A Sneaky Gasoline Tax?
North Carolina's Tax May be High, but the Formula isn't Fiendish

By Andrew Brod

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On January 1 the state of North Carolina raised its gasoline tax by 2.8 cpg (cents per gallon), to 29.9 cpg. The anger generated by the increase seems to be dying down, but there's still a good deal of resentment. There's even a website for this: **www.stopthegastaxhike.com**.

In many ways the anger and resentment are understandable. The current tax is an all-time high for the state, which was one of only five states that raised their gasoline taxes on January 1. The increase was the largest in North Carolina since 1989, when it rose 5.2 cpg. We have one of higher gasoline taxes in the country, and the highest in the Southeast. Our tax is higher than South Carolina's 16 cpg, Virginia's 17.5 cpg, and Tennessee's 21 cpg. It's higher than the federal government's tax of 18.4 cpg.

But most of the anger over the tax increase appears to be the result of *why* it rose. The tax follows a formula that causes it to rise when the wholesale price of gasoline in North Carolina rises. In other words, motorists are hit twice when gasoline prices rise, first at the pump and then (after a delay) by a higher tax.

The gasoline tax is recalculated every six months, with a new tax going into effect every January 1 and July 1. Gasoline is taxed at a rate of 17.5 cpg plus 7 percent of the average wholesale price in the state during a six-month base period. The wholesale price the state uses for this calculation is actually a weighted average of gasoline and diesel prices.

The base period used for the latest tax rate was April through September of last year. As you'll recall, Hurricanes Katrina and Rita hit at the end of that period, driving gasoline prices sharply upward. As a result, the average wholesale price during that period was about $1.78 per gallon, the highest it's ever been, and about 40 cpg higher than the price used to set the tax last July. Seven percent of $1.78 is 12.4 cpg, and when you add that to 17.5 cpg you get the new tax.

Of course no one likes taxes. But it's worth asking whether the objections to the gasoline tax increase are specific to this tax, or about taxes in general. Or are they a function of timing? After all, one year ago the state raised the gasoline tax by 2 cpg, and there was nothing like the outrage generated by this year's 2.8 cpg increase.

Moreover, 2.8 cpg is quite small compared to the fluctuations we've seen in the retail price of gasoline over the last year. In that time, gasoline in North Carolina has been as cheap as $1.85 and as expensive as $3.20, a swing of $1.40 per gallon. A year ago gasoline in the state was about 50 cpg cheaper than today. Do we really want to spend our energy getting angry about 2.8 cents?

In a sense, the current tax of 29.9 cpg is lower than it used to be. The 22.3 cpg tax of January 1992 was about 33 percent of the average wholesale price. The current tax is about 17 percent of the wholesale price. As a percentage of price, the tax has shrunk. Put differently, the state takes a smaller percentage of our gasoline expenditures than it did 14 years ago.

A family that buys 30 gallons of gasoline every week will see its driving costs rise by less than $45 per year as a result of the higher tax. That's not nothing, but it's not a lot. Last weekend the Lundberg Survey reported that the average gasoline price in the U.S. had risen by 3 cpg in just two weeks, which will increase annual driving costs by roughly the same amount as the N.C. tax increase. There was no comparable anger.

Of course there is a difference. The increase reported by the Lundberg Survey was the result of market forces around the country and the world. We can complain all we want, but it's not going to stop China and India from continuing to buy more and more automobiles, gasoline, and crude oil. In contrast, the gasoline tax is under the control of our elected representatives in Raleigh, and some loud complaining might sway them.

Is there reason to complain? At first blush, it does seem like an odd way to structure a tax. The North Carolina gasoline tax is a combination of a pure excise tax, in which a flat rate of so many cents per unit is assessed, and a pure *ad valorem* tax, which is expressed as a percentage of the price. Most retail sales taxes are pure *ad valorem* taxes, whereas the state's cigarette tax of 30 cents per pack is a pure excise tax.

The excise component of the state gasoline tax is the 17.5 cpg, while the 7 percent part is the *ad valorem* component. That component of the tax rises in dollar terms as the price of gasoline rises. Those who are angry about the tax increase often point to this, claiming that it's unreasonable for the tax to depend on the price of gasoline.

Of course, a moment's reflection should remind us that this happens all the time with products that are subject to sales tax. When tomatoes are in season and relatively cheap, the dollar tax we pay for them falls. When tomatoes are out of season and relatively expensive, the dollar amount paid per tomato rises.

Besides, if it *is* unreasonable for the gasoline tax to change with the price of gasoline, it should be unreasonable when prices are falling as well. From 1992 to 2002, the tax fell as often as it rose. On July 1, 2002, it fell by 2.1 cpg. The long-term prospects are for continued gradual increases in gasoline prices, and hence our gasoline tax. But look for a decline on July 1 of this year, given the drop in prices after the hurricane season ended. Will anyone complain then?

Is North Carolina's tax unique? No. The gasoline taxes in Kentucky and West Virginia are very similar, each one the sum of an excise component and a percentage of an average wholesale price.

A half-dozen or more states, including Georgia, levy a pure excise tax on gasoline but also subject gasoline to the state sales tax. In those states, the *ad valorem* component is implicit. And it's recalculated instantly. North Carolina's tax didn't reflect last fall's price spikes until this month. In Georgia and other states, the tax rose as soon as the price did.

Many states have special taxes in certain regions. Virginia adds a 2 percent sales tax in areas located within or adjacent to the Northern Virginia Transportation District. One of the oddest gasoline taxes belongs to Wisconsin, which adjusts its tax annually based on the rate of general inflation. This means its gasoline tax can rise even when the price of gasoline has fallen. (State legislators have voted to discontinue this curious formula in 2007.)

So North Carolina's gasoline tax isn't so unusual. But does it make sense? For this we need to be clear about its purpose. Like most states, North Carolina taxes gasoline in order to maintain its roads. This is reasonable because as long as gasoline prices are stable, gasoline purchases are a good proxy for how much people drive and hence how much wear and tear they cause on the roads.

However, as gasoline gets more expensive, it's unlikely that drivers will drive more and require the state to do more road maintenance. Unless the idea is that fuel price increases reflect increases in the state's maintenance costs (hey, maybe Wisconsin's tax isn't so odd!), it's hard to argue that the tax should rise along with price.

In any case, the state has shown that it has another purpose in mind for its gasoline tax. Since 2001 it's diverted over $500 million dollars from the Highway Trust Fund to its general operating fund. It doesn't take a cynic to guess why the governor and the state legislature are so reluctant to cap the gasoline tax at the old level of 27.1 cpg.

Even though we have a relatively high gasoline tax here in North Carolina, its structure isn't bizarre, and whether or not it's appropriate is an argument that could go either way. This leads me to conclude that most of the anger about this tax increase isn't about the details of this tax, but about high taxes in general. Even the website I cite at the beginning of this column seems bothered mainly by how high the gasoline tax is. And maybe it is too high. But that's an issue for another column.

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