

# Memorandum

To: CHAIR AND COMMISSIONERS

CTC Meeting: June 30-July 1, 2010

Reference No.: 4.3  
Information Item

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Subject: **ANALYSIS OF THE IMPACT OF THE FUEL TAX SWAP**

## **ISSUE:**

On March 22, 2010, Governor Schwarzenegger initiated a "Fuel Tax Swap" by signing Assembly Bills 6 and 9 of the eighth extraordinary session (ABX8 6 and ABX8 9) into statute. The fuel tax swap is complicated, but it serves to stabilize transportation funding and to provide a dedicated source of revenue to fund debt service on transportation related bonds, such as the Proposition 1B program approved by voters in November 2006.

As a result of the fuel tax swap, the Department of Finance (Finance) forecasts the following changes in funding for 2010-11 through 2014-15 in comparison to the projections displayed in the 2010 Fund Estimate:

- State Transportation Improvement Program (STIP) for highways and the Local Streets and Roads (LS&R) program will be funded with an average increase of \$33 million per year relative to Proposition 42 revenues.
- The State Highway Operation and Protection Program (SHOPP) will be funded with an average increase of \$136 million per year.
- Net resources for Public Transportation Account (PTA) funded STIP will decrease by \$408 million per year. Decreases in expenditures will partially offset the shortage of revenues by \$182 million per year. This results in a net reduction of \$227 million per year, which will likely eliminate any significant STIP capacity from the PTA. There will be great difficulty in replacing this loss of funding for transit STIP capacity:
  - Motor vehicle revenues deposited in the SHA are restricted by the State Constitution from funding transit STIP except for public mass transit guideways and their related fixed facilities.
  - Although revenues deposited in the SHA for STIP may fund this limited transit STIP, this would be a direct reduction to, and at the expense of highway STIP capacity.
  - Another option is to federalize transit capital to offset the reduction in resources to the PTA, but again, this would be a reduction to, and at the expense of, highway STIP capacity. In addition, the Department of Transportation does not have the State budget authority to federalize transit STIP in 2010-11.

As a note, Finance's projections use a higher growth rate of excise tax on gasoline and diesel in comparison to those that were assumed and approved in the adoption of the 2010 Fund Estimate.

### **BACKGROUND:**

The fuel tax swap contained in ABX8 6 affects four different State taxes — sales tax on gasoline, the excise tax on gasoline, the sales tax on diesel fuel, and the excise tax on diesel. Local sales taxes remain unchanged and will continue to include gasoline and diesel fuel. ABX8 6 contains the following key changes:

- Beginning July 1, 2010, ABX8 6 eliminates the 6 percent State portion of sales tax on gasoline, and with it, the funding source for Proposition 42 and spillover (a funding formula dedicated to public transportation). ABX8 6 also eliminates the State's 4.75 percent tax on 9 cents of the excise tax on gasoline authorized by Proposition 111.
- ABX8 6 raises the excise tax on gasoline by 17.3 cents per gallon on July 1, 2010, for a total excise tax of 35.3 cents per gallon. Starting March 1, 2011, and each March 1 thereafter, ABX8 6 authorizes the State Board of Equalization (BOE) to estimate how much revenue would have been raised by the sales tax on gasoline and adjust the gasoline excise tax to raise an equivalent amount for the following year. As a result, the new tax will have the same level of volatility as the existing sales tax.
- ABX8 6 retains the existing sales tax on diesel fuel (4.75 percent) and raises it by another 1.75 percent on July 1, 2011, to generate about \$120 million in additional funds for public transit, for a total of approximately \$435 million in 2011-12.
- ABX8 6 offsets the diesel sales tax rate increase by lowering the excise tax on diesel from 18 cents per gallon to 13.6 cents per gallon, effective July 1, 2011. Similar to the excise tax on gasoline, this will be adjusted by the BOE on March 1 of each year to maintain revenue neutrality.

ABX8 9 provides for the 17.3 cent per gallon increase in excise tax on gasoline to be distributed as follows:

- ABX8 9 funds debt service on highway-related transportation bonds as the first priority. As a result, about \$603 million would be used for debt service in 2010-11. Debt service will increase incrementally and peak at approximately \$1.3 billion in 2017-18.
  - ABX8 9 also directs the Legislature to withhold \$650 million in 2010-11 for future appropriation. The 2010-11 May Revision to the Governor's Budget revises this withholding to be loaned to the General Fund with repayment due by June 2013.
- After debt service has been set aside in 2010-11, the remaining revenues (approximately \$1.3 billion) will fund the STIP (50 percent) and LS&R program (50 percent).
- After debt service has been set aside in 2011-12 and thereafter, the remaining revenues will be distributed accordingly:
  - 44 percent to STIP
  - 44 percent to LS&R
  - 12 percent to the SHOPP

The enclosed “Fuel Tax Swap Changes” compares how the enactment of ABX8 6 and ABX8 9 has changed the distribution of State excise tax revenues to funds and programs. The enclosed “Fuel Tax Swap Flow Chart” displays the distribution of 2010-11 State excise tax revenues from the pump to the various transportation funds and programs.

Attachment

<b>Fuel Tax Swap Changes</b>	
<b>Before ABX8 6 &amp; ABX8 9</b>	<b>After ABX8 6 &amp; ABX8 9</b>
<p><b><u>State Excise Tax on Gasoline</u></b></p> <ul style="list-style-type: none"> <li>- 18 cents/gallon.</li> <li>- About 64% of revenues to the State Highway Operation and Protection Program (SHOPP).</li> <li>- About 36% of revenues to cities and counties.</li> </ul>	<p><b><u>State Excise Tax on Gasoline</u></b></p> <ul style="list-style-type: none"> <li>- 18 cents/gallon.               <ul style="list-style-type: none"> <li>- About 64% of revenues to the SHOPP.</li> <li>- About 36% of revenues to cities and counties.</li> </ul> </li> <li>- 17.3 cent/gallon increase to excise tax on gasoline effective July 1, 2010, and is adjusted each year to maintain revenue neutrality with the loss of State sales tax on gasoline. Debt service on transportation General Obligation bonds receives funding priority each year. The remaining funds distributed accordingly:               <ul style="list-style-type: none"> <li>2010-11: First \$650 million loaned to General Fund. Repayment is due by June 2013.                   <ul style="list-style-type: none"> <li>50% to the State Transportation Improvement Program (STIP).</li> <li>50% to Local Streets &amp; Roads (LS&amp;R).</li> </ul> </li> <li>2011-12 and thereafter:                   <ul style="list-style-type: none"> <li>44% to STIP.</li> <li>44% to LS&amp;R.</li> <li>12% to SHOPP.</li> </ul> </li> </ul> </li> </ul>
<p><b><u>State Sales Tax on Gasoline</u></b></p> <ul style="list-style-type: none"> <li>- 4.75% sales tax on 9 cents/gallon (Proposition 111) to the Public Transportation Account (PTA) for transit STIP.</li> <li>- 5.00% sales tax on gasoline (Proposition 42) is distributed accordingly:               <ul style="list-style-type: none"> <li>- 40% to the Transportation Investment Fund for STIP highways.</li> <li>- 40% to LS&amp;R.</li> <li>- 20% to the PTA for transit STIP.</li> </ul> </li> <li>- Spillover revenues to the PTA for transit STIP.</li> </ul>	<p><b><u>State Sales Tax on Gasoline</u></b></p> <ul style="list-style-type: none"> <li>- All sales taxes on gasoline are eliminated on July 1, 2010.</li> </ul>
<p><b><u>State Excise Tax on Diesel</u></b></p> <ul style="list-style-type: none"> <li>- 18 cents/gallon.               <ul style="list-style-type: none"> <li>- About 69% of revenues to the SHOPP.</li> <li>- About 31% of revenues to cities and counties.</li> </ul> </li> </ul>	<p><b><u>State Excise Tax on Diesel</u></b></p> <ul style="list-style-type: none"> <li>- 13.6 cents/gallon rate effective July 1, 2011, and is adjusted each year to maintain revenue neutrality with the increase to sales tax on diesel.               <ul style="list-style-type: none"> <li>- About 69% of revenues to the SHOPP.</li> <li>- About 31% of revenues to cities and counties.</li> </ul> </li> </ul>
<p><b><u>State Sales Tax on Diesel</u></b></p> <ul style="list-style-type: none"> <li>- 4.75% sales tax on diesel to the PTA for operations and transit STIP.</li> </ul>	<p><b><u>State Sales Tax on Diesel</u></b></p> <ul style="list-style-type: none"> <li>- 4.75% sales tax on diesel to the PTA for operations and transit STIP.</li> <li>- 1.75% additional sales tax on diesel effective July 1, 2011, to the PTA for operations and transit STIP.</li> </ul>
<p><b><u>PTA Debt Service</u></b></p> <ul style="list-style-type: none"> <li>- The 2010-11 Governor's Budget proposed a transfer of \$57 million from the PTA to the Transportation Debt Service Fund (TDSF) in 2009-10.</li> <li>- The 2010-11 Governor's Budget proposed a transfer of \$254 million from the PTA to the TDSF in 2010-11.</li> </ul>	<p><b><u>PTA Debt Service</u></b></p> <ul style="list-style-type: none"> <li>- ABX8 9 requires a transfer of \$142 million from the PTA to the TDSF in 2009-10.</li> <li>- ABX8 9 requires a transfer of \$254 million from the PTA to the TDSF in 2010-11.</li> </ul>
<p><b><u>State Transit Assistance (STA)</u></b></p> <ul style="list-style-type: none"> <li>- Transfers from the PTA eliminated from 2009-10 through 2012-13.</li> <li>- In 2013-14 and thereafter, 50% of Proposition 111 and sales tax on diesel; 75% of Proposition 42 apportionment; and two-thirds of spillover would be transferred from the PTA to STA.</li> </ul>	<p><b><u>STA</u></b></p> <ul style="list-style-type: none"> <li>- Transfers from the PTA are reinstated.</li> <li>- \$400 million appropriated from the PTA to STA for expenditure in 2009-10 and 2010-11.</li> <li>- In 2011-12 and thereafter, 75% of sales tax on diesel revenues are transferred from the PTA to STA.</li> <li>- \$23 million in non-Article XIX transfers (Section 183.1 of the Streets &amp; Highways Code) will be transferred from the PTA to STA in 2011-12.</li> <li>- \$12 million in non-Article XIX transfers will be transferred from the PTA to STA in 2012-13.</li> </ul>
<p><b><u>Section 183.1 of the Streets &amp; Highways Code (S&amp;HC)</u></b></p> <ul style="list-style-type: none"> <li>- Historically, the State Highway Account (SHA) has received non-Article XIX (not constitutionally protected). These revenues have been transferred to the PTA for operations &amp; transit STIP.</li> <li>- The 2010-11 Governor's Budget proposed to transfer the 2009-10 Section 183.1 revenues to the SHA and re-transfer the amount to the PTA.</li> <li>- The 2010-11 Governor's Budget proposed to transfer the 2010-11 Section 183.1 revenues to the SHA and then re-direct the amount to the TDSF.</li> </ul>	<p><b><u>Section 183.1 of the S&amp;HC</u></b></p> <ul style="list-style-type: none"> <li>- ABX8 9 requires the 2009-10 Section 183.1 transfer to the PTA to be reversed to the SHA. The bill further requires transfer from the SHA to the TDSF for debt service.</li> <li>- ABX8 9 requires the 2010-11 non-Article XIX revenues to be transferred from the SHA to the TDSF.</li> <li>- In 2011-12, and thereafter, the SHA will receive non-Article XIX revenues. These will be subsequently transferred to the PTA for operations &amp; transit STIP.</li> </ul>

**Fuel Tax Swap Flow Chart**  
**2010-11 State Excise Tax on Gasoline and Diesel**  
**Based on the May Revision to the Governor's Budget**  
 (numbers may not total due to rounding)

