MN HOUSE RESEARCH

Highway Finance

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Executive Summary

This publication summarizes Minnesota's finance structure for highway systems (including roads and bridges). Most funding comes from outside the state's general fund. A framework set by the Minnesota Constitution directs revenue to transportation purposes from three transportation-related taxes—a motor fuels tax, a tax on vehicle registration, and a motor vehicle sales tax. Federal aid, revenue from other state sales taxes, and bonds are other notable sources of funding. The funding is distributed to state and local road systems based on a combination of several constitutional and statutory formulas.

Contents

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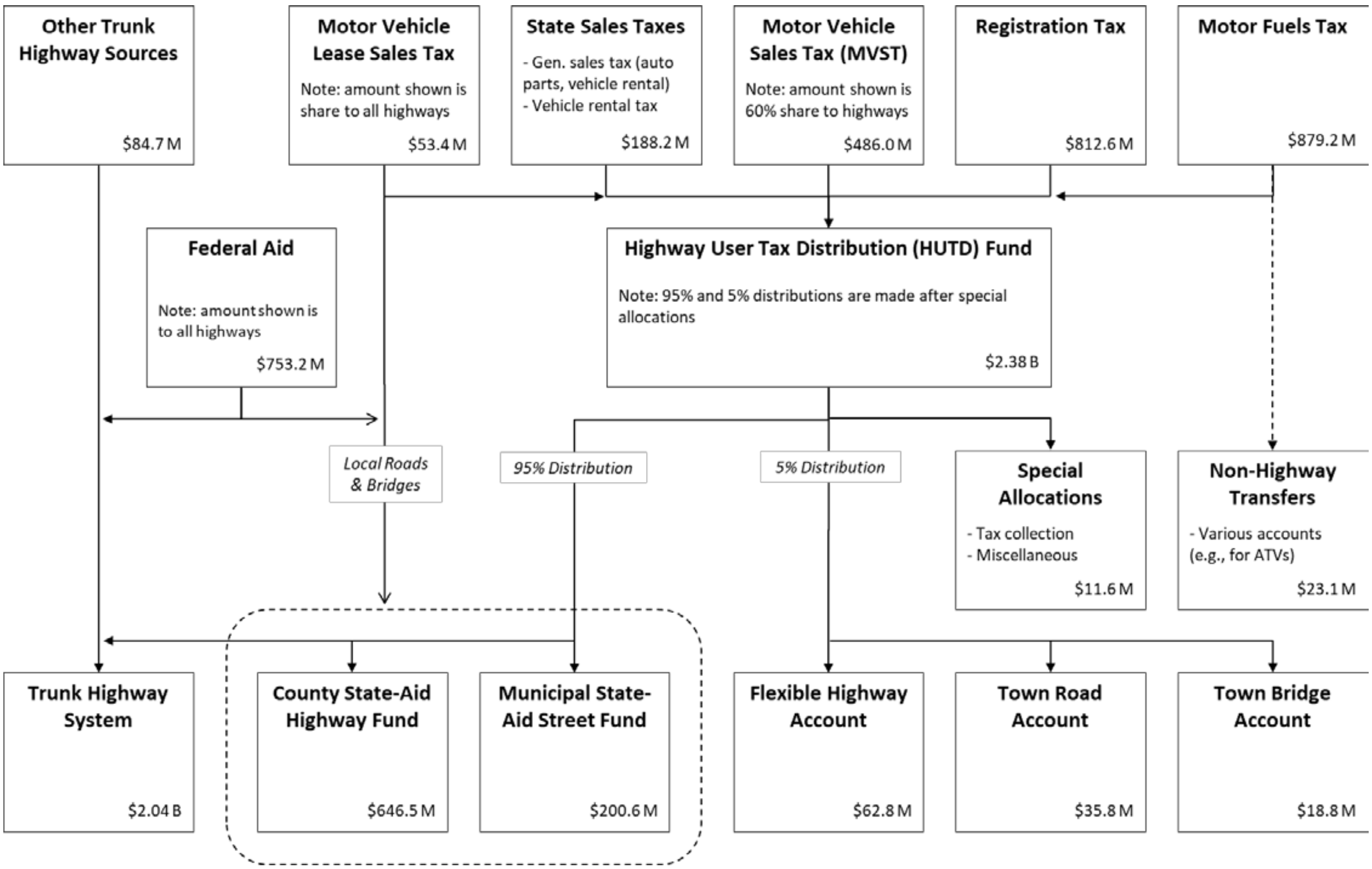
Finance Overview

The chart below summarizes the core flow of highway funding from state and federal sources.



Notes: Amounts are for fiscal year 2020. "Local roads and bridges" category includes $179.3 million in federal aid and $43.9 million from motor vehicle lease sales tax revenue. HUTD funds include $4.5 million from fees and investments. The chart does not show (1) $303.1 million in fiscal year 2020 spending from bond proceeds for both state and local roads, (2) onetime general fund appropriations, (3) MVST and motor vehicle lease sales tax revenue allocated to transit, (4) some investment income, and (5) some federal funds for traffic safety and enforcement. Motor fuels tax revenue goes to the highway user tax distribution fund and "nonhighway transfers" shares are then transferred to other accounts.

Constitutional and Statutory Framework

The Minnesota Constitution is integral to the state's transportation finance structure, particularly in establishing a framework for funding highways ("highways" is used in a broad sense to encompass streets and bridges at the state as well as local level). Among its features, the constitution: (1) dedicates 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 on use of the funds as well as characteristics of each road system. Minn. Const. art. XIV.

Highway finance involves several formulas. A constitutional distribution formula addresses funding for both state and local road systems, and local funds are further allocated through multiple statutory formulas (such as to distribute aid among counties). State statutes further specify fiscal policies such as taxation rates and requirements for local aid.

Highway Funding Sources

Motor Fuels Tax

The motor fuels tax is the most sizeable highway funding source, with revenue totaling $879.2 million in fiscal year 2020.

It is imposed at a per-gallon rate and collected from petroleum distributors. The tax rate varies across fuel classifications. The total state tax rate is 28.5 cents per gallon for gasoline, diesel, and some gasoline blends, which includes a 3.5-cent per gallon surcharge that is tied to debt service on trunk highway bonds authorized in 2008. Minn. Stat. §§ 296A.07, subd. 3; 296A.083. The 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. The most recent rate changes result from 2008 legislation that phased in an 8.5-cent tax increase over fiscal years 2008 to 2013. Laws 2008, ch. 152.

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—about $23.1 million in fiscal year 2020—is attributed to fuel use in nonhighway activities, such as operating ATVs and motorboats, and transferred into various accounts related to those activities. Minn. Stat. § 296A.18. The funds are primarily administered by the Department of Natural Resources.

Registration Tax

The state imposes a registration tax (also known as tab fees) on motor vehicles domiciled in Minnesota. The tax applies annually to passenger vehicles as well as to trucks and other vehicles that use public streets and highways. Fiscal year 2020 revenue totaled $812.6 million.

Following changes made by the 2020 Legislature, the tax for passenger vehicles depends on the original vehicle price as well as its age. With a new passenger vehicle, the tax is calculated as (1) a flat $10; plus (2) the amount resulting from the following formula:

- 1.285 percent of the manufacturer's suggested retail price (MSRP); or 1.25 percent of the MSRP plus the destination charge, for vehicles first registered prior to November 16, 2020; multiplied by
- a depreciation factor that reduces the tax calculated against the MSRP.

In the first year of vehicle life, the tax calculation is performed against 100 percent of the vehicle's MSRP, so in effect there is no depreciation factor applied. In a vehicle's second year, the depreciation factor is 90 percent. It drops by 10 percentage points for each year of vehicle life through the tenth year.

For a vehicle in its 11th or succeeding year, the formula is replaced with a $25 minimum value amount. Minn. Stat. § 168.013, subd. 1a. The minimum value amount is added to the flat $10, so that the total minimum tax on passenger vehicles is $35.[1]

Trucks are taxed on the basis of weight and age. The tax on trucks and truck-tractors depends on weight following a schedule established by statute, with a 25 percent reduction after eight years of life. For farm trucks there is a weight-based tax that is reduced after eight years of life (the percentage depreciation depends on vehicle weight). Buses are similarly taxed on weight following a separate schedule, with depreciation beginning in the third year of life. Motorcycles carry a flat tax of $10 annually. Minn. Stat. § 168.013.

There are exemptions for some vehicles, such as those owned by educational institutions and used to transport pupils to and from school. Minn. Stat. § 168.012, subd. 1.

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. It is imposed instead of the general sales tax, which has a comparatively higher rate of 6.875 percent. (The 0.375 percent increment is due to a 2008 constitutional amendment—the Legacy amendment—that funds outdoor heritage, clean water, parks and trails, and arts and cultural heritage.) Some older autos as well as collector's vehicles have flat tax rates instead. The flat tax is $10 for vehicles that are at least ten years old and have a resale value of under $3,000, and is $150 for some collector vehicles. Minn. Stat. §§ 297B.02, 297B.025. MVST is collected by auto dealers or by deputy registrars when the vehicle is registered.

Historically, MVST revenue had been allocated both to the state's general fund and to transportation purposes, with periodic changes and suspension in funds provided to transportation. Voters in 2006 approved a constitutional amendment dedicating all MVST revenue to transportation purposes, which was phased in over fiscal years 2008 to 2012.

The constitution also places restrictions on the allocation between roads and transit, requiring that:

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

[1] Other fees apply and are not discussed here.

MVST funds are distributed by statutory formula at 60 percent for highways and 40 percent to transit. Minn. Stat. § 297B.09, subd. 1. Fiscal year 2020 revenue for the highway portion totaled $486.0 million.

State Sales Taxes

Legislation enacted in 2017 allocates sales tax revenue streams that had previously gone to the general fund. Laws 2017, 1st spec. sess., ch. 3, art. 3, §§ 109-110. The bulk of the transportation funding increase is directed to the highway user tax distribution (HUTD) fund, which provides for formula-based distribution of money across state and local road systems. Fiscal year 2020 revenue totaled $197.7 million. The revenue sources are:

- a portion of the general sales tax revenue that is attributed as resulting from sales of automotive parts;
- the entire general sales tax revenue from short-term vehicle rentals;
- all revenue from a separate motor vehicle rental tax, which is imposed on short-term rentals at a 9.2 percent rate; and
- motor vehicle lease sales tax revenue (see below).

General sales tax revenue from automotive parts. A flat dollar amount is specified in law to be allocated from general sales tax revenue attributable to auto parts sales. (It is at a level that does not reflect total sales estimates.) The amount allocated to transportation increased over a phase-in, and is set at $145.6 million annually beginning in fiscal year 2020. Minn. Stat. § 297A.94, para. (g).

Motor vehicle lease sales tax revenue. Longer term leases of passenger vehicles and smaller trucks are subject to the general sales tax (imposed at a 6.875 percent rate). The revenue stream is also known as the motor vehicle lease sales tax (MVLST), although it is not a separate tax. The legislature allocated a portion to county roads and transit starting in fiscal year 2010 (prior to that, revenue had gone entirely to the general fund). The distribution was restructured in 2017 legislation to direct all of the revenue to transportation (after accounting for a constitutionally dedicated share under the Legacy amendment). The distribution follows an allocation formula (discussed in the Funding Allocation section below). In fiscal year 2020, MVLST revenue allocated to highway purposes amounted to $53.4 million.

Other Sources

Other notable sources of highway funding are as follows.

- **Federal aid** is a significant funding source. It is provided through a number of programs that include formula-based allocations to the state as well as discretionary assistance. Fiscal year 2020 aid totaled $753.2 million, split $573.9 million for trunk highways and $179.3 million for local roads.

- **Other trunk highway sources** for the state's trunk highway system come from various Minnesota Department of Transportation activities, such as construction work performed under an agreement with local units of government, fees for permits, land and equipment sales, and fines. Revenue from these sources totaled $84.7 million in fiscal year 2020.

- **General fund appropriations** for road systems are sometimes made in transportation budget legislation, although it is not a typical highway funding source (other than in bonding, discussed below). There were no fiscal year 2020 general fund appropriations.

Bonding

Historically, the legislature has used state bonds to fund both state and local highway projects. There are several forms of bonding, the most relevant of which are highlighted below.

- **Trunk highway bonds** are a specialized form of general obligation bonding and are constitutionally limited to capital projects that are part of, or functionally related to, the trunk highway system. Repayment of debt on the bonds is from the trunk highway fund.

- **General obligation (G.O.) bonds** are regularly authorized for local roads and bridges; they are also known as local road and bridge bonding. (The legislature has also authorized general obligation bonding for other transportation capital such as ports, bus facilities, and light rail.) The bond proceeds cannot be used for projects on the trunk highway system. Debt service is paid from the general fund. Minn. Const. arts. XI, § 5 (e); XIV, § 11.

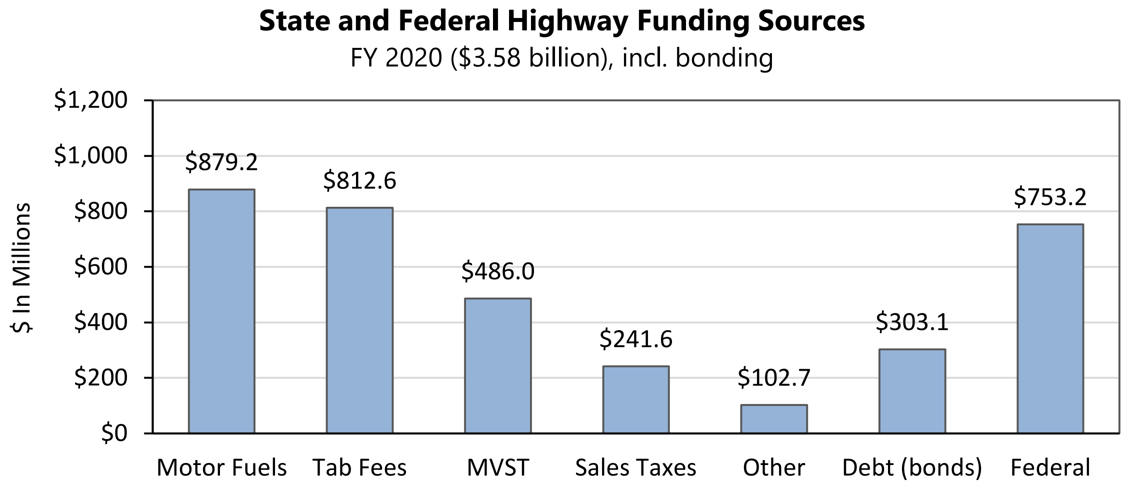
Since bonds carry an obligation of future repayment with interest, proceeds from bond issuances represent debt. Nonetheless, use of bond proceeds enables spending and can therefore be viewed as a funding source.

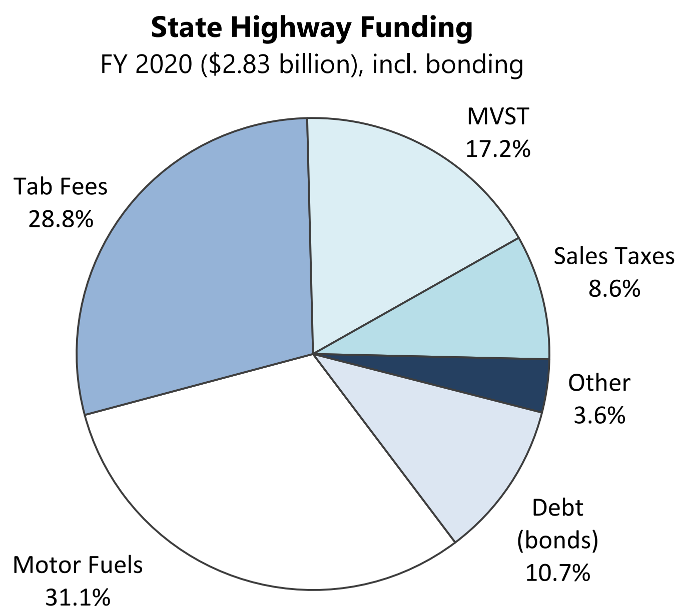
Legislative *authorizations* to issue bonds are distinct from *expenditures* and can occur prior to the bond issuance, as highway projects can commonly take place over multiple fiscal years. (Bonds are issued based on anticipated cash flow needs of bond-funded projects, in amounts designed to cover upcoming project costs until the next bond sale.)

In fiscal year 2020, proceeds from bonding totaled $303.1 million for state and local roads. This amount represents funding expenditures for project costs in the fiscal year.

Highway Funding Amounts

The charts below summarize fiscal year 2020 state and federal highway funding, which is for the trunk highway system as well as aid to local government. In the charts, bonding debt is treated as a form of funding.





Notes – all charts: (1) “Motor fuels” category includes revenue for fuel attributed to nonhighway uses; (2) “MVST” category only contains highway funding; (3) “Other” category is primarily trunk highway system revenue and includes some investment income; (4) both “Debt” and “Federal” categories include funds for state as well as local road systems; and (5) amounts exclude some federal funds for traffic safety and enforcement.

Funding Allocation

Constitutional Formula

Much of the revenue from transportation-related taxes (excluding a portion of the motor vehicle sales tax) initially goes into the highway user tax distribution fund. The HUTD fund is constitutionally established and mainly serves as a distribution passthrough to other highway-related funds.

Following some transfers and special allocations (such as for tax collection costs), the bulk of HUTD fund money is allocated in two parts based on a constitutional framework. The following formulas apply to distribution of revenue from both transportation-related taxes and some state sales taxes.

95 percent distribution. First, 95 percent is distributed into dedicated highway funds, as outlined in the following table. This is a constitutional formula.

HUTD Distribution

Share	Destination	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 based on two statutory formulas. Minn. Stat. § 162.07.
9%	Municipal state-aid street (MSAS) fund	City streets in the state-aid system; apportioned to cities based on a statutory formula. Minn. Stat. § 162.13.

5 percent "set-aside." Second, allocation of the remaining 5 percent in the HUTD fund is somewhat less constricted. The money can be directed by statute, but under the constitution must only go into one or more of the three core highway funds (the trunk highway fund, CSAH fund, and the MSAS fund). Funds are currently put into the CSAH fund and then divided as follows, based on requirements set in state statute. Minn. Stat. § 161.081.

HUTD Set-Aside Allocation

Share	Destination	Use
53.5%	Flexible highway account	(1) Twin Cities metropolitan area county highways[i], (2) "turnbacks"—trunk highways being turned over to cities or counties, (3) safety improvements on local roads, and (4) routes of regional significance
30.5%	Town road account	Town roads; allocated to counties proportionally based on town road miles, to be distributed to towns. Minn. Stat. § 162.081.
16%	Town bridge account	Town bridges

Share	Destination	Use
Notes [i] A share of funds in the flexible highway account must be allocated to counties in the Twin Cities metropolitan area. The distribution is proportional based on county population, except that the populations of Minneapolis and St. Paul are not counted. Minn. Stat. § 161.081, subd. 3.		

A constitutional provision specifies that the split within the 5 percent set-aside cannot be changed more than once every six years. The latest change went into effect July 1, 2009.

Motor Vehicle Sales Tax (MVST)

Since fiscal year 2012 (following the constitutional dedication phase-in), MVST revenue has been divided between highways and transit as follows. Minn. Stat. § 297B.09.

MVST Allocation

Share	Destination	Use
60%	HUTD fund	State and local highways; revenue into the HUTD fund is then allocated by formulas (as outlined in previous tables)
36%	Metropolitan area transit	Transit in Twin Cities metropolitan area
4%	Greater Minnesota transit	Transit systems in Greater Minnesota

State Sales Taxes

The 2017 Legislature directed additional revenue to highways using state sales tax sources.

State Sales Taxes Revenue to Transportation

Source	Transportation Share	Destination
Gen. sales tax – auto parts	$145.6 million annually	HUTD fund
Gen. sales tax – vehicle rental	All revenue	HUTD fund
Vehicle rental tax	All revenue	HUTD fund
Motor vehicle lease sales tax	All revenue	Various (see below)
Notes Revenue into the HUTD fund is then allocated by formulas (as outlined in previous tables).		

Motor Vehicle Lease Sales Tax Revenue

Following 2017 changes, the formula to distribute motor vehicle lease sales tax revenue allocates all of the revenue to transportation purposes. (The changes eliminate a portion of revenue that had been retained in the general fund.) The allocation is outlined below.

Motor Vehicle Lease Sales Tax Revenue Allocation

Share[i]	Destination	Use
38%	Metro area county roads	Some Twin Cities metropolitan area counties[ii]
38%	Greater Minnesota transit	Transit systems in Greater Minnesota
13%	Local bridge program	Local bridge replacement and rehabilitation
11%	HUTD fund	State and local highways; revenue into the HUTD fund is then allocated by formulas (as outlined in previous tables)

Notes
Amounts are in millions.

[i] Amounts are net of Legacy amendment funds.

[ii] The revenue does not go to Hennepin or Ramsey County and is distributed proportionally based on the population of the other five metropolitan counties. Minn. Stat. § 297A.815, subd. 3, para. (c).

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