SOUTH CAROLINA
REVENUE AND FISCAL AFFAIRS OFFICE

FRANK A. RAINWATER
Executive Director

September 25, 2020

Mr. W. Hartley Powell
Director
South Carolina Department of Revenue
P.O. Box 125
Columbia, SC 29214

Dear Mr. Powell:

This letter is to provide you with our estimates for the 2020 Individual Income tax credit for preventative maintenance on a motor vehicle pursuant to S.C. Code of Laws §12-6-3780. We will provide annual updates for this credit through tax year 2022, after which the credit is eliminated. Because of the interest in this issue, I am using this opportunity to share more details about our analysis and the risks and other factors affecting our estimate. If you or your staff have any questions, please do not hesitate to contact us.

This code section allows a resident taxpayer to claim a refundable income tax credit for preventive vehicle maintenance on private passenger motor vehicles as defined in Section 56-3-630, including motorcycles, registered in this state. The credit may not exceed the lesser of the resident's actual motor fuel user fee increase incurred as a result of the increases imposed in Section 12-28-310(D) or the amount the resident pays for vehicle maintenance. Vehicle maintenance includes, but is not limited to, costs incurred for new tires, oil changes, and regular vehicle maintenance. A taxpayer may claim the credit for up to two qualifying vehicles. Total credits are limited to a maximum by tax year, which is $85,000,000 for 2020.

The Revenue and Fiscal Affairs Office (RFA) is required to estimate the number of taxpayers expected to claim the credit for each tax year and the total amount expected to be claimed annually on or before September 30th. In the event that RFA estimates that the total credits claimed will exceed the maximum amount of the aggregate credit allowed, RFA shall certify to the Department of Revenue (DOR) the pro rata adjustment to the credit.

1000 ASSEMBLY STREET, SUITE 421 ▪ COLUMBIA, SOUTH CAROLINA 29201 ▪ (803) 734-3793 ▪ RFA.SC.GOV

We have reviewed DOR's guidance for the credit and the experience of the first two years of the credit and considered these factors in our analysis. Our estimates are based upon the experience of the first two years and adjustments to account for the potential increase in the number of taxpayers claiming the credit as the tax rate increases. This analysis also incorporates a discussion regarding the risks associated with missing the estimate and the impact on both the state and taxpayer and how that factors into our estimates.

The following table provides data from DOR regarding the first two years of the tax credit.

Total Amount of Credits Claimed and Number of Taxpayers

Year	Taxpayers	Dollars	Average Credit	Proration	Average Gallons
YTD as of September					
Tax Year 2018	81,079	$1,973,450	$24	63.4%	1,280
Tax Year 2019	79,185	$3,394,320	$43	78.6%	1,116
Final – Actual and Estimated					
Tax year 2018	82,448	$2,009,421	$24	63.4%	1,281
Tax Year 2019 (e)	80,522	$3,451,632	$43	78.6%	1,116

Source: Department of Revenue; Estimates by SC RFA

The credit may not exceed the actual motor fuel user fee increase incurred by a taxpayer as a result of the increase in Section 12-28-310(D) or actual maintenance expenses. Section 12-28-310(D) increases the current $0.16 per gallon motor fuel user fee by $0.02 per gallon per year for six years for a total increase of $0.12 per gallon of fuel. The first increase occurred July 1, 2017, and will continue each July 1 thereafter until July 1, 2023. However, the credit must be claimed for increases incurred on a tax year basis. Therefore, we have estimated the motor fuel increase based upon one-half of the increase for each fiscal year. The increase was $0.06 for January through June of 2020 and then $0.08 for July through December, resulting in an average increase of $0.07 in 2020.

Based upon the 2018 final and 2019 year-to-date tax returns, approximately the same number of taxpayers will claim the credit. The credit amount averaged $24 in 2018 and $43 in 2019. These amounts translate into estimated total gallons of 1,280 and 1,116 on average each year. Using 1,116 gallons and the increased tax rate of 0.07, the average tax credit amount would increase to $78 in 2020 if the amount is not prorated.

Estimate, Risks, and Potential Impacts
The major issue and risk factors are determining how many taxpayers will actually claim the credit. Tax year 2018 and 2019 had a very low claim rate relative to our estimates of the number of eligible vehicles, as shown in the table below. However, many more taxpayers are potentially eligible to claim the credit in future years. Further, the tax credit amount is continuing to increase, which may affect the number of taxpayers claiming the credit.

Tax Year	Estimated Eligible Vehicles	Average Credit	Potential Total Credits	Maximum Total Credits Allowed
TY 2018	4,058,434	$15	$62,581,000	$40,000,000
TY 2019	4,144,607	$26	$106,107,000	$65,000,000
TY 2020	4,190,836	$36	$149,629,000	$85,000,000
TY 2021	4,221,530	$46	$193,043,000	$110,000,000
TY 2022	4,252,451	$56	$236,756,000	$114,000,000

Source: Department of Motor Vehicles, Vehicle Registrations; U.S. DOT Highway Statistics projected gallons; Calculations by RFA

In developing the estimate, therefore, we considered the implications of how a missed estimate would impact the taxpayer, the State's General Fund, and the Infrastructure Maintenance Fund.

In Section 12-6-3780, the Department of Transportation (DOT) is required to transfer sufficient funds to DOR by January 31st to offset the estimated total credit, as the credit is not intended to impact the State's General Fund. If the amount transferred from the Safety Maintenance Fund to DOR is not sufficient to fund the total estimated credits, DOT is required to transfer sufficient funds to offset the credit fully. If the total credit amount claimed by all taxpayers in a tax year is less than the amount transferred by DOT, then the excess reverts back to DOT as soon as practicable within the same year that the transfer occurred.

Conversely, if the estimate and required transfer are less than the actual amount of the credits claimed, the credit would still be credited or refunded as part of DOR's normal income tax processing system, but the difference would have to be absorbed by the State's General Fund as the statute does not provide for an alternate source.

Although the statute allows for a pro rata adjustment of the credit to guard against issuing credits in excess of the annual maximum, an incorrect pro rata adjustment could impact the taxpayer or the General Fund, and our analysis considered the risk to both parties. If a pro rata adjustment is made but fewer taxpayers take the credit than estimated, then the amount of credit is too low and taxpayers who took the credit could have received a higher amount. This event occurred with the tax credit for 2018 and 2019. However, if the pro rata adjustment is not low enough, more taxpayers take the credit, and total credits exceed the transfer, then the additional credits are paid by the General Fund.

The major issue in this analysis, therefore, is estimating how many taxpayers actually will claim the credit. Based upon our estimates, total credits could have been $3,165,254 in 2018 and $4,494,313 in 2019 without the pro rata adjustments. At this time, however, we continue to be concerned about over or underestimating compliance.

Conclusion
In making our estimate for tax year 2020, we considered the economic and financial data, as well as the risks and settled on the following.

First, we believe the data and process for estimating the full potential amount of credits based upon eligible vehicles and an average of 510 gallons per vehicle is reasonable and totals $149,629,000.

The next step would then be deciding on how many taxpayers will take the credit and whether a proration is necessary so the total credits do not exceed the maximum. This presents us with three choices: (1) assume all eligible taxpayers will take the credit and thereby prorate the credit by 56.8 percent to stay under $85,000,000, (2) assume less than 56.8 percent of eligible taxpayers will take the credit and allow those to take the maximum, or (3) have some option in between the first two.

The risk in overestimating the credits results in the unused credits being returned to DOT, and the risk in underestimating the credits means the State's General Fund is reduced by the difference. The risk in over or under estimating the claims also affects the taxpayer. New to our analysis this year is a concern over how COVID-19 is affecting revenue both from the State's General Fund and DOT.

Therefore, now that we have two years of actual data, we have greater confidence in balancing these risks and factors. Our estimate for the tax credit for tax year 2020 is

$25,161,515 and is based on an assumption that 322,088 taxpayers will claim an average credit of $78. This analysis projects an increase in taxpayers claiming the credit but at a much lower rate than in our previous estimates. This estimate does not require a pro rata adjustment in tax year 2020 to reduce credits claimed below $85,000,000.

Forecast

Year	Taxpayers	Average Gallons	Average Credit	Total Credits	Proration
Tax Year 2020	322,088	1,116	$78	$25,161,515	100%

We hope this explanation provides meaningful insight and understanding on our estimate. But again, if we may be of any further assistance, please advise.

Sincerely,

Frank A. Rainwater

FAR/lhj

cc: Ms. Christy Hall, Secretary of Transportation
Mr. Meredith Cleland, Department of Revenue