INFORMATION BRIEF
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Highway Finance Overview

This brief summarizes the core state finance structure for roads and bridges in Minnesota. Most road funding is handled outside the state's general fund. Following a framework set in the Minnesota Constitution, revenue from three transportation-related taxes—a motor fuels tax, a tax on vehicle registration, and a motor vehicle sales tax—is directed to transportation purposes. Federal aid, revenue from state sales taxes, and bonds count among other notable sources. Highway funding is distributed among state and local road systems based on multiple constitutional and statutory formulas.

The brief primarily covers fiscal year 2017 finances, and does not provide detail on additional tax sources reallocated from the general fund starting in fiscal year 2018. (The reallocation consists of a portion of general sales tax revenue from auto parts sales, general sales tax revenue from short-term vehicle rentals, collections from a separate vehicle rental tax, and motor vehicle lease sales tax revenue.)

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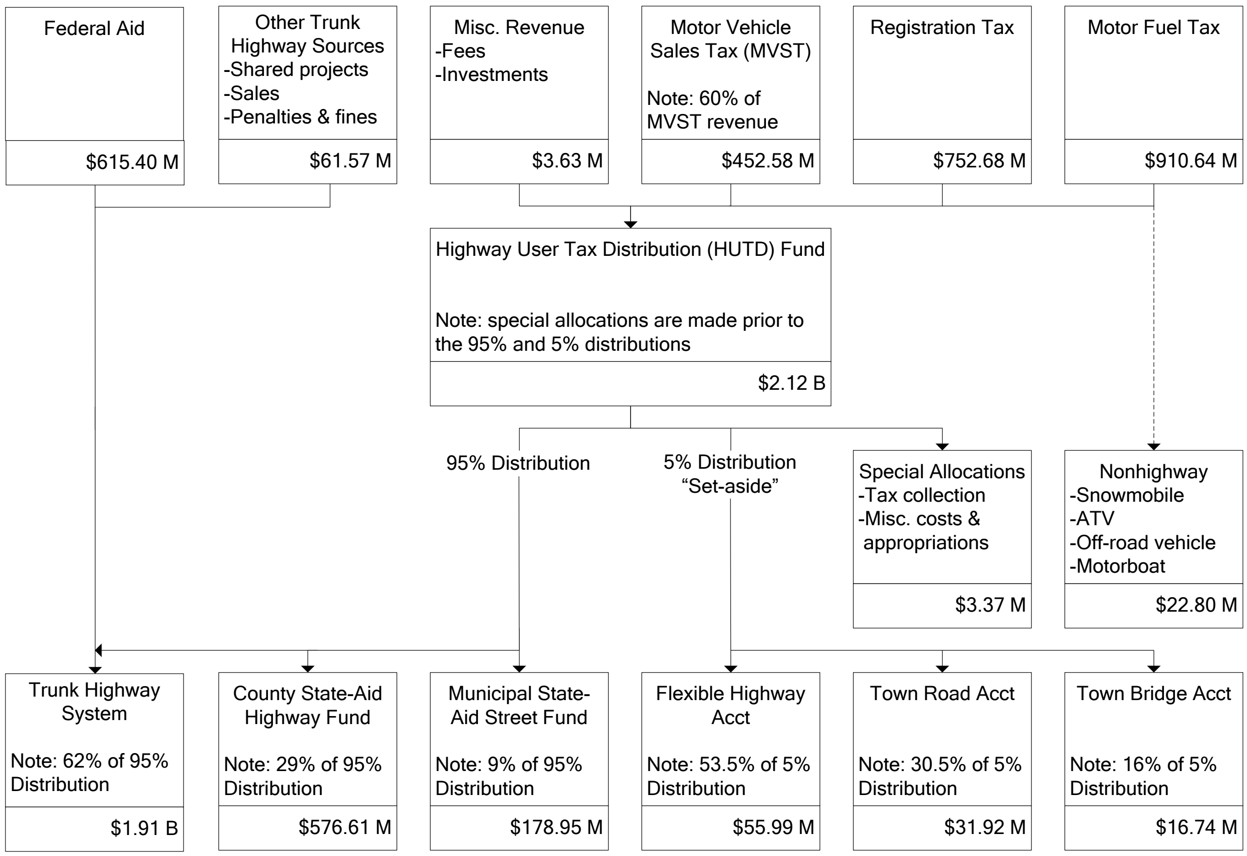
Finance Summary

The chart below summarizes the flow of highway funding from state and federal sources, with fiscal year 2017 amounts. (State sales tax sources beginning in fiscal year 2018 are not shown.)



Notes: the chart does not show (1) $229.3 million in FY 2017 bonding for state and local roads, (2) $140.7 million in federal aid to local government, (3) $33.4 million from motor vehicle lease sales tax revenue distributed to some counties, (4) 40 percent of MVST revenue allocated to transit, (5) some investment revenue, and (6) some federal funds for traffic safety and enforcement. The amount to the highway user tax distribution fund includes nonhighway account transfers related to motor fuels tax revenue.

Constitutional Framework

The Minnesota Constitution is integral to the transportation finance structure, particularly as it establishes the framework for funding highways. It (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 a combination of formulas: a constitutional distribution addresses funding for both state and local road systems, and local funds are further allocated through multiple statutory formulas (such as in distributing aid among counties). State statutes further specify fiscal policies such as taxation rates and program requirements for local aid.

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 total state tax rate is 28.5 cents per gallon for gasoline, diesel, and some gasoline blends. It 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 (although aviation fuels are not discussed here). 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.

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

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 $22.8 million in fiscal year 2017[2]—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 annual tax applies to passenger vehicles as well as trucks and other vehicles that use public streets and highways. There are exemptions for some vehicles, such as ones owned by the federal government and educational institutions when used to transport pupils to and from school. Minn. Stat. § 168.012, subd. 1.

[1] Rates are for gasoline and diesel, and in some years include a debt service surcharge. Rates exclude (1) a “blink on” fee of 2 cents per gallon for petroleum tank cleanup (imposed part-year based on an account fund balance), and (2) an inspection fee. Minn. Stat. §§ 115C.08, subd. 3; 239.101, subd. 3.

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

For passenger vehicles, the tax depends on the original vehicle 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 factor. The factor is 90 percent in a vehicle's second year. It drops by 10 percentage points each year until its 11th year, when the formula changes from a percentage to a flat $25. Minn. Stat. § 168.013, subd. 1a. Hence the minimum tax on passenger vehicles is $35. The formula was last changed in 2008. Laws 2008, ch. 152.

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. Farm trucks pay 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 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. It is imposed instead of the general sales tax (which is at a rate of 6.875 percent due a 2008 constitutional amendment related to funding 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 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 the amount provided to transportation. Voters in 2006 approved a constitutional amendment dedicating all MVST revenue to transportation purposes. The dedication was phased in over fiscal years 2008 to 2012.

The Constitution also places allocation restrictions on the split between roads and transit, 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.

Funds are currently distributed by statutory formula at 60 percent for highways and 40 percent to transit. Minn. Stat. § 297B.09, subd. 1.

Other 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 2017 aid was split $615.4 million for trunk highways and $140.7 million for local roads.
- Longer term leases of passenger vehicles and smaller trucks are subject to the 6.875 pecent general sales tax. **Sales tax revenue from motor vehicle leases**—known as the motor vehicle lease sales tax (MVLST) although it is not separate tax—has been partially allocated to county roads along with transit since fiscal year 2010. (Historically it had gone entirely to the general fund.) The funding share for county roads amounted to $33.4 million in fiscal year 2017. The distribution of revenue was modified in 2017 legislation, which will boost highway funding starting in year 2018. Laws 2017, 1st spec. sess., ch. 3, art. 3, § 109.
- Additional **state sales tax revenue** reallocations made in 2017 transportation finance legislation will increase highway funding in fiscal year 2018 on an ongoing basis. The additional funding is from (1) general sales tax revenue from sales of automotive repair and replacement parts, (2) general sales tax revenue from short-term vehicle rentals, (3) collections from a separate vehicle rental tax, and (4) motor vehicle lease sales tax revenue.
- While not a typical source for highway funding (other than through bonding, discussed below), **general fund appropriations** for roads have been provided in some years. There are no appropriations for fiscal year 2017.
- Additional **trunk highway fund sources** for the state's trunk highway system come from various activities, such as construction work performed under an agreement with local units of government, fees for permits, land and equipment sales, and fines.

Bonding

State bonds have historically been used 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 comes from the trunk highway fund.
- **General obligation bonds** are regularly provided for local roads and bridges; they are also known as local road and bridge bonding. (General obligation bonding has also been used 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.

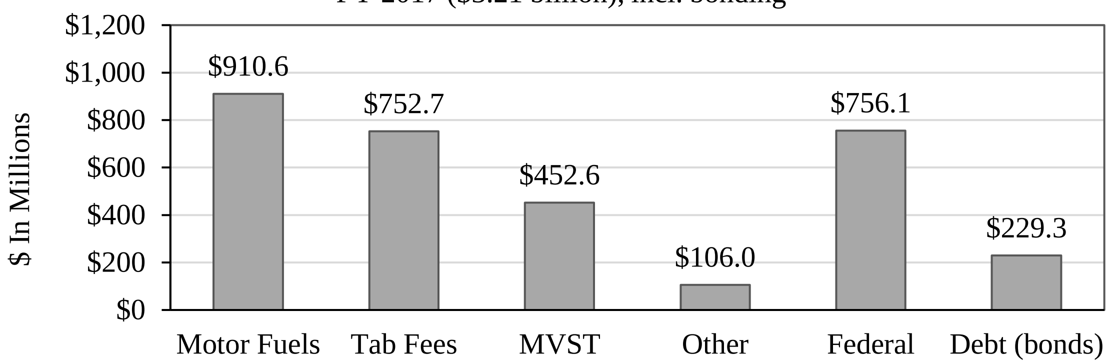
Since bonds carry an obligation of future repayment with interest, proceeds from bond issuances represent debt rather than additional revenue. Nonetheless, proceeds from bonds sales can be viewed as a type of funding source. In fiscal year 2017, **bonding funds totaled $229.3 million** for state and local roads (primarily funding trunk highway system projects, at $211.9 million). This amount only represents funding *expenditures* for project costs in the fiscal year.

Legislative *authorizations* to issue bonds are distinct from expenditures and may occur in a year 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.)

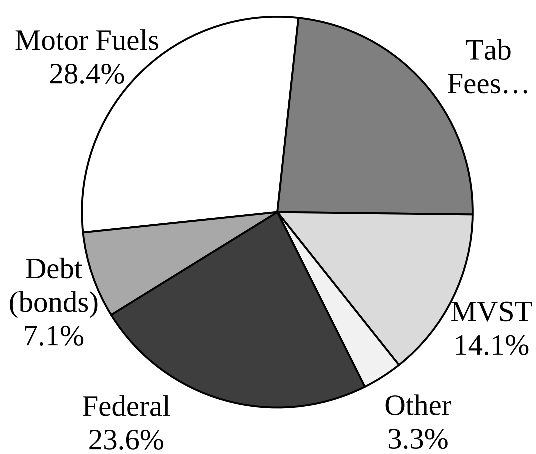
Highway Funding Amounts

The charts below summarize fiscal year 2017 state and federal highway funding—for the trunk highway system as well as aid to local government. A couple treat bonding debt as a form of funding.

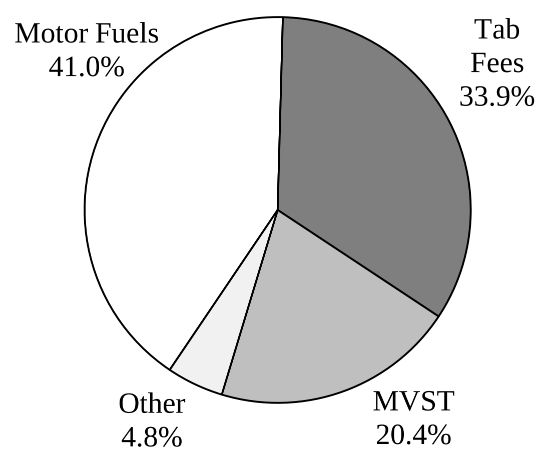
State and Federal Highway Funding
FY 2017 ($3.21 billion), incl. bonding



Highway Funding Distribution
FY 2017 ($3.21 billion), incl. bonding



State Funding Distribution
FY 2017 ($2.22 billion)



Notes – all charts: (1) "Motor fuels" category includes revenue for fuel attributed to nonhighway uses; (2) "MVST" category contains only highway funding; (3) "Other" category is primarily trunk highway system revenue and includes some motor vehicle lease sales tax revenue and 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.

Allocation Structure

Constitutional Formula

Revenue from the primary state taxes (that is, the motor fuels tax and the motor vehicle registration tax, along with a portion of the motor vehicle sales tax) initially goes into the highway user tax distribution (HUTD) fund. The HUTD fund is constitutionally established and mainly serves as an allocation 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 formula.

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

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 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 of the HUTD fund is somewhat less constricted. The money can be directed by law, 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.

Percent	Allocation	Use
53.5%	Flexible highway account	(1) 16 percent for Twin Cities metropolitan area county highways[3], (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

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.

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[3] Under a provision first established in 2008, 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. Under a 2017 change, 16 percent of the flexible highway account fund is allocated in this manner to metropolitan counties. The percentage essentially reflects additional funding that was made available due to changes to transportation finance made in the mid- to late 2000s. Minn. Stat. § 161.081, subd. 3.

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.

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

Motor Vehicle Lease Sales Tax Revenue

The formula for distributing motor vehicle lease sales tax revenue has been amended at different points. The 2017 Legislature enacted a restructuring that allocates the revenue to transportation purposes. Laws 2017, 1st spec. sess., ch. 3, art. 3, § 109. The distribution in fiscal year 2017 is described below.

Portion	Allocation	Use
First $32 million	General fund	Nondedicated state revenue (a portion is used to cover the Legacy amendment requirements)
50% of remainder[4]	County state-aid highway fund	Some Twin Cities metropolitan area counties
50% of remainder	Greater Minnesota transit	Transit in Greater Minnesota

Starting in fiscal year 2018, the revenue distribution changes to the following formula (which is net of sales tax funds distributed under the Legacy amendment).

Percent	Allocation	Use
38%	County state-aid highway fund	Some Twin Cities metropolitan area counties[5]
38%	Greater Minnesota transit	Transit in Greater Minnesota
13%	State transportation fund	Local bridge improvement program
11%	Highway user tax distribution fund	State and local highways; the funds are allocated by constitutional formula (as outlined previously)

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

[4] The amount is $33.4 million for fiscal year 2017. Aid distribution to counties is on a calendar year basis, so it will not match fiscal year collections.

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