeling from depressed tax revenues and years of recession-related funding cuts will be further squeezed with a shift of that money to the state. Sales tax revenues dropped by 15 percent or more in many Georgia counties since 2012, when state lawmakers passed a batch of generous new tax exemptions.[18] Depressed sales tax revenue puts pressure on cities and counties to increase property taxes or find other ways to raise money. Many local school districts already raised property taxes since the economic downturn to cover shortfalls caused by the combined loss of state support and declining local tax revenues.[19]

Lawmakers Can Protect Public Investments with Common Sense Tax Reforms

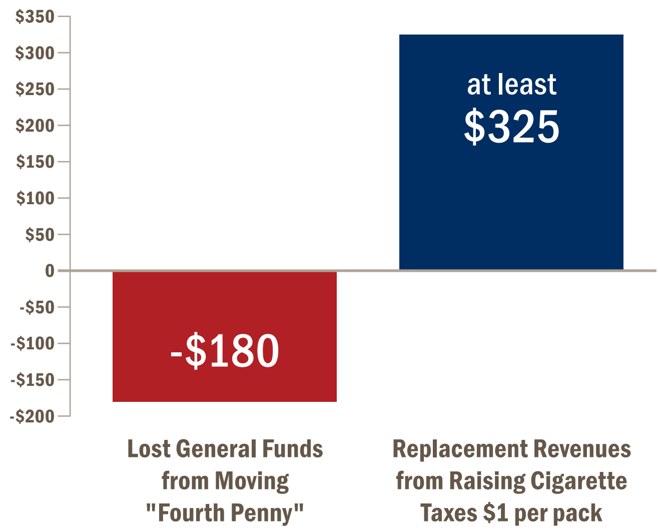
Diverting state and local money to transportation projects jeopardizes a range of services that voters rely on and could undermine other public investments critical to economic growth. Legislators should replace this money if they embrace HB 170. Several available revenue options would have only a modest effect on most taxpayers.

Filling the "Fourth Penny" Hole

To replace the $180 million in state funds lost by eliminating the sales tax portion of Georgia's state gas tax, lawmakers could raise Georgia's cigarette tax to around the national average. At 37 cents per pack, Georgia has the fourth lowest cigarette tax in the nation and the lowest rate among its neighbor states.[20] Hiking the state's cigarette tax by $1 per pack raises an estimated $325 to $400 million annually, assuming a similar increase is applied to other tobacco products.[21] Georgia's tobacco tax rate would then rank in the middle of cigarette taxes nationwide.[22]

Higher Cigarette Tax Could Replace Lost General Funds

Estimated annual revenue change, in millions



Source: Joint Study Committee on Critical Transportation Funding; Georgia Department of Audits and Accounts; University of Georgia

Lawmakers can also scale back unproven income tax credits, limit itemized deductions or return Georgia's generous exemption for retirement income back to prerecession levels to generate new state revenues. More details on these options and others are available in our 2014 report "Menu of Revenue Options to Pave Way for Georgia's Rebound: 2014 Update."

Compensating Local Governments

To replace the estimated $520 million in diverted local funds, lawmakers could expand the sales tax base to include some now-exempt household services. Georgia's sales tax isn't keeping up with changing consumer preferences. Services like auto repair and lawn care increased from 30 percent to 45 percent of U.S. household purchases from 1970 to 2012. Meanwhile purchases for cars, televisions and other tangible goods fell from 49 percent to 34 percent.[23] Extending the sales tax to cover common services taxed in at least 15 states would net Georgia's local governments a total of about $600 million per year.[24]

Lawmakers could also end expensive sales tax holidays and review the state's broad array of sales tax exemptions to spur more local revenue. More details on Georgia's complex system of sales tax breaks are available in our 2015 report "Tax Facts: Georgia Gives Up Billions through the Tax Code."

Conclusion

Georgia needs more money for transportation and some the ideas proposed in the 2015 Legislature's initial funding plan are sensible tax reforms. But HB 170 doesn't include replacement revenues to avoid boosting transportation at the expense of other state and local services. Most of the money is merely shifted from existing budgets that support schools, hospitals, public safety and other essential services. That approach comes with negative side effects. Lawmakers should change course and revise the plan to replace those lost revenues.

Endnotes

[1] The new excise rate will rise in future years if lawmakers accept the proposal to index the tax to fuel efficiency standards and inflation.

[2] The rate is slightly lower in a handful of counties that only levy a 2 percent local sales tax, rather than the standard 3 percent. Total gas taxes are slightly higher in the city of Atlanta, which levies a 4 percent local sales tax. The T-SPLOST (transportation local option sales tax) is not applied to gasoline.

[3] GBPI calculations, weighted for population, using data from Federation of Tax Administrators. State motor fuel tax rates, updated January 1, 2015

[4] Georgia's state and local gas tax rate varies over time. The 28 cent per gallon rate included in this report is based on an average local sales tax rate of 2.97 percent and the 2014 statewide average price of gas of $2.95 per gallon. Due to falling oil prices, Georgia's state and local gas tax dropped to 27 cents per gallon in January 2015. This report keeps the slightly higher 2014 rate in order for data on gas tax rates to be consistent with revenue data for the 2014 fiscal year.

[5] American Petroleum Institute. State motor fuel taxes, rates effective January 1, 2015.

[6] The proposed rate for diesel fuel is 33 cents per gallon.

[7] Rising fuel standards are causing state gas tax revenues to erode nationwide because as drivers go the same distance on less gasoline, they pay less in motor fuel tax. Average fuel efficiency is projected to rise by 67 percent by 2025, with the full impact felt around 2040. "Pay Per Mile Tax is Only a Partial Fix," Institute on Taxation and Economic Policy (ITEP). May 2014.

[8] GBPI analysis of Georgia Department of Revenue data.

[9] Existing data only allow for an estimate of potential revenue gain to City of Atlanta. That municipality would have raised between $3.4 and $5 million from a 3 cents per gallon tax in the 2014 fiscal year, depending on whether the tax was applied solely to gasoline or to all forms of taxable fuel (i.e. gasoline, diesel, aviation fuel).

[10] The personal component of this fee will raise about $4 million annually. It is unclear how much the commercial component will raise. One estimate puts the combined revenue effect of both fees at $7.5 million annually.

[11] "High(way) Finance," State Policy Reports. March 2014. Alternative-fuel vehicles will are estimated to account for 49 percent of new vehicle sales by 2035. Original estimate is from the US Energy Information Administration.

[12] Figures in this section come from the final report of the transportation joint study committee. To expand the transportation network, the report suggests that Georgia needs as much as $5.4 billion more per year through at least 2035.

[13] Initial calculations are approximate and in the case of new revenues from the International Fuel Tax Agreement are dependent on unverifiable third-party estimates. New transportation funding includes $520 million transferred from local government tax bases; $180 million shifted from state General Fund; roughly $69 million in new excise gas tax revenue for FY 2016; around $60 million from the International Fuel Tax Agreement; and $5 to $10 million from a new fee on electric and natural gas vehicles.

[14] "Survey of State and Local Gasoline Taxes," Minnesota House Research office. July 2014.

[15] This estimate differs slightly from the widely-cited $516 million figure for annual revenue gain to local governments of sales taxes on gas. The latter number is the amount of funds local governments collected from sales taxes on gasoline in the 2014 fiscal year, according to Department of Revenue (DOR) data. The $520 million number is a more general estimate of annual revenues calculated by GBPI based on Georgia's average statewide sales tax of 2.97 percent, the current $2.95 price of gas set by DOR and the prevailing estimate for annual statewide revenue from every 1 cent of motor fuel tax, $60 million.

[16] Local option sales taxes include SPLOST, ESPLOST, ELOST, LOST, HOST, MOST and MARTA taxes. The specific mix of taxes varies by county. Some counties only levy 2 percent instead of 3 percent. "Local Sales Taxes Collected on Motor Fuel Sales," Georgia Municipal Association. Accessed 1/30/2015.

[17] SPLOSTs expire every six years and ESPLOST expire every five years, but the specific expiration dates would vary by county. The initial draft of the bill indicates that the 1 percent MARTA sales tax in Fulton and DeKalb counties would still apply to gas. That tax raised about $25 million from purchases of gasoline in the 2014 fiscal year.

[18] "Unaccountable Agriculture Tax Break Hurting Rural Georgia," Georgia Budget and Policy Institute (GBPI). 12/4/2014.

[19] "The Schoolhouse Squeeze 2014," Georgia Budget and Policy Institute. 9/2/2014.

[20] Federation of Tax Administrators. Cigarette tax rates as of 1/1/2014. Per pack cigarette taxes are 43 cents in Alabama, 45 cents in North Carolina, 57 cents in South Carolina, 62 cents in Tennessee and $1.34 in Florida.

[21] Any proposed increase in Georgia's tobacco tax will require a new state fiscal note to determine a more precise revenue estimate. The two existing estimates date to 2010 and 2012 and suggest a $1 per pack increase would raise either $325 or $400 million, respectively.

[22] The current median state— where half of states have higher tobacco taxes and half have lower ones—is Iowa, where cigarettes are taxed at $1.36 per pack.

[23] Michael Leachman and Michael Mazerov. "Four Steps to Moving State Sales Taxes into the 21st Century," Center on Budget and Policy Priorities (CBPP). 7/9/2013.

[24] Estimate provided to GBPI by the Institute on Taxation and Economic Policy (ITEP) upon request. For further details on expanding Georgia's sales tax to cover services, see "Menu of Revenue Options to Pave Way for Georgia's Rebound," Georgia Budget and Policy Institute. June 2014.