

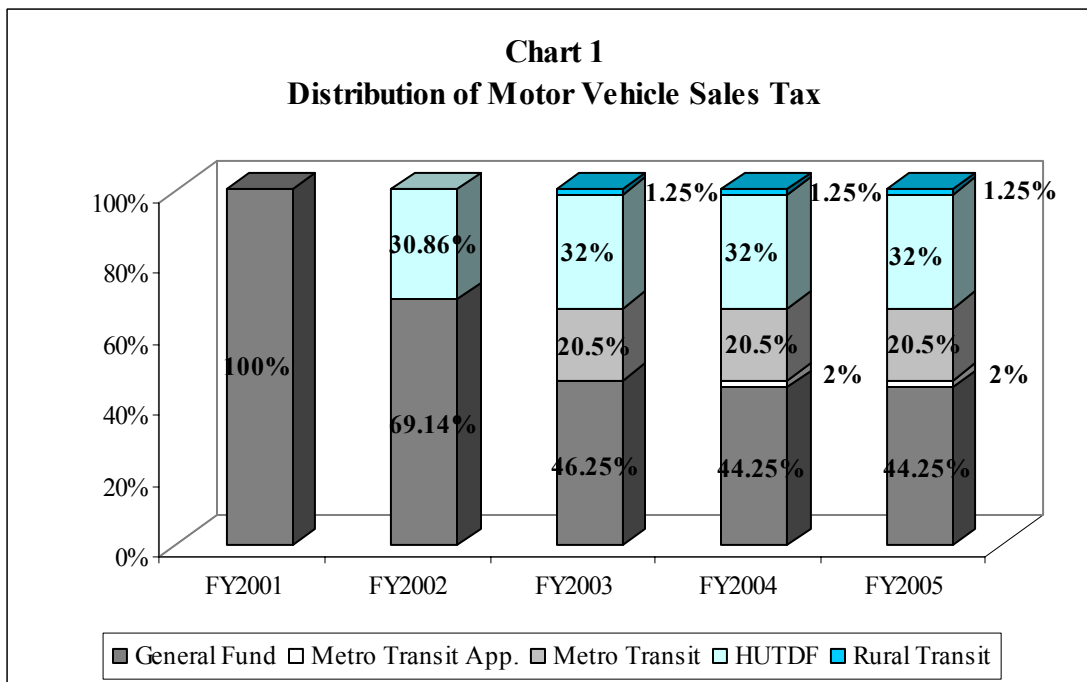


ISSUE BRIEF

**Dedication of Motor Vehicle Sales Tax Revenues for
 Replacement of Vehicle Registration Tax and Transit Property Tax Revenues**
 January 2003

Minnesota taxes the sale of motor vehicles at the same rate as the state general sales tax, or 6.5 percent of the purchase price of the vehicle less the value of any trade-in vehicle. The tax generated \$614 million in FY 2002. The distribution and use of these revenues is determined by statute. From 1993 through FY 2001, all proceeds from the motor vehicle sales tax (MVST) were deposited into the state general fund. However, tax law changes in two areas altered that distribution beginning in FY 2002, including:

- In FY 2002, 30.86 percent of MVST revenues were dedicated to the highway user tax distribution fund (HUTDF) to replace lost revenues resulting from a reduction in the motor vehicle registration tax enacted in 2000. This statutory dedication increased to 32 percent of MVST for FY 2003 and each year thereafter.
- Beginning with FY 2003, 20.5 percent of MVST revenues are dedicated to metropolitan area transit fund, and an additional 1.25 percent is dedicated to a rural transit fund, to replace the property tax as the funding source for those programs. Further, an additional 2.0 percent of MVST revenues are dedicated to a metropolitan area transit appropriation account beginning with FY 2004, but unlike the other funds dedicated to metropolitan transit, these funds require an appropriation from the Legislature before they can be spent.

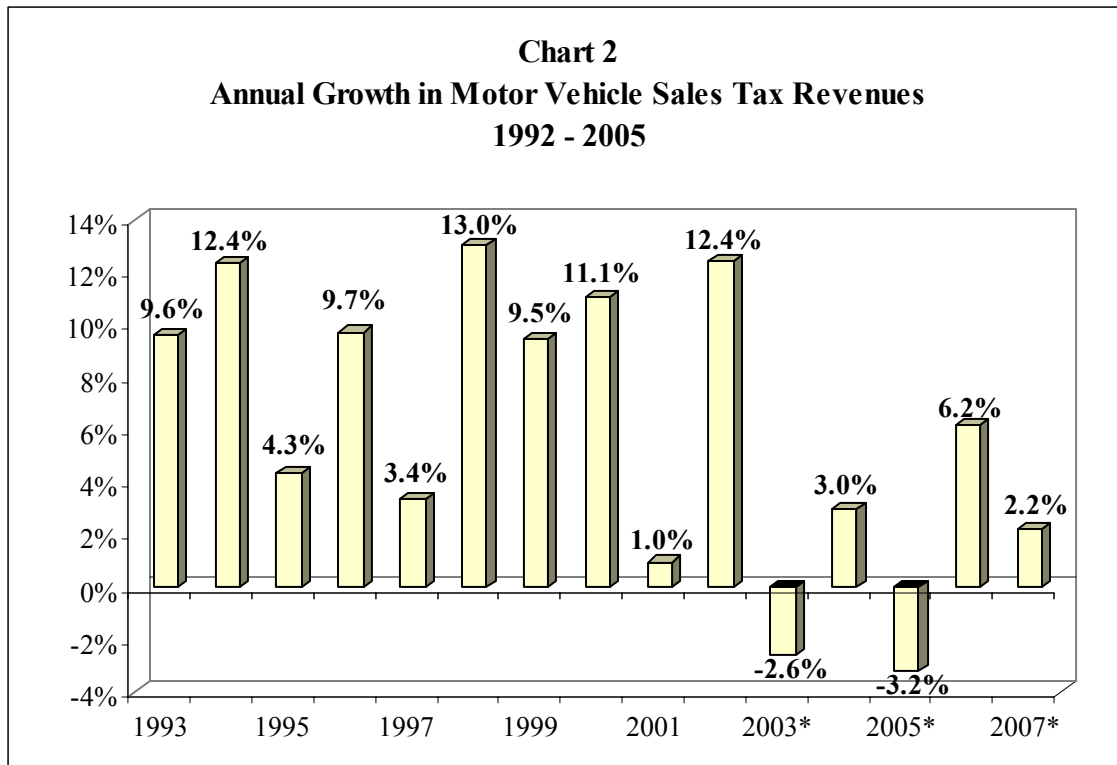


As a result of the dedications to HUTDF and the various transit funds, only 44.25 percent of MVST revenues will go to the general fund by FY 2004, or about \$273 million of the projected \$616 million expected to be generated by the tax. Table 1 summarizes projected MVST revenues by fund.

Table 1
Motor Vehicle Sales Tax Revenues by Fund and Account
FY 2001 – FY 2005
(in millions)

	FY 2001 (Actual)	FY 2002 (Actual)	FY 2003 (Nov. 02)	FY 2004 (Nov. 02)	FY 2005 (Nov. 02)
General Fund	\$ 546	\$ 425	\$ 277	\$273	\$264
HUTDF		189	191	197	191
Greater Minnesota Transit Fund			7	8	7
Metropolitan Area Transit Fund			123	126	122
Metropolitan Transit				12	12
Appropriation Account					
Total	\$ 546	\$ 614	\$ 598	\$ 616	\$ 596

Strong motor vehicle sales led to consistent growth in MVST revenues throughout the 1990's. Between FY 1992 and FY 2002, MVST revenues grew from \$270 million to \$614 million; an average annual increase of 8.6 percent. However, as illustrated by Chart 2, year-to-year growth has varied greatly, from a high of 13.0 percent in 1998 to a low of 1.0 percent in 2001. The November 2002 forecast projects that MVST revenues will decline by 2.6 percent in FY 2003 before rebounding in FY 2004.



Motor Vehicle Registration Tax Reductions

The motor vehicle registration tax, also known as the license tax or tab fees, was enacted in the 1920's and is paid annually by all vehicles using the public streets and highways. Proceeds from the tax totaled \$480 million in FY 2002. While the rate of tax is set by statute, the proceeds from the tax are dedicated to the HUTDF by the state constitution. From the HUTDF, those revenues are used to pay for state trunk highways (60%), county-state aid streets (31%), and municipal state aid streets (9%).

Passenger vehicles—including cars, light pick-up trucks and vans with a carrying capacity of $\frac{3}{4}$ ton or less—are taxed based on the age and the depreciated base value of the vehicle, subject to certain maximums enacted in 2000. Specifically, the tax is equal to a \$10 base fee plus 1.25 percent of the depreciated base value of the vehicle¹ up to a maximum of \$189 for vehicles in their 2nd year of vehicle life, and \$99 for vehicles in their 3rd through 10th year of vehicle life. The minimum tax on passenger vehicles is \$35. Non-passenger vehicles, such as trucks, buses, and recreational vehicles, are taxed based on their weight and age.

Table 2
Motor Vehicle Registration Tax Revenues
(in millions)

<u>FY</u>	<u>Revenues</u>	<u>Change</u>
1992	370,650	5.4 %
1993	404,655	9.2
1994	403,146	-0.4
1995	427,293	6.0
1996	449,719	5.2
1997	486,256	8.1
1998	511,876	5.3
1999	556,282	8.7
2000	606,844	9.1
2001	454,554	-25.1
2002	473,232	5.7
2003*	487,617	3.0
2004*	503,524	3.3
2005*	519,947	3.3

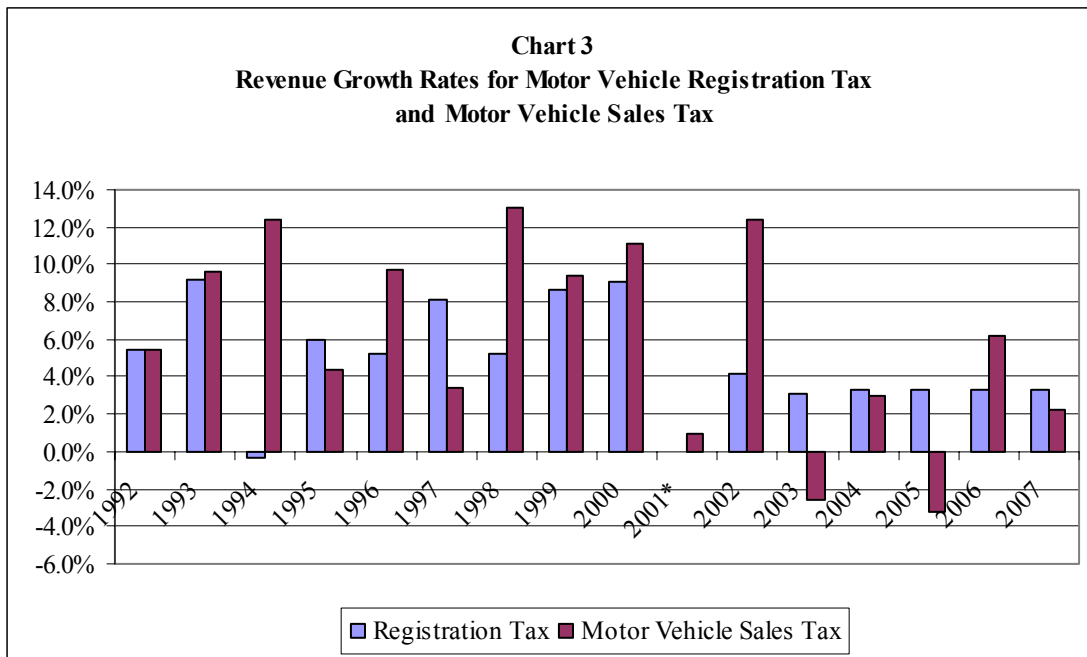
* November 2002 forecast.

¹ The base value is the manufacturers retail sales price depreciated to 90 percent of base value in the 3rd and 4th years of vehicle life, 75% in years 5 and 6, 60% in year 7, 40% in year 8, 30% in year 9, and 10% in year 10.

As reflected in Table 2, consistent with the tax reductions enacted in 2000 (first effective June 1, 2000), registration tax revenues declined by \$152 million, or 25.1 percent, from FY 2000 to FY 2001. Of that revenue decline, \$11.7 is attributable to an unanticipated early implementation of the maximums², resulting in a net annual decline of \$140.3 million for FY 2001.

To replace the lost revenue to the HUTDF, \$150 million of MVST revenue was transferred from the general fund to the HUTDF in FY 2001 and, as noted above, 30.86 percent of MVST in FY 2002, and 32 percent in FY 2003 and each year thereafter, is statutorily dedicated to the HUTDF to permanently replace lost registration tax revenues due to this tax cut.

Analysis of the registration tax revenue displayed in Table 2 reveals an average annual growth rate of 6.4 percent from 1992 to 2000, with greater growth from 1995 to 2000 (7.3 percent) than from 1991 to 1995 (5.0 percent). By comparison, MVST revenues increased by an average annual rate of 9.1 percent from 1992 to 2000 and by 8.7 percent from 1992 and 1995, and 9.3 percent from 1995 to 2000. Chart 3 shows a comparison in the revenue growth rates for the motor vehicle registration and sales taxes.



* In FY 2001, registration tax revenues declined by 25.1 percent following a reduction in the tax rate.

The maximum rates enacted in 2000 will alter the revenue growth patterns for the registration tax. As reflected in Table 2 projections for years 2003-2005, year-to-year increases in registration tax revenue are now mostly dependent on growth in the number

² The tax reduction was intended to become effective July 1, 2000, but a drafting error led to a legal challenge that resulted in an earlier effective date.

of vehicles registered and less dependent on increases in the base value of the vehicles being purchased. Consequently, registration tax revenue growth is expected to be slower, and flatter, than prior to the tax reductions enacted in 2000. As general price inflation pushes a larger proportion of vehicles to the maximum tax rates of \$189 and \$99, year-to-year revenue growth will become almost exclusively dependent on the number of vehicles registered.

Transit Levy Takeovers

Until 2002, the property tax was the primary source of revenue for both urban and rural transit in Minnesota. As part of the property tax reforms enacted in 2001, the legislature prohibited the use of the property tax for funding transit operations in the metropolitan area and replaced those revenues, and existing rural transit levies, with a dedicated portion of MVST revenues.

Metro Transit Levies: As indicated in Chart 1 on the front page, beginning in FY 2003, 20.5 percent of MVST revenues are dedicated to the newly created “Metropolitan Area Transit Fund” to replace property tax revenues eliminated beginning calendar year 2002. Beginning in FY 2004, an additional 2 percent of MVST is dedicated to a newly created “Metropolitan Area Transit Appropriation Account” to be used for metro area transit subject to legislative appropriation.

Based on the November 2002 forecast, Table 3 illustrates how the current forecast of MVST revenues for metro area transit compares to estimates of maximum property tax revenues hypothetically available under the previous funding system.

Table 3
**Dedicated Metro Transit Revenues:
 MVST –v- Hypothetical Property Tax**
(in millions)

Fiscal Year	Transit Fund	Appropriation Account	Total MVST Revenue	Hypothetical Property Tax Revenue**
2003	120.9	11.5	132.4	116.9
2004	126.1	12.2	138.3	128.1
2005	126.0	12.6	138.6	137.7

* 2002 property tax amounts based on actual metro tax capacity; 2003-2005 based on estimated tax capacity.

** Based on Metro. Transit estimates of maximum levy on metro area tax levy.

Rural Transit Levies: As indicated in Chart 1 (page 1), beginning in FY 2003, 1.25 percent of MVST revenues are dedicated to a newly created “Greater Minnesota Transit Fund” to make payments, beginning in calendar year 2002, to all transit authorities outside of the seven-county metropolitan that existed in 2001. Initial payment amounts were set equal to the amount the transit authority levied in property taxes in

2001 plus six percent, provided the forecast for 1.25 percent of MVST exceeded the amount necessary to make those payments.

A variety of concerns were raised during the 2001 session regarding the appropriateness of using this formula aid to permanently replace transit levies. Those concerns included that rural transit systems initiated after 2001 would not receive any aid, that new systems typically have higher marginal costs than older, larger systems, and that tying a local government's levy limit to the amount of transit aid it received reduced flexibility over how much transit service to provide. To address these concerns, the Department of Transportation was directed to complete a study by January 2003 to advise the legislature on strategies for either retaining the new formula or replacing the formula with an alternative means of distributing Greater Minnesota Transit Fund revenues.

Options for Undedicating Motor Vehicle Sales Tax Revenues

Past legislatures have statutorily dedicated motor vehicle sales tax revenues to highway funding and then undedicated all or a portion of that revenue stream during tight budget times (see House Research Information Brief: The Motor Vehicle Sales Tax Transfer, January 2002). However, unlike previous circumstances, the current MVST dedications were established to replace other revenue sources rather than to provide additional funding for roads. Therefore, in the absence of replacing or reinstated those other revenue sources, a reduction in the current dedications would significantly reduce funding for highways and transit. Further, because MVST revenues fluctuate from month-to-month, as shown in Table 4, the timing of legislative action would also influence the general fund impact of changes to the MVST dedications. For example:

HUTDF Dedication: Suspending the MVST dedication to the HUTDF effective March 1, 2003, would add an estimated \$68.3 million to general fund revenues in FY 2003 and reduce funding for roads and streets by the same amount. Eliminating the dedication beginning July 1, 2003, would increase FY 2004-05 general fund revenues by \$388 million.

Transit Dedications: Reductions in or elimination of the MVST dedications to metropolitan and rural transit systems would increase general fund revenues but because 2003 property taxes have already been determined, property taxes could not be reinstated to fund those programs until 2004. Consequently, the earliest that property tax revenues could be available for transit would be June 2004. Motor vehicle sales tax dedications for transit programs are projected to \$135.8 million in FY 2005.

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Table 4 Estimated MVST Dedications to HUTDF by Month (in millions)		
<u>Month/FY</u>	<u>HUTDF</u>	<u>Transit</u>
October 02	\$72.2 YTD	49.0 YTD
November 02	13.6	9.3
December 02	13.5	9.2
January 03	11.8	8.0
February 03	12.0	8.1
March 03	16.7	11.4
April 03	16.7	11.4
May 03	16.6	11.3
June 03	<u>18.3</u>	<u>12.4</u>
FY 2003	191.4	130.1
July 03	\$16.2	11.5
August 03	17.3	12.3
September 03	15.8	11.2
October 03	17.8	12.7
November 03	14.8	10.5
December 03	14.7	10.4
January 04	13.3	9.5
February 04	13.5	9.6
March 04	18.8	13.4
April 04	17.8	12.6
May 04	17.7	12.6
June 04	<u>19.4</u>	<u>13.8</u>
FY 2004	197.1	140.1
July 04	\$16.6	11.8
August 04	17.7	12.6
September 04	16.1	11.5
October 04	17.3	12.3
November 04	14.4	10.3
December 04	14.3	10.2
January 05	12.4	8.8
February 05	12.5	8.9
March 05	17.5	12.4
April 05	16.9	12.0
May 05	16.8	11.9
June 05	<u>18.4</u>	<u>13.1</u>
FY 2005	190.9	135.8