



The New Gas Tax: What it is and How it Works

OFFICE OF LEGISLATIVE RESEARCH AND GENERAL COUNSEL

HIGHLIGHTS

- Utah first implemented an excise tax on motor fuel¹ (gasoline) in 1923, at a rate of 2.5 cents per gallon. Eighteen years later, in 1941, Utah implemented an excise tax on special fuels² (diesel). Revenues generated from these taxes funded a variety of projects, including the state's transportation infrastructure.
- The state is facing an estimated \$11.3 billion shortfall in projected transportation needs over the next 25 years because, in real dollars, revenue from these taxes is going down as transportation needs are going up.
- In 2015, to begin addressing this shortfall the Legislature passed HB 362, Transportation Infrastructure Funding, changing the motor and special fuel taxes from an excise tax to a modified sales tax.
- The rate of the new modified sales tax is 12% of the statewide average wholesale pretax price of a gallon of regular unleaded motor fuel during the previous three fiscal years.
- Beginning in 2016, the new modified sales tax on a gallon of unleaded gasoline and diesel fuel will be no less than 29.4 cents. This amounts to a 4.9 cent increase over the current per gallon excise tax.
- These new taxes allow the per gallon tax to rise and fall with the price of fuel, whereas an excise tax is a flat rate per gallon, regardless of the price. In this manner, the new taxes provide an annual adjustment as the statewide average wholesale price of fuel fluctuates within the floor (\$2.45) and ceiling (\$3.33) prices, which could not be easily accomplished with an excise tax.
- Revenue generated from this new modified sales tax through 2040 is estimated to be \$4.3 billion. Although this new tax represents a significant step toward funding transportation, according to the state's estimates, the tax still falls \$7 billion short in meeting the state's projected transportation needs.

Motor and Special Fuel³ Taxes

Utah, like nearly every other state, levies a tax on motor and special fuels. Utah does not, however, levy both an excise and a sales tax on motor and special fuels like is done in twelve other states.

First implemented in Utah in 1923 as an excise tax on motor fuel only, then expanded in 1941 to include an excise tax on special fuel, the state has built its roads and highways primarily from the revenues from these two taxes.

Figure 1 compares Utah's motor and special fuel tax rates to the taxes levied in other western states.

Figure 1 - Motor and Special Fuel Rates in Western States

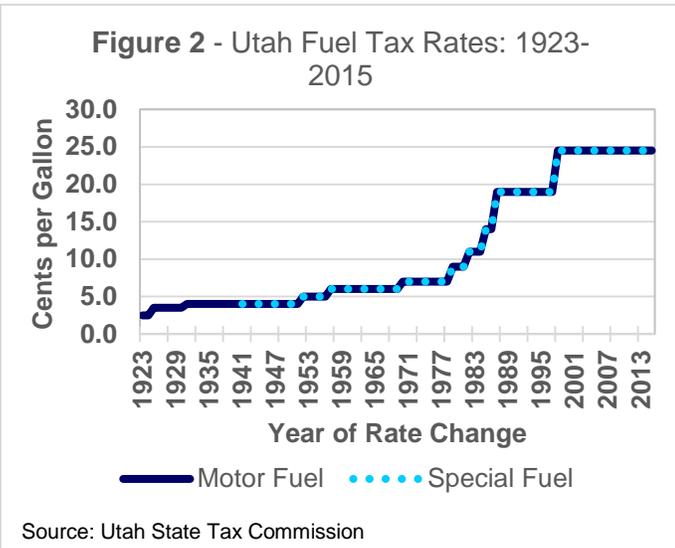
State	Motor Fuel	Special Fuel
California	42.4¢	39.4¢
Washington	37.5¢	37.5¢
Nevada	33.9¢	28.6¢
Idaho	32.0¢	32.0¢
Oregon	31.1¢	30.3¢
Montana	27.8¢	28.5¢
Utah	24.5¢	24.5¢
Wyoming	24.0¢	24.0¢
Colorado	22.0¢	20.5¢
Arizona	19.0¢	27.0¢
New Mexico	18.9¢	22.9¢

Source: American Petroleum Institute

Motor and Special Fuel Tax: A Historical Perspective

In 1941, Utah implemented an excise tax on special fuel of 4 cents per gallon, the same rate it had levied on motor fuels. The revenue generated by these taxes was deposited into the General Fund. Although many of these taxes were used to fund transportation needs, some of the revenue was allocated for other purposes.

In 1961, in an effort to assure better transportation funding, the state approved a constitutional amendment, providing that "[p]roceeds from fees, taxes, and other charges related to the operation of motor vehicles on public highways and proceeds from an excise tax on liquid motor fuel . . . shall be used for: . . . (b) the construction, maintenance, and repair of State and local roads . . ."



Since then, in addition to other transportation uses authorized by the constitutional amendment, taxes on motor and special fuels have been deposited into the Transportation Fund and have been exclusively used to construct, maintain, and repair Utah's transportation infrastructure. Fees, taxes, and other charges earmarked by this amendment are also deposited into the Transportation Fund.

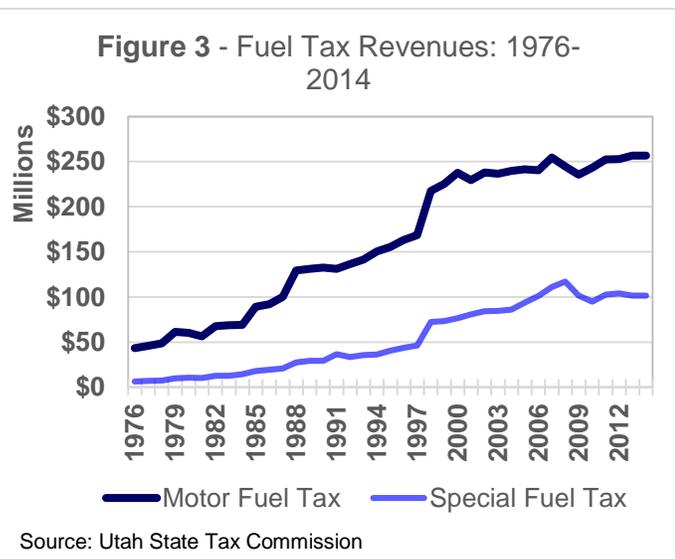


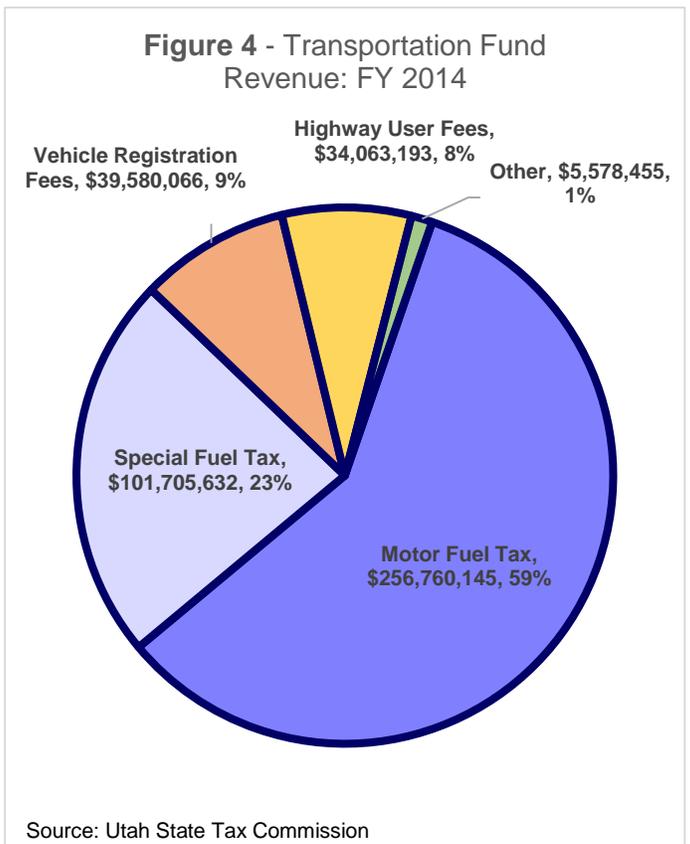
Figure 2 shows the increases and total tax per gallon for motor and special fuel taxes since each tax was implemented.

Figure 3 shows the amount of annual revenue collected from motor and special fuel taxes since 1976.

Allocation of Motor and Special Fuel Taxes

The Utah Transportation Commission is responsible to annually prioritize transportation projects and to determine the funding levels for those prioritized projects. These projects are paid for with money from the Transportation Fund, the Transportation Investment Fund, and the Critical Highway Needs Fund.⁴

Revenue from the motor and special fuel taxes are deposited into the Transportation Fund. In fact, 82% of the Transportation Fund is made up of revenues from motor and special fuel taxes. The balance of the Transportation Fund is made up from vehicle registration and highway user fees. The Transportation Fund is primarily used to pay for the maintenance of state highways (see Figure 4).

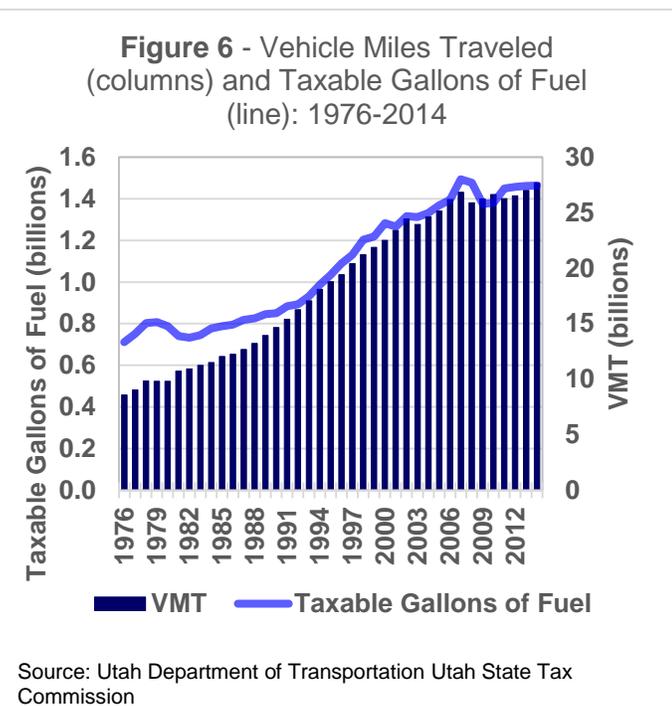
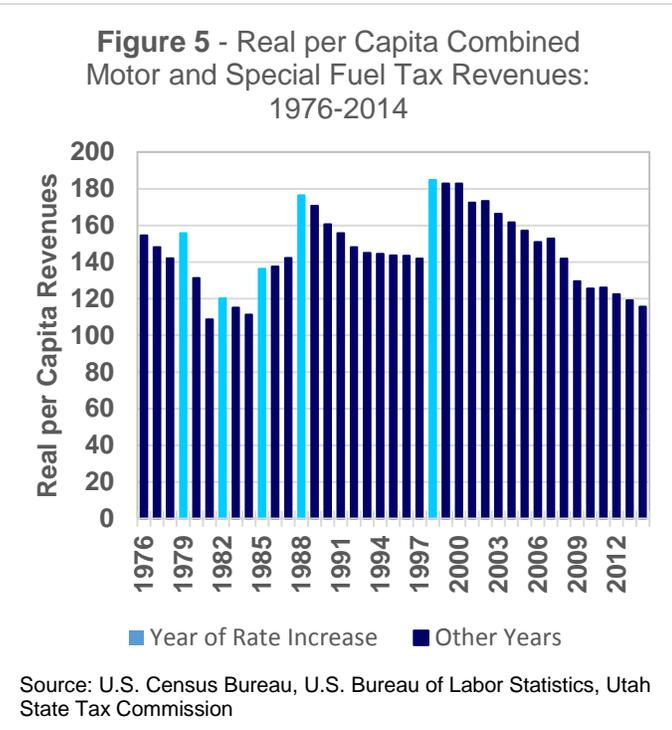


To guide the Transportation Commission in allocating these funds, state law directs that 70% of Transportation Fund money goes to the Utah Department of Transportation and 30% goes to the B

and C Roads Account for distribution to cities and counties based on a funding formula that includes factors like road length and pavement type.

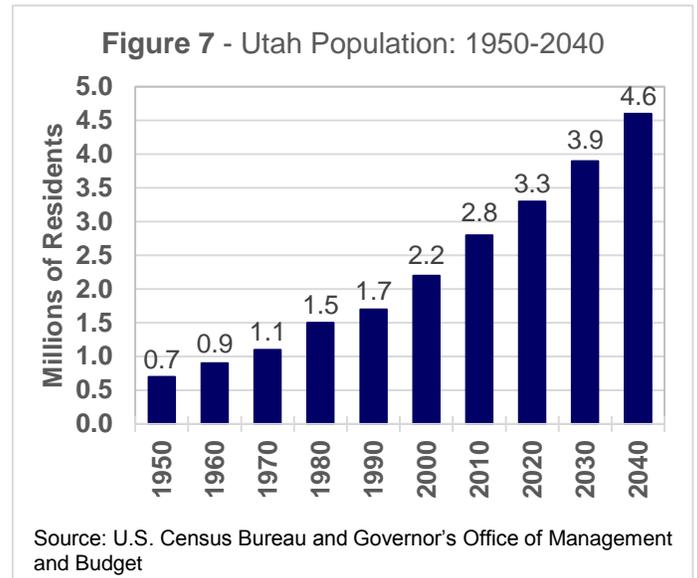
Current Motor and Special Fuel Taxes are Inadequate

The current fuel tax is inadequate because it is levied at a constant rate, which loses value each year due to inflation (see Figure 5), increased construction costs, and more fuel efficient vehicles (see Figure 6).



Additionally, a rapidly growing population not only requires more new roads, but also demands more efficient and safer roads and highways (see Figure 7).

With no change in Utah's transportation funding it is estimated that Utah will experience an \$11.3 billion shortfall in meeting its projected transportation needs over the next 25 years.⁵



A New Funding Structure

Excise Tax - Repealed

Because the current excise tax of 24.5 cents per gallon is no longer adequate in providing the necessary transportation revenues, the 2015 Legislature created a new funding structure by passing HB 362, Transportation Infrastructure Funding.

Within this new structure, the current tax, last increased in 1997, will continue through December 31, 2015. Beginning on January 1, 2016, the current excise tax will be replaced with a modified sales tax, allowing the tax rate to annually increase or decrease according to a preestablished process.

New Tax Rate

Unlike a traditional sales tax, which is assessed at the retail level as a percentage of the purchase price, this new modified sales tax is based on the statewide average wholesale pretax price of a gallon of regular unleaded motor fuel during the previous three fiscal years.

Through 2018, at the end of each fiscal year, the new tax will be calculated as 12% of the statewide average wholesale price of the previous fiscal year. Beginning in 2019, the tax will be annually calculated as 12% of the statewide average wholesale price of the previous three fiscal years. The tax rate will remain in effect for one calendar year regardless of price fluctuations during that calendar year.

Minimum/Maximum Tax Rate per Gallon

To protect consumers and the state against volatile fuel prices, the new tax establishes both a minimum and maximum tax per gallon. As a modified sales tax of 12%, if the statewide average wholesale pretax price of a gallon of regular, unleaded motor fuel was \$2.45 or less in fiscal year 2015, the minimum tax will be 29.4 cents during the 2016 calendar year. This results in no less than a 4.9 cent per gallon increase when the new tax takes effect on January 1, 2016.

For each 10 cent increase in the statewide average wholesale price above \$2.45, the tax will increase by 1.2 cents per gallon until the average price is at or above \$3.33 per gallon (see Figure 8).

When the statewide average wholesale price per gallon is equal to or greater than \$3.33, the maximum tax will be 40 cents per gallon. This modified sales tax allows an annual rate of adjustment, either up or down within the floor (\$2.45 or 29.4¢) and ceiling (\$3.33 or 40¢) prices, depending on the statewide average wholesale price of a gallon of regular, unleaded motor fuel.

The Minimum Tax Rate is Adjusted for Inflation

To protect the Transportation Fund from the diminishing effects of inflation, the minimum tax rate is to be annually adjusted for inflation beginning the first year after the statewide average wholesale price of fuel reaches \$2.45. This inflationary adjustment to the floor (minimum tax rate) is equal to the annual percentage change in the consumer price index.⁶

The first year after the statewide average wholesale price of fuel reaches \$2.45, the Utah State Tax Commission will annually adjust the minimum tax rate by the percent change in the consumer price

Figure 8 - Average Price per Gallon/New

Statewide Average Wholesale Price	Tax Rate
\$3.45	40.0 ¢ (max rate applied)
\$3.35	40.0 ¢ (max rate applied)
\$3.33	40.0 ¢
\$3.25	39.0 ¢
\$3.15	37.8 ¢
\$3.05	36.6 ¢
\$2.95	35.4 ¢
\$2.85	34.2 ¢
\$2.75	33.0 ¢
\$2.65	31.8 ¢
\$2.55	30.6 ¢
\$2.45	29.4 ¢
\$2.35	29.4 ¢ (min rate applied)
\$2.25	29.4 ¢ (min rate applied)

Source: Office of Legislative Research and General Counsel

index or zero, whichever is greater. Note: since 1940, the annual consumer price index has only been a negative number in 1949, 1955, and 2009.

The trigger for implementing the annual inflation adjustment to the minimum tax rate is the first year after the statewide average wholesale price reaches \$2.45. That year is represented as year 1 in the first column of Figure 9.

The purpose of Figure 9 is to demonstrate how the floor is annually adjusted to inflation. This calculation requires several assumptions. First, one has to assume some hypothetical statewide average fuel prices. The per gallon fuel prices used are random prices, generated for demonstration purposes only. These fuel prices are not projections or predictions of actual fuel prices. Second, the 2.3% used to represent the consumer price index is actually the 10-year average of the index. Actual fuel prices and actual consumer price indexes will differ. Given these assumptions, Figure 9 demonstrates how the floor (minimum tax rate) will rise at the same rate as inflation once the price of fuel reaches \$2.45.

Utah State Tax Commission to Calculate Statewide Average Wholesale Price of Gasoline and Adjust Minimum Tax Rate for Inflation

The Utah State Tax Commission will annually adjust the floor (minimum tax rate) for inflation once the

Figure 9 – Hypothetical Annual Inflation Adjustment to the Minimum Tax Rate

Year ¹	Fuel Price ²	Annual Inflation Adjustment ³	Floor	Min Tax Rate
	\$3.05	Ceiling reached	\$3.33	40.0¢
	\$3.45	Ceiling reached	\$3.33	40.0¢
	\$3.40	Ceiling reached	\$3.33	40.0¢
13	\$3.39	3.22 + (3.22 * 2.3%)	\$3.29	39.8¢
12	\$3.29	3.15 + (3.15 * 2.3%)	\$3.22	38.8¢
11	\$3.29	3.08 + (3.08 * 2.3%)	\$3.15	37.8¢
10	\$3.10	3.01 + (3.01 * 2.3%)	\$3.08	37.0¢
9	\$2.80	2.94 + (2.94 * 2.3%)	\$3.01	37.2¢
8	\$3.30	2.87 + (2.87 * 2.3%)	\$2.94	37.2¢
7	\$3.20	2.81 + (2.81 * 2.3%)	\$2.87	34.4¢
6	\$2.80	2.75 + (2.75 * 2.3%)	\$2.81	33.7¢
5	\$2.20	2.69 + (2.69 * 2.3%)	\$2.75	33.0¢
4	\$2.50	2.63 + (2.63 * 2.3%)	\$2.69	32.3¢
3	\$2.80	2.57 + (2.57 * 2.3%)	\$2.63	31.6¢
2	\$2.65	2.51 + (2.51 * 2.3%)	\$2.57	30.8¢
1	\$2.35	2.45 + (2.45 * 2.3%)	\$2.51	30.1¢
	\$2.60	Floor reached	\$2.45	29.4¢
	\$2.34	Floor not reached	\$2.45	29.4¢
	\$2.20	Floor not reached	\$2.45	29.4¢

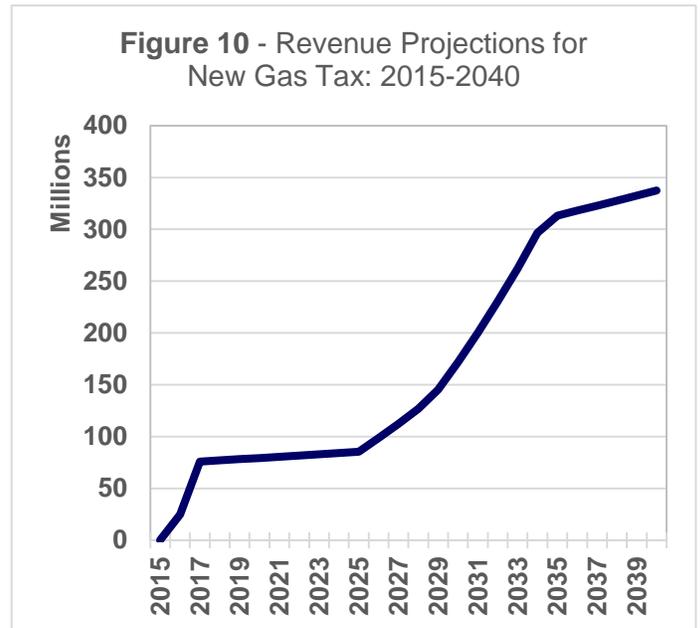
¹ Year 1 represents the first year after the statewide average pretax price of a gallon of regular unleaded fuel reaches \$2.45.
² Beginning in 2019, the statewide average price of fuel is based on the previous three fiscal years. Prior to that date, the statewide average price is based on the previous fiscal year. The fuel prices used in this Figure 9 are assumed to be the statewide average prices. These fuel prices are not projections or predictions of future fuel prices.
³ The consumer price index is produced by the U.S. Bureau of Labor Statistics. The percentage change of 2.3% used in Figure 9 is the average percentage change in the consumer price index since 2005.

Source: Office of Legislative Research and General Counsel

price of fuel reaches \$2.45 and calculate the statewide average price of a gallon of regular unleaded motor fuel using pretax wholesale prices supplied by an oil pricing service. The Tax Commission will annually adjust and publicly announce the new tax rate in cents per gallon, rounded to the nearest one-tenth of a percent, no less than 60 days before January 1 of each year, when the new tax rate will take effect.

Projected Transportation Needs Outpace Projected New Tax Revenues

Over the next 25 years, assuming the statewide average pretax price of fuel does not reach \$2.45 until 2023, the projected revenues from this new modified sales tax on motor and special fuels are estimated to be \$4.3 billion, \$7 billion short of meeting the estimated transportation needs during that same period (see Figure 10).



Source: Office of Legislative Fiscal Analyst

New Local Option Sales and Use Tax Authorized

Local governments receive 30% of the Transportation Fund to construct, maintain, and repair local roads. Additionally, local governments have also been authorized to levy local option sales and use taxes up to .80% for transportation needs. Under this new taxing structure local governments are authorized to levy an additional .25% sales and use tax for roads and public transit districts only. If local governments believe revenues are insufficient for their needs, they may implement this new tax with voter approval. Revenue raised by this new sales and use tax will reduce the projected revenue shortfall.

Other Special Fuels

Some fuels, such as natural gas, liquified natural gas, and hydrogen are not conveniently measured by the gallon. Such fuels have been taxed at lower rates as both a reward and an incentive for consumers to use these cleaner burning fuels.

Although state policy continues to provide an incentive for consumers to use cleaner burning fuels by keeping taxes low, under the new taxing structure taxes on natural gas will increase over time.

Beginning July 1, 2015, the tax on compressed and liquified natural gas will go from 8.5 cents to 10.5 cents per fuel gallon equivalent. This rate will increase by 2 cents each fiscal year until the tax rate is 16.5 cents per fuel gallon equivalent in 2018. The tax on clean burning special fuels is an excise tax because the rate is not based on a percentage of the sales price.

The maximum tax rate on gasoline and diesel is 40 cents per gallon, whereas the maximum tax on compressed natural gas, liquified natural gas, and hydrogen is 16.5 cents. Revenue raised by taxing these clean burning fuels will reduce the projected shortfall in transportation needs.

End Notes

¹ Motor fuel is gasoline or gasohol but does not include aviation or diesel fuel.

² Special fuel is diesel fuel and any other fuel, except motor and aviation fuel, used to operate a motor vehicle on the public highways of the state.

³ The new modified sales tax on special fuel includes diesel, but excludes compressed natural gas, liquified natural gas, and hydrogen. These cleaner burning fuels will continue to be taxed on a flat rate per gallon equivalent, regardless of price.

⁴ The Transportation Investment Fund receives revenue from an annual transfer of about \$70 million from the Transportation Fund, legislative appropriations, a designated portion of vehicle registration fees, sales and use tax dedications, and voluntary contributions. Money in the Transportation Investment Fund is used primarily for construction, reconstruction, and renovation of state and federal highways. The Critical Highway Needs Fund receives revenue from voluntary contributions and appropriations made by the Legislature. Money in this fund is used for state and federal highway projects identified by UDOT and prioritized by the Utah Transportation Commission that are high priority due to high growth in the surrounding areas, impacts from commercial and energy development, the opportunity for congestion mitigation, the availability of local matching funds, and the need for alternative routes in conjunction with Interstate 15 reconstruction projects.

⁵ The Utah Department of Transportation, Utah's metropolitan planning organizations, the Utah Transit Authority, and other local transit agencies have produced an estimate of Utah's transportation needs.

⁶ The consumer price index, as explained by the United States Bureau of Statistics, is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The basket of goods includes food, housing, clothing, gasoline, medical services, education, and recreation. This index is regularly used as a measure of inflation as experienced by consumers in their day-to-day living expenses.

SUMMARY

- Except for cleaner burning natural gas and hydrogen, the new motor and special fuel tax rate is 12% of the statewide average wholesale pretax price of a gallon of regular unleaded fuel.
- Beginning on January 1, 2016, the minimum tax on a gallon of unleaded gas and diesel fuel will be at least 29.4 cents.
- This new tax rate is annually increased as inflation and the statewide average wholesale price of fuel increases, until the tax is 40 cents per gallon.
- The maximum 40 cent per gallon tax rate is met when either the statewide average wholesale price reaches \$3.33 or the inflationary adjustment to the minimum tax rate meets or exceeds 40 cents per gallon.
- Although this new modified sales tax on gasoline and diesel represents a significant step toward funding transportation, the modified sales tax on motor and special fuel still falls \$7 billion short in meeting the state's projected transportation needs over the next 25 years.
- Any revenue raised by local governments by implementing a .25% local option sales and use tax for roads and public transit districts will go toward reducing the projected revenue shortfall.
- Any revenue raised from the tax on other special fuels, such as natural gas and hydrogen, will all go toward reducing the projected revenue shortfall.