

DEPARTMENT: of Finance

STATE OF MINNESOTA

Office Memorandum

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DATE: March 30, 2005

TO: Senator Richard Cohen, Chair
Senate Finance Committee

Representative Jim Knoblach, Chair
House Ways and Means Committee

FROM: Peggy S. Ingison *PSI*
Commissioner

SUBJECT: License Fee Report

The attached License Fee Report has been prepared pursuant to Laws of 2004, chapter 284, article 1, section 5. The report outlines current practices used to account for and appropriate licensing fee revenue. The report also makes recommendations for the consistent treatment of that fee revenue.

If you have any comments regarding this report or further questions about the treatment of license fees please contact me.

cc: Matt Massman
✓Bill Marx

License Fee Report

Minnesota state government collects nearly \$900 million annually in different types of departmental revenues. During the 2004 legislative session, the Department of Finance was asked to provide information on the licensing portion of revenues collected by the state and to review accounting of that revenue. This report finds that the state has relatively consistent practices for reporting and spending such income. There are exceptions to standard practice but they tend to allow for special oversight of the revenue.

The information in this report is intended to comply with the requirement of the Laws of 2004, Chap. 284, Art. 1, sec. 5 which states:

By January 2, 2005, the commissioner of finance must report to the Finance Committee of the senate and the Ways and Means Committee of the house of representatives on the different procedures for accounting for and appropriating licensing fee revenue, and must make recommendations for consistent treatment of that fee revenue.

Background

Information on licenses and fees is presented with each biennial budget in the Departmental Earnings Report. This document shows detailed information on the past and projected collections and their uses for each source of revenue. In FY 2004, the state collected \$493 million in fee and license revenue. Within this group, 47% (\$234 million) was categorized as "Business/Regulatory," 36% (\$178 million) was from "Service User" fees, and 9% (\$44 million) was classified as "Occupational Licensure."

At lower levels of detail, information is available but the categories are not entirely consistent. In some cases, this is simply because of differences in wording. The terms used by state programs such as "license," "certificate," "inspection," "registration," "permit," "surcharge," and "fee" are often terms of convenience, not terms with distinct and consistent definition. Further, there are numerous instances of license revenues that are not actual license fees, but contain the word "license" in the title (license exam fees, license credentials fees, license reinstatement, license penalties, etc).

To provide more refined information, the Department of Finance and the statewide accounting system (MAPS) require revenue codes to further categorize financial data. These codes provide much useful information but do not guarantee uniformity because Finance gives agencies the latitude to adapt codes to their business systems and practices. For instance, many license fees are recorded with a distinct revenue code, but others may combine license fees with other related revenues (late fees, exam fees, etc). Another variation is to record the original license fee as license revenue under one code (e.g. cosmetologist license), and record the renewal of that license under another code (e.g. cosmetologist renewal). This practice facilitates the tracking of all license categories in a given agency, and is preferred by the Office of the Legislative Auditor for financial audit purposes.

Practicality and expediency appear to be at the root of many of the license fee accounting decisions. Legislators may have chosen to segregate some license fees to ensure they

were only spent for the statutory purposes. Others may have been segregated at the request of interest groups. It may be that at the time the license fee was created, the general fund did not have sufficient resources to fund the licensing activity. Or the new treatment may be the solution to an older problem. Prior to the medical professions fund consolidation, occasional legal settlements forced individual boards to seek deficiency appropriations. Pooling the receipts into a separate fund allowed a surplus in one account to cover a shortfall in another, and has virtually eliminated this problem.

Accounting and Appropriating License Revenues

There are two basic accounting issues for license fees – where the money is deposited and whether there is authority to spend it.

Where money is deposited is important because it determines whether it is for a special purpose (dedicated) or whether it can be mixed with other revenues (non-dedicated). The use restriction can be at the fund level like the Trunk Highway Fund, or it can be at the account level within a fund, like many accounts in the Game and Fish Fund. Nearly all revenues in the General Fund are non-dedicated.

Authority to spend depends on the appropriation type. Statutory appropriations provide spending authority that is codified in law. This means that expenditures are ongoing and not dependent on the passage of an appropriation bill. Direct appropriations are made in biennial or annual budget bills and are for limited periods of time, usually a biennium.

For licenses, the differences in these accounting treatments is not always as significant as it may sound. While dedicated receipts are logically given statutory appropriation authority, non-dedicated receipts may also be informally reserved. Many license revenues are required by law to be deposited into a special fund or account where they can only be appropriated for defined purposes. Other license fee revenues are simply deposited into the general fund and a direct appropriation is made to finance the license activity.

License Categories

The categories listed below are functional in nature, and do not represent differences found in MAPS. They are intended to present a simple, more abbreviated list.

Professional/Occupational Licenses

In this group, the license attests that the recipient has met specified educational or skill competencies, and is in compliance with on-going educational or other requirements. This category protects the public by making it easy to identify those individuals qualified and competent to provide professional services.

Within this category, most fees are non-dedicated. Of this majority, most are deposited to the general fund, although a significant amount also go into the State Government Special Revenue fund. While technically non-dedicated receipts, this fund is directly appropriated for statutorily defined purposes, making them de facto dedicated receipts.

All department of Commerce business and professional license fees are non-dedicated receipts to the general fund. Fees received from licensing stock brokers, real estate agents, insurance agents, residential contractors, and investment advisors are considered general state government revenue and can be used for any purpose. In contrast, license fees from dentists, dieticians, family therapists, doctors, nurses, and other medical professionals go into a dedicated fund, where they are directly appropriated for activities associated with the licensing practice.

The Professional/Occupational category also has several dedicated license fees. The license fees for attorneys, electricians, commercial pesticide applicators, horse racing, and gambling industry licenses are all dedicated receipts deposited in the special revenue fund.

Whether dedicated or not, license fees are most often used to fund the administrative costs of the licensing program, but in some cases (residential contractors and attorneys), a portion of the fees are also dedicated for compensation of victims of illegal or unethical practices.

Regulatory Licenses

While not a distinct class or category in the accounting system, many licenses issued by the state are regulatory in nature. Possession of a license attests that the recipient (most often a place of business instead of an individual) has been inspected by an authority and found to be in compliance with established laws, policies, and practices. This practice enhances public safety by giving citizens confidence that licensed businesses and individuals follow established practices.

Most fee revenues in this category are non-dedicated to the general fund, but the Agriculture department for example, deposits license and inspection fees in the Agriculture fund as dedicated receipts (food handlers license fees, and commercial feed and grain inspection fees). Attorney registration fees are classified by the Legal Profession Boards as both regulatory and as occupational (one fee is charged, but receipts are divided between the two categories). Both types are dedicated revenues in the special revenue fund.

User Licenses

Possession of these licenses conveys to (primarily) law enforcement personnel that the holder has paid the associated fee established to participate in a given activity. No particular skill or education is usually required (drivers license is the major exception). Special laws may apply to the activity, but the purchase of a license does not require demonstration of any knowledge of these laws (again, drivers license is the exception). Likewise, possession of a license is no guarantee these laws have been complied with. Examples include:

Vehicle Registrations - Possession of "license" plates conveys that the holder has paid the fee to register the vehicle with the state, and has thus purchased the right to operate the vehicle in a lawful manner (this is an example of the terminology issue cited above. The distinction between a license and a registration is not clear, and the terms are often used

interchangeably). Common examples include passenger cars and trucks, commercial vehicles, snowmobiles, ATV's, boats, motorcycles and jet skis, etc.

Recreational Activities – Convey individual rights to hunt, fish, trap, ski, etc.

In all these cases, the receipts are non-dedicated to a special fund, and directly appropriated for related purposes.

Revenue Only

Some license fees exist only to generate revenue. Revenues are dedicated to a specific purpose, often unrelated to the fee. Examples include special automotive license plates, where the additional fees benefit critical habitat or veterans programs.

Recommendations

We believe that the state should continue its practices for the accounting of license revenues. In general, this means that we continue to give flexibility to future decision makers to use state resources for the highest state priorities. In most instances, we believe that depositing license revenues as non-dedicated receipts should be the preferred model. Often, this would mean depositing revenues into the General Fund where virtually all money is directly appropriated.

Treatment of License Fee Revenues

		Appropriation Type	
		Direct	Statutory
Treatment Of Receipts	Dedicated	Large Fund Oversight Statewide Benefit New fees with unknown revenues and expenses	User License Fees
	Non-dedicated	Regulatory License Occupational License Business License	N/A

The exception to this rule is when the primary benefit of a license falls to the individual (e.g. a fishing license). In these instances, the general rule would be to dedicate the revenues for that particular purpose. Depending on the characteristics of the program, the Legislature may then choose whether it is necessary to make direct appropriations or allow for more permanent, statutory spending authority.

In the future, a test question for determining the preferred accounting method might be: *Would the state continue to regulate this behavior even if the activity did not recover its costs?* A major function of government is to protect the general welfare by ensuring that individuals and businesses follow fair and safe practices. It follows that these activities should be considered along with other uses of general tax revenues.

Although we believe this model should be the standard, we recognize that there are exceptions. The legislature might choose to dedicate receipts and directly appropriate them in cases where the license requirement is new and the demand is unknown (making revenue and expense estimates difficult). However, once a history has been established, the activity should be examined for conversion to a non-dedicated, directly appropriated model. Another exception is funds that generate large amounts of revenue that require direct legislative oversight (e.g. Game & Fish and Natural Resources funds).

In those cases where the benefit goes to an individual, and the state incurs discretionary costs to provide that benefit or uses the revenue to support that activity, the fees should be dedicated. This is especially true when the fees reflect a quid pro quo agreement (e.g. snowmobile and ATV interest groups have agreed to finance the construction of recreational trails in exchange for vehicle registration fees).

For the most consistent treatment of license revenues, we recommend the legislature use the following process to determine the proper accounting and appropriation methods.

1. Determine if the receipts should be dedicated or not.
 - a. Does the greatest benefit from the license requirement accrue to the state as a whole? If yes, the receipts should be non-dedicated.
 - b. Does the greatest benefit from the license requirement accrue to an individual, group, or the user? If so, the revenue should be dedicated.
 - c. Does the license generate large amounts of revenue relative to costs? If so, it should be non-dedicated.
2. Determine how the receipts should be appropriated.
 - a. Would the state regulate the activity even if the fees did not recover the full cost of the regulation? If so, the activity should be directly appropriated.
 - b. Are the revenues committed to a specific use or purpose? If so, they should be statutorily appropriated.
 - c. Is the fee revenue generated at the request of the license holders and spent for their benefit? If so, it should be statutorily appropriated.
 - d. Does the legislature desire direct oversight as to how the funds are spent? If so, directly appropriate.