INFORMATION BRIEF
Research Department
Minnesota House of Representatives
600 State Office Building
St. Paul, MN 55155

Matt Burress, Legislative Analyst
651-296-5045

October 2014

Highway Finance

This briefing summarizes the basic finance structure and funding for roads in Minnesota. It outlines the three core funding sources—a motor fuels tax, a tax on vehicle registration, and a motor vehicle sales tax—along with other notable sources, and discusses how funds are allocated across state and local roads.

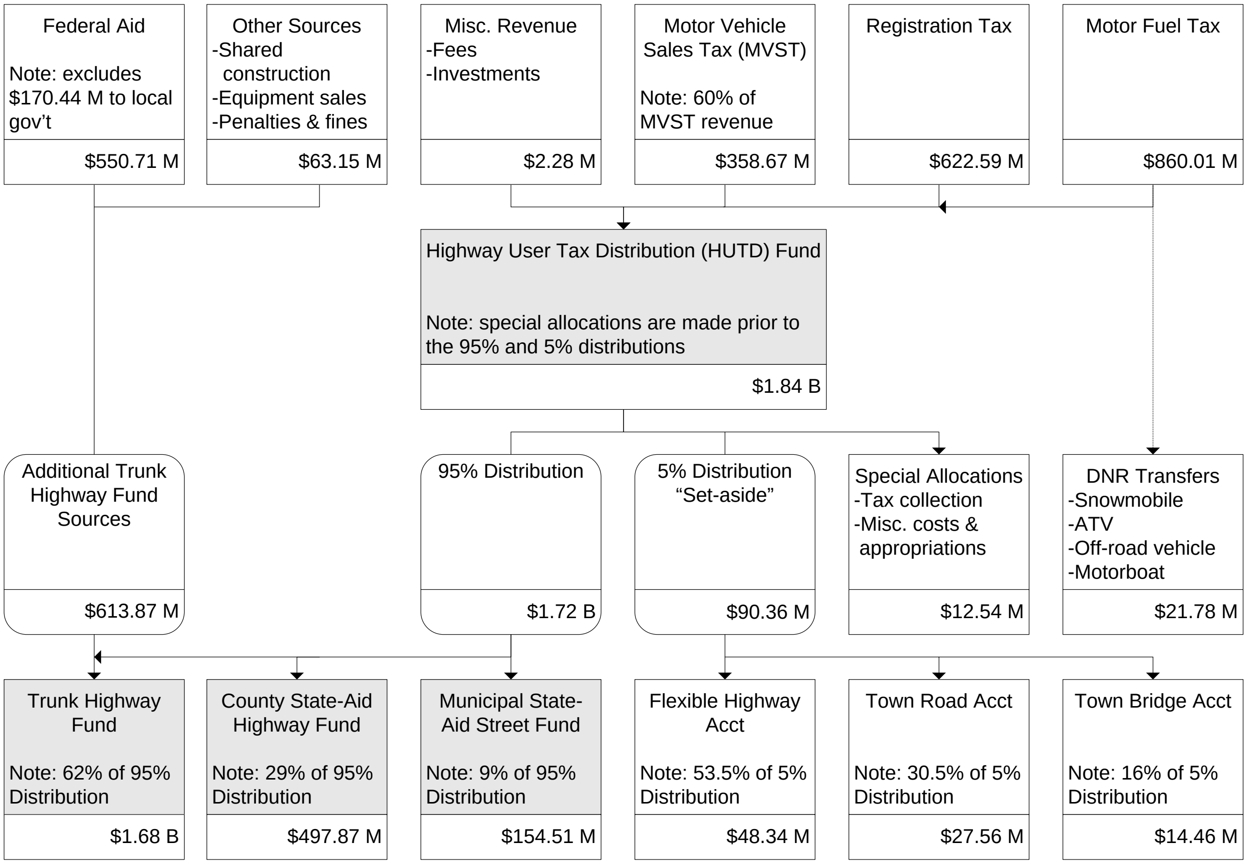
Constitutional Framework

The Minnesota Constitution is integral to the structure of transportation finance, particularly as it establishes the framework for funding highways. It (1) dedicates certain sources of funding to be "used solely for highway purposes," through authorized taxes on motor fuels, motor vehicle registration, and motor vehicle sales; (2) establishes accounting funds for transportation finance; (3) allocates tax revenues among state, county, and municipal roads; and (4) establishes requirements related to use of the funds as well as characteristics of each road system. Minn. Const. art. XIV. State statutes further specify fiscal policies such as taxation rates, allocation formulas, and program requirements for local aid.

Nearly all road funding is handled outside of the state's general fund, primarily coming from three transportation-related taxes as well as federal aid. Funds are allocated to the state trunk highway system and local roads. The allocations reflect a combination of constitutional and statutory formulas.

Funding and Allocation Summary

The chart below summarizes the flow of highway funding from state and federal funds (using fiscal year 2013 amounts).



Note: excludes (1) proceeds from trunk highway and other general obligation bonds, and (2) $14.4 million in motor vehicle lease sales tax revenue.

Highway Funding Sources

Motor Fuels Tax

The motor fuels tax is imposed at a per-gallon rate and collected from petroleum distributors. The tax rate varies across fuel classifications. The rate for regular gasoline is the same for diesel and some gasoline blends. Minn. Stat. § 296A.07, subd. 3. The tax rate for other fuel types, such as E85 and compressed natural gas (CNG), is proportional to that of gasoline based on energy content of each fuel. Legislation passed in 2008 phased in an 8.5-cent tax increase, so that starting in fiscal year 2013, the rate for gasoline and diesel is 28.5 cents per gallon (and proportional for other fuel types). Laws 2008, ch. 152.

Period	Rate per gallon (in cents)[1]
FY 1987-2007	20.0
FY 2008-2012	20.0 – 28.0 (various)
FY 2013 and after	28.5

[1] Rates for some years include a debt service surcharge and exclude a "blink on" $0.02 per gallon fee for petroleum tank cleanup (imposed part-year based on an account fund balance). Minn. Stat. § 115C.08, subd. 3.

Constitutional language dedicates tax revenue from motor fuel "used for propelling vehicles on the public highways of this state." Minn. Const. art. XIV, § 10. Revenue is handled in a couple of ways when the fuel is not used for transportation on public roads.

- Taxes paid on fuel used in nonhighway commercial operations, principally farming, are refunded.
- A portion of tax revenue—$21.8 million in fiscal year 2013[2]—is attributed to fuel use in nonhighway activities, such as operating ATVs and motorboats, and transferred into various Department of Natural Resources accounts for those activities. Minn. Stat. § 296A.18.

Motor Vehicle Registration Tax

The state imposes a registration tax (also known as tab fees) on motor vehicles domiciled in Minnesota. The annual tax applies to passenger vehicles as well as trucks and other vehicles that use public streets and highways. One major exception is vehicles owned by government agencies (including school buses).

For passenger vehicles, the tax depends on the vehicle's original value as well as its age. Vehicles are taxed at (1) 1.25 percent of the *base value* multiplied by a *depreciation factor*, plus (2) $10.

- The *base value* is the manufacturer's list price (without options) for a particular make and model when the vehicle was new.
- The *depreciation factor* is a yearly reduction following a statutory schedule.

In the vehicle's first year of life there is in effect no depreciation. The depreciation is 90 percent in a vehicle's second year, and it drops by 10 percentage points each year until its eleventh year (when the formula changes from a percentage to a flat $25). Minn. Stat. § 168.013, subd. 1a. Hence the minimum on passenger vehicles is $35. Legislation in 2008 modified the schedule for depreciating the base value and eliminated caps on the amount of tax due. Laws 2008, ch. 152.

Trucks are taxed on the basis of weight and age. The tax on trucks and truck-tractors depends on weight, but includes a 25 percent reduction after eight years of life. Farm trucks pay a weight-based tax that is reduced after eight years of life. Buses are also taxed on weight, with depreciation beginning in the third year of life. Motorcycles have a flat tax of $10 annually. Minn. Stat. § 168.013.

Motor Vehicle Sales Tax (MVST)

The motor vehicle sales tax, or MVST, is a 6.5 percent tax applied to the sale price of new and used motor vehicles. Minn. Stat. § 297B.02. It is imposed instead of the general sales tax. Some older autos as well as collector's vehicles have a flat tax instead. MVST is collected by auto dealers or when the vehicle is registered.

[2] This amount represents about 2.5 percent of motor fuels tax revenue for the year.

Historically, MVST revenue has gone to both transportation and the general fund. Voters in 2006 approved a constitutional amendment that dedicates all MVST revenue to transportation purposes, phased in over fiscal years 2008 to 2012. The Constitution also places allocation restrictions, requiring that:

- "no more than 60 percent" of the revenue go to highways; and
- "not less than 40 percent" go to public transit assistance. Minn. Const. art. XIV, § 13.

Other Revenue Sources

Other notable sources of highway funding are as follows.

- **Federal aid** is a signficant funding source. It is provided through a number of federal programs that include formula-based allocations to the state as well as discretionary assistance. Fiscal year 2013 aid amounted to $550.7 million for trunk highways and $170.4 million for local roads.
- The **motor vehicle lease sales tax** has been partially allocated to county roads as well as transit since fiscal year 2010. The tax is imposed on leases of passenger vehicles and smaller trucks, at the same rate as the state's general sales tax (6.875 percent, of which 0.375 percent is constitutionally dedicated under the Legacy amendment). Collections for counties amounted to $14.4 million in fiscal year 2013.
- Additional **trunk highway fund revenue** for the state's trunk highway system comes from various comparatively smaller sources, such as construction work performed under an agreement with local units of government, fees for permits, and fines.

Bonding

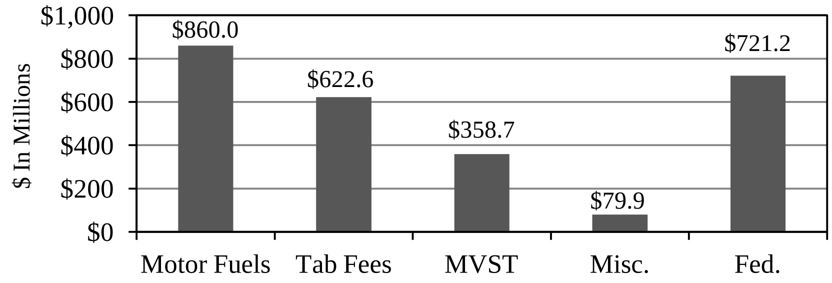
State bonds have traditionally been used to fund both state and local highway projects. However, since bonds carry an obligation for future repayment with interest, proceeds from bond issuances represent debt rather than "new" revenue. There are several types of bonds.

- **Trunk highway bonds** are a specialized form of general obligation bonding and are constitutionally limited to capital projects on the trunk highway system.
- **General obligation bonds** are available for local roads and bridges (as well as other transportation capital such as light rail and bus facilities). They cannot be used on the trunk highway system. Minn. Const. arts. XI, § 5 (e); XIV, § 11.

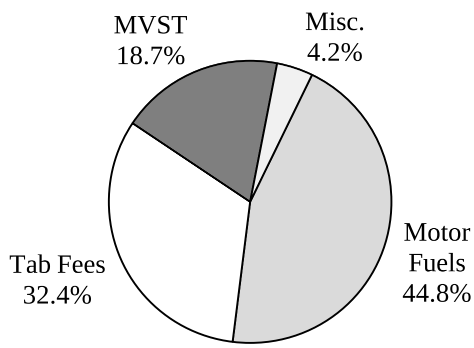
Highway Funding Levels

The charts below summarize fiscal year 2013 highway funding from both state and federal sources (for the trunk highway system as well as aid to local government).

State and Federal Highway Funding
FY 2013 ($2.64 billion)



Distribution of State Highway Funding
FY 2013 ($1.92 billion)



Notes: (1) "Motor fuels" category includes revenue for fuel attributed to nonhighway uses; (2) "MVST" category only contains highway fundng; (3) "Misc." category is primarily trunk highway system revenue and includes motor vehicle lease sales tax revenue; and (4) charts exclude bond proceeds.

Revenue Allocation

Constitutional formula. Revenue from the primary state taxes goes into the highway user tax distribution (HUTD) fund. Following some special allocations (such as for tax collection costs), it is allocated in two parts following a constitutional formula. Minn. Const. art. XIV, § 5.

First, **95 percent** is distributed into dedicated highway funds, outlined in the following table.

Percent	Allocation	Use
62%	Trunk highway fund	Trunk highway construction, maintenance, and administration
29%	County state-aid highway (CSAH) fund	County roads in the state-aid system, apportioned to counties by two statutory formulas. Minn. Stat. § 162.07.
9%	Municipal state-aid street (MSAS) fund	City streets in the state-aid system, apportioned to cities by statutory formula. Minn. Stat. § 162.13.

Second, there is a **5 percent "set-aside."** Under the Constitution, the money is legislatively directed but must only go into the three core highway funds (the trunk highway fund, CSAH fund, and the MSAS fund). The 5 percent set-aside distribution cannot be changed more than once every six years. (The latest change went into effect July 1, 2009.) Funds are currently distributed by statute into the CSAH fund and then divided as follows. Minn. Stat. § 161.081.

Percent	Allocation	Use
53.5%	Flexible highway account	(1) metropolitan county highways, (2) trunk highways being turned over to cities or counties, (3) safety improvements on local roads, and (4) routes of regional significance; there is a required minimum for Twin Cities metropolitan area counties[3]
30.5%	Town road account	Town roads; allocated to counties proportionally based on town road miles, to be distributed to towns
16%	Town bridge account	Town bridges

Motor vehicle sales tax (MVST). Since fiscal year 2012, following a phase-in period, MVST revenue has been split among highways and transit, as follows. Minn. Stat. § 297B.09.

Percent	Allocation	Use
60%	Highway user tax distribution (HUTD) fund	State and local highways; further allocated by constitutional formula (in the same manner as outlined above)
36%	Metropolitan area transit	Transit in Twin Cities metropolitan area
4%	Greater Minnesota transit	Transit in Greater Minnesota

Motor vehicle lease sales tax. Following recent shifts, motor vehicle lease sales tax revenue (excluding Legacy funds) for fiscal year 2015 and after is distributed as follows.

Portion	Allocation	Use
First $32 million	General fund	Nondedicated state revenue
50% of remainder[4]	County state-aid highway fund	Certain Twin Cities metropolitan area counties[5]
50% of remainder	Greater Minnesota transit	Transit in Greater Minnesota

For more information about highway finance, visit the transportation area of our website, www.house.mn/hrd/.

[3] Under a provision established in 2008, 50 percent of a portion in the flexible highway account termed the "excess sum" must be allocated to counties in the Twin Cities metropolitan area. The county distribution being used is proportional based on population, but excluding the populations of Minneapolis and St. Paul. "Excess sum" is essentially a measure of new funding, consisting of revenue within the account resulting from: (1) the motor fuels tax at a rate above 20 cents per gallon (which was the tax rate on gasoline before the 2008 legislation); (2) new revenue from the registration tax above an amount collected in fiscal year 2008 and adjusted for inflation (designed to identify increased revenue due to changes made in 2008); and (3) MVST revenue above the amount yielded by an allocation to the flexible highway account in fiscal year 2007 (the last year prior to commencing a phase-in of all MVST revenue to transportation).

[4] Forecasted fiscal year 2015 revenue is $21.7 million. (Actual distribution to counties is on a calendar year basis and will not match fiscal year collections.) From Minnesota Management and Budget, *Consolidated Fund Statement, End of 2014 Legislative Session*, June 27, 2014.

[5] The funds are allocated separately from most state-aid dollars. Following state statute, revenue does not go to Hennepin or Ramsey counties and must be distributed proportionally based on the population of each of the other five metropolitan counties. Minn. Stat. § 297A.815, subd. 3.