EXHIBIT D-1

Report of the New Revenue Subcommittee

Part One

OVERVIEW & RECOMMENDATIONS

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To the
Blue Ribbon Committee on Highway Finance

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Senator John Paul Capps
Chairman
Blue Ribbon Committee on Highway Finance

Senator Capps:

On behalf of the New Revenue Subcommittee, I am pleased to submit our report to the full Blue Ribbon Committee on Highway Finance for your consideration.

The attached report summarizes the Subcommittee's recommendations in Part One and, provides all of the Policy Briefs developed for each new revenue source in Part Two.

We also transmit a computerized analysis tool that will let the full Committee propose a range of "what-if" scenarios with multiple revenue sources. An important key in using the tool is being able to set a revenue target against which to measure tax receipts. We believe this important topic should be pursued to a clear resolution by the full Committee as soon as possible.

In addition to the support of the legislative staff and the Highway Department staff, the Subcommittee would like to publicly acknowledge the extra efforts of Dr. Marsha Guffey of Metroplan, Mr. Bill Lynch for his work on researching Public Private Partnerships and Tolling and Mark McBryde and Andrew Stephens of Stephens Inc. for developing the computer based analysis tool. Finally Dr. Dave Ellis of the Texas Transportation Institute at Texas A&M University was very helpful in providing data and insights gleaned from their similar work for the Texas Department of Transportation.

Sincerely yours,

Jim McKenzie
Chair, New Revenue Subcommittee

Introduction

In its initial deliberations, the Subcommittee determined to set a funding target range for AHTD rather than a single number and to analyze the adequacy of that revenue source over the 2011-2020 decade. The subcommittee believed that, if possible, several revenue sources should be used to achieve the targets rather than relying on a single one. There was a strong preference for revenue sources that could be phased-in over a number of years to lessen the economic shock to Arkansas families and businesses. Finally, there was a strong preference for user based fees, although there was also a recognition that more general revenues should be analyzed as well.

It was determined to focus on new revenue sources that could raise substantial revenue. As a consequence, motor vehicle registration fees and other miscellaneous revenue sources were not considered at this time.

The Subcommittee specifically identified the following revenue sources to research:

- Income Tax
- General Sales Tax
- Removal of the Sales Tax Exemption on Motor Fuels
- Special Sales Tax on New and Used Autos
- Special Sales Tax on Auto Parts and Service
- New Excise Tax on the Wholesale Price of Motor Fuels
- Indexing the Current Gas and Diesel Excise Taxes
- Vehicle Miles Traveled (VMT) Tax
- Carbon Tax
- Weight Distance Tax
- Public Private Partnerships/Tolling

The table on the following page compares these options in a compact form. The actual revenue that could be generated from each is dependent on the rate at which the tax is levied and the phase-in period that is ultimately chosen.

External Factors

In calculating the expected return of each tax to AHTD a number of external factors were taken into account and projected over the decade. They are detailed in the Policy Brief Adjustment Factors. The growth in annual vehicle miles traveled and the improvement in average fleet fuel efficiency in the light duty fleet (cars, SUVs and light trucks) and the commercial truck fleet are off-setting trends that impact total revenue. The Energy Information Administration and Moody's provided estimates of gasoline and diesel average annual pump prices. The work of the Texas Department of Transportation and the Texas Transportation Institute were used in estimating the fleet

Revenue Source	Income Tax	General Sales Tax	Sales Tax on Motor Fuels	Spectial Sales Tax on New & Used Autos	Special Sales Tax on Auto Parts & Service	Excise Tax on Wholesale Price of Motor Fuels	Vehicle Miles Traveled Tax	Carbon Tax (per lb of carbon)	Weight Distance Tax	PPP/ Tolling
Increment of Tax	1%	1%	6%	1%	*	6%	¢ per mile not esti- mated	1/4¢ / lb of carbon	1¢ per mile	n/a
Net Revenue to AHTD 2011	$18.08 Million	$393 million	$209 million	$35 million	*	$233 million	Not est- mated	$66 million	$18.15 million	n/a
Net Revenue to AHTD 2020	No pro- jections	$525 million	$245 million	No pro- jections	•	$277 million	Not esti- mated	$65 milliion	no pro- jections	n/a
Elastic	Yes	Yes	Yes	Yes	*	Yes	No	No	No	n/a
Ability to Phase-In	Yes	Yes	No	Yes	*	Yes	Yes	Yes	Yes	n/a
User Fee	No	No	Yes	Yes	*	Yes	Yes	Yes	Yes	Yes
Tax Administration	Existing	Existing	Unknown	Existing	* Not allowed by SSTA	New/ Existing	New	Can be tied to existing	New	New

adsorption of high efficiency vehicles as a result of new federal Corporate Average Fuel Economy (CAFÉ) standards. The Consumer Price Index and the Construction Cost Index were provided by the Legislative Research staff.

Policy Briefs, Data Sets and an Analysis Tool

The Subcommittee developed policy briefs concisely explaining all of the considered options, using best available data to project their revenue potential into the coming years. It should be pointed out that these analyses provide a reasonable estimate of future revenues for the purposes of gross comparison. They are not part of a comprehensive econometric analysis and most certainly can be improved and refined with further work.

Mark McBryde and Andrew Stephens volunteered to develop a computer-based tool that will allow the Committee to test one or more revenue sources at various rates and phased in over different periods. It should prove useful in helping the Committee in comparing alternatives and in projecting their performance over the coming decade.

Establishing Revenue Targets

In order to test the adequacy of any new revenue source, it is critical to establish a specific target or targets to test against. For this purpose, the Subcommittee set as an initial target the revenue necessary to restore the purchasing power of the excise tax base to 2005 levels and to protect it at that level through 2020.

A second level target should be established with information from the Highway Department defining the revenue needed to meet the system preservation needs identified for the 2011-2020 period, plus the anticipated new federal requirements for system preservation and safety included in the draft federal Surface Transportation Authorization Act.

The third level target is that revenue needed to build specific new capacity projects – the classic highway program with lines on a map. The Subcommittee has requested AHTD provide target numbers for level two, and they are working on it at this time.

Recommendations

The Subcommittee sorted the proposed revenue options into five categories – Strongly Recommend, Recommend for Consideration, Not Recommended at This Time, Not Recommended and Needs Further Study.

Strongly Recommended

Indexing the Gas and Diesel Excise Tax

Indexing the existing gas and diesel excise taxes to the Construction Cost Index three-year trailing average is strongly recommended as a way to protect the purchasing power of the main highway revenue base. This option provides elasticity to the base, utilizes the existing and highly efficient tax collection system, and is highway user based. The Construction Cost Index is directly related to the costs of building and maintaining roadways in Arkansas, and the three-year trailing average smoothes the volatility of any sudden price moves due to international events or weather related disasters.

It is recommended that 2005 be used as the base year from which to index and that the goal should be to Restore and Protect – to restore the purchasing power of the excise taxes to 2005 levels and to protect that purchasing power from inflationary erosion over the next decade.

It is further recommended that the indexing be an annual and automatic administrative function of the Department of Finance and Administration, that a cap of 2¢ per year be set beyond which an automatic adjustment could not go, and that a hard floor be set at the previous year's indexed rate so that the excise taxes cannot be automatically reduced by administrative action, but only reduced by action of the General Assembly.

New Excise Tax on the Wholesale Price of Motor Fuels

Levying a new excise tax on the wholesale price of motor fuels is strongly recommended as a method for raising new revenue over and above protecting the current tax base. This option has most of the strengths of removing the sales tax exemption without the fatal flaws. It is a user fee. It provides a new revenue source with elasticity. It can be phased-in and has the potential to raise substantial revenue. It can be levied at the same point in the supply chain as the current excise tax on fuel volume, and it is expected the administrative and collection costs will be comparably low. Since it is levied at a uniform rate statewide, it avoids some of the locational disruptions that removing the sales tax exemption would cause, and it does not cause oil retailers to change their method of operation.

Recommended for Consideration

Special Sales Tax on New and Used Autos

Levying a special sales on top of the state's existing sales tax new and used vehicles and dedicating that revenue for transportation is an option recommended for consideration by the full committee. If the full committee chooses to transfer existing state sales tax on new and used cars from the general fund to highways, it should consider the impact of levying an additional special sales tax on new and used autos.

Not Recommended at This Time

Vehicle Miles Traveled Tax

The VMT tax is not recommended for consideration at this time because of uncertainties over collection methods and technologies, privacy issues and absence of federal standards. However, it is the consensus of opinion in the transportation profession that because of shifts to hybrid, electric and alternative fueled vehicles in the future, a direct mileage charge for the light duty fleet will be necessary to maintain the transportation system.

Average fleet fuel efficiency is projected to accelerate rapidly after 2020 and a national policy on VMT taxes is expected prior to that time. From a long-term revenue perspective, it is recommended that AHTD begin planning for transitioning to a VMT tax beginning in 2020 in order to be prepared to move quickly once national standards are established.

Carbon Tax

The carbon tax is not recommended for consideration at this time. Although the carbon tax has some advantages (for example, it would only take a simple majority to enact, it can be phased in and it could raise substantial revenue), it is not elastic and is not strictly a highway user fee. It carries additional handicaps in that it would be a new tax with potentially confusing administrative requirements and policy goals.

The subcommittee felt that if and when federal policy on global warming and green house gas reduction requirements were firmly established, the carbon tax could be reconsidered in light of those policies.

Public Private Partnership/Tolling

Based on extensive analysis by AHTD, tolling existing and certain proposed new roadways is not currently viable. The subcommittee does suggest that future changes in federal policy regarding tolling existing freeways could make tolling a useful tool for some improvements to major facilities. Tolling and the use of public private partnerships to finance improvements should be periodically reassessed as to their usefulness as circumstances change in the future.

Not Recommended

Income Tax

A general income tax increase is not recommended for further consideration. The individual and corporate income tax is not a user fee, which would therefore generate significant inequities into highway finance. Additionally, the income tax would not generate significant revenue except at very high rates.

General Sales Tax Increase (1%)

A general gross receipts and use tax increase of 1% is not recommended for further consideration. Like the income tax, the general sales tax is not a user fee and would generate substantial inequities into highway finance. There is also concern that the combined state and local sales tax rates are approaching a point of saturation with the public, and that an additional cent of state sales tax would impinge on local governments' ability to raise needed revenue from their most productive source.

Removal of Sales Tax Exemption on Motor Fuels

The removal of the sales tax exemption on motor fuels is not recommended for further consideration. Although this option has several advantages (for example, it is elastic, it is a highway user fee, it can be adopted by a simple majority vote and it does raise substantial revenue), it also has some fatal flaws. The Streamlined Sales Tax Agreement (SSTA) requires that the entire 6% state sales tax and all local sales taxes be applied immediately if the exemption is removed. The result would be a very stiff tax hike that would result in a serious economic shock to highway users.

The SSTA also requires that the sales tax be applied at retail to the consumer and levied on the final purchase price that includes federal and state excise taxes. The resulting tax-on-a-tax is generally considered poor tax policy. Because 1.5 cents of the state sales tax and some local sales taxes are dedicated to non-highway use, removing the sales tax exemption would cause a substantial diversion of highway user revenue to non-highway uses. Finally, the distribution inequities of potentially widely varying pump prices due to differing local sales tax rates and the costs of upgrading fuel pumps to calculate the new tax, would cause a substantial burden on oil marketers, particularly small mom and pop operations.

Special Sales Tax on Auto Parts and Services

This tax would violate the Streamlined Sales Tax Agreement and is not recommended for further consideration.

Needs Further Study

Weight Distance Tax

The Policy Brief on Equitable Share for Heavy Trucks outlines a framework for determining what a fair contribution for commercial trucking should be. However, no current analysis was available from AHTD that would have allowed the subcommittee to recommend an equitable method to adjust the taxes of commercial trucks. The weight distance tax is one method of collecting taxes from heavy trucks, but not the only one. The members of the Advisory Committee representing the trucking industry both strongly preferred using traditional means such as excise taxes and license fees to make such an adjustment and strongly opposed weight distance taxes for a variety of reasons.

While many members of the subcommittee felt that the trucking industry's contribution to the state highway system should be adjusted upward, much more work needs to be done in this area before a credible and equitable recommendation can be made.

Dedication of Streamlined Sales Tax Agreement Revenue to Highways

A new proposal surfaced near the end of the subcommittee deliberations to dedicate all revenue generated under the Streamlined Sales Tax Agreement to transportation rather than allowing it to go into the General Fund. It is unclear whether this is a revenue transfer or a new revenue source, but at any rate, no analysis has been done on the proposal. If the full committee deems this worth pursuing, additional staff work will have to be done.

License Fees and Miscellaneous Revenues

License fees and miscellaneous revenues together represent approximately 27% of the total AHTD revenue exclusive of the severance tax. The subcommittee initially focused on new revenue sources that could raise substantial funds and did not research the potential for increases in license fees for either the light duty or commercial truck fleets (see Policy Brief on Equitable Share for Heavy Trucks) or for other miscellaneous revenue. The subcommittee now feels that further study on these revenue sources would be beneficial.