PUBLIC HEARING

ON

Bill 20-199, "Title VII, Subtitle CC, Motor Vehicle Fuel Tax Amendment Act of 2013"

Before the

Committee on Finance and Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

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John A. Wilson Building, Room 120

Testimony of
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Good morning, Chairmen Evans and Members of the Committee on Finance and Revenue. My name is Yesim Yilmaz, Director of Fiscal and Legislative Analysis at the Office of Revenue Analysis. I am pleased to testify for the Office of the Chief Financial Officer on Subtitle VII (CC) of Fiscal Year 2014 Budget Support Act, known as the Motor Vehicle Fuel Tax Amendment Act of 2013.

The Motor Vehicle Fuel Tax Amendment Act changes the way the District would tax motor fuel consumption. At present, the District levies a tax of 23.5 cents per gallon for every gallon of motor fuel imported to the District. The tax is levied at the wholesale level, and the collections are dedicated to the Highway Trust Fund, which is used, together with federal contributions, to maintain the District's roads and highways.

The proposal will replace the District's current excise tax on motor fuel with an *ad valorem* tax of 8.3 percent of the wholesale price. The main difference between an excise tax and an *ad valorem* tax, is that an excise tax is levied per unit of a sale and revenues depend only on the volume sold, while an *ad valorem* tax is levied on the *value* of a sale, and the revenue take depends both on the volume sold and the price at which it is sold.

In the region, there is some move to tie the amount of motor fuel tax to the price of motor fuels, or price level in general. For example, Virginia recently replaced its 17.5 cent excise tax with a 3.5 percent sales tax on the wholesale price of gasoline and a 6 percent sales tax on the wholesale price of diesel fuel. In addition, Northern Virginia customers pay a 2.1 percent retail sales tax per gallon. Maryland has recently tied its excise tax set at 23.5 cents to the Consumer Price Index, and instituted an additional 1 percent retail sales tax on motor fuels. In both jurisdictions, the wholesale or retail motor fuel sales taxes are scheduled to increase if the states cannot generate additional revenues from remote sales taxes, which can only be implemented if the Congress enacts the Marketplace Fairness Act.

The proposal under consideration in the District of Columbia sets the motor fuel tax rate to 8.3 percent of District-wide wholesale price, with the further limitation that for the purposes of the calculation of the tax, this price cannot be lower than the rate that prevailed on May 19, 2013. There is no mechanism to determine what District-wide wholesale price prevailed on May 19, 2013. The most relevant publicly available data is the New York Harbor Conventional Gasoline spot price, which shows that at the close of the day on May 17 (May 19 is a Sunday, so no price data is available), the wholesale price of gasoline was $2.81 per gallon. At this rate, the annualized motor fuel tax revenue would be $21,616,000 in FY 2014. The FY 2014 certified revenue under the current excise tax regime is $21,780,000.

Oil and gas prices are notoriously hard to project. One study, by Professor James Hamilton of University of California, San Diego, shows that many different factors or events regulate oil prices at different times, and it is very difficult to predict changes to these factors ahead of time (although it might appear obvious to us, when they happen). Looking at data between 1970 and 1997, Professor Hamilton shows that prices of crude oil can go up or down by 15 percent each quarter, without anyone being able to say why.[1] So, if we start with a barrel price of $100 today, by the end of September the price may be as low as $74, and as high as $135, and such swings would be considered "normal" given the history of oil prices. And by the time Fiscal Year 2014 ends, the price could be as low as $40 per barrel or as high as $237.

These findings suggest that the *ad valorem* tax is likely to result in larger volatility in the collections, and it will be very hard to reliably estimate the revenue that could be collected. The futures markets (the NYMEX Futures, in this case) suggest a continuing decline in wholesale gas prices, but studies have shown that futures prices are not necessarily better than current prices in explaining price movements. Given these uncertainties, the Office of Revenue Analysis will use the legislated price floor (that is, the floor for tax purposes) in calculating the four-year revenue impact.

To ensure that the per gallon revenue raised under the proposed 8.3 percent sales tax is at least 23.5 cents, so the proposal could be deemed revenue neutral, the legislation could specify a price floor rather than referring to a price that prevailed at a certain day. Given the proposed tax rate of 8.3 percent, that floor price of $2.83 per gallon would be considered "revenue neutral."

[1] Hamilton, James D. Understanding Crude Oil Prices, *Energy Journal* 2009, 30(2) pp. 179-206. Working paper available at http://dss.ucsd.edu/~jhamilto/understand_oil.pdf, accessed on June 7, 2013.

Finally, as I mentioned before, there is no simple way to determine what District-wide wholesale gas prices would be. The Energy Information Administration publishes rack prices for all states, but no longer includes District of Columbia in this publication. As currently drafted, the legislation refers to "state-wide" prices, a term that is under-defined, and will likely cause implementation problems. However, these implementation problems identified by the Office of Tax and Revenue are easily remedied. Attached to my testimony is substitute language for the bill which effectuates its purpose while simplifying administration.

This concludes my testimony. I am happy to answer any questions you have at this time.

Recommended legislative language

§ 47-2301

(a) (1) The District of Columbia shall levy and collect a tax of 8.3% of the wholesale price of motor vehicle fuels within the District of Columbia, sold or otherwise disposed of by an importer or by a user, or used for commercial purposes.

(2) The tax imposed by subsection (a) shall be adjusted effective April 1 and October 1 of each year by changes in the New York Harbor Conventional Gasoline spot price from $2.83 per gallon, as of the preceding January 1 and July 1, respectively, rounded to the nearest one-half cent, provided, however, that the wholesale price of motor fuel used to calculate the tax shall not be less than $2.83 per gallon.