South Dakota Legislative Research Council

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HIGHWAY REVENUE CHANGES -- A DECADE LATER

In 1985 the Legislature made major changes regarding the collection and distribution of motor fuel taxes and motor vehicle license fees in the state. Prior to these changes the state and local governments had shared in the revenues from these sources. The changes resulted in the state receiving all the motor fuel tax and local governments receiving most of the motor vehicle license fees. But what has happened since then? Have the state and local governments both benefited from these changes? This memorandum will review the changes that took place in 1985 and take a look at the results of these changes over a decade later.

Background

The foundation for the changes in 1985 was an interim study by the 1984 Local Government Study Commission (LGSC). The study was the result of a concurrent resolution which passed the 1984 Legislature requesting the appointment of an interim committee to conduct a comparative study of state, county, township, and city highway funding needs and highway funding efforts. The LGSC was also directed by the Executive Board to study motor vehicle licensing and the distribution of those funds. The commission extensively reviewed the methods used to distribute the revenue from motor fuel taxes and motor vehicle license fees. The LGSC also looked at the distribution of similar funds in surrounding states. The commission found some of the distribution formulas used in the state to be based on factors that were outdated and difficult to justify. The commission then reviewed a number of options that the Legislature could pursue in changing the distribution of various funding options.

In conjunction with the commission's study, the Department of Transportation (DOT) conducted a statewide study of highway needs at the state, county, township, and municipal levels. The DOT study and report were not completed until January 1985; therefore, the LGSC did not make any specific recommended changes because the commission felt any proposed changes should take into consideration the results of the highway needs study. The LGSC did indicate there were adequate options available to increase highway revenues to local governments without significantly affecting the DOT's ability to maintain state highways and without increasing any highway user fee or tax.

The DOT study was presented to the Legislature early in the 1985 Session. The study indicated that additional annual revenues of approximately $3.8 million for counties, $3.5 million for cities, and $800,000 for townships were needed to meet on-going highway needs and address the backlog of highway needs over a twenty-year period.

The Changes

The South Dakota Highway Users Conference then made a recommendation to the 1985 Legislature, which was introduced by the LGSC chair, to modify the way highway revenues were distributed and to address these local highway needs. Their proposal was adopted by the Legislature and contained significant changes regarding the distribution of motor fuel taxes and the distribution of motor vehicle license fees. The proposal also included replacing the 3% initial motor vehicle license fee with the 3% excise tax on motor vehicles.

The first change was to eliminate the counties' portion of motor fuel tax revenue. Counties had received 1/8 of the total motor fuel collections after various minor deductions and the state highway fund received the remainder. The state would now receive all of the motor fuel tax revenue. The argument presented by the proponents for the change was that the new system would allow the Legislature to increase funding to the state highway fund without also increasing the amount to the counties which may not have demonstrated a need for the revenue. This change at the time resulted in the state receiving an additional $5.9 million.

The second change was to retain all revenue from motor vehicle license fees at the local level. Prior to this the state highway fund received 54.5% of all motor vehicle license fees. This amounted to about $10.8 million a year. That money was placed under the change into a Local Government Highway and Bridge Fund and distributed to counties, cities, and townships based on their portion of total highway needs that had been previously identified by the DOT study. The counties' portion of this fund was also increased to cover their loss of motor fuel tax revenues. This distribution among counties, municipalities, and townships is established in SDCL 32-11-35. This change initially resulted in counties receiving about $2.3 million more a year than previously, cities about $2 million more a year, and townships about $600,000 more a year. The proponents advocated that, under this change, if additional funding needs were demonstrated at the local level, motor vehicle license fees could be adjusted to meet the need.

The third change was to enact a 3% motor vehicle excise tax to replace the 3% initial registration fee on motor vehicles. The initial registration fee was only charged on new vehicles or previously unregistered vehicles based on the manufacturer's sticker price of a new vehicle or the book value of a used vehicle. This fee was paid only upon the first registration of a vehicle in the state. The new excise tax is applied to the purchase price of a new or used vehicle at the time the vehicle's title is issued or transferred. On a new vehicle transaction involving a trade-in the tax is paid on the difference in value. Consequently, less tax is collected from new vehicles but more tax is collected overall because of the tax on used vehicles. All of the excise tax goes to the state highway fund, as had the initial registration fee. The proponents advocated that the excise tax would bring in an additional $4.9 million a year.

The S.D. Highway Users Conference proposal was presented to the Legislature as being revenue neutral to the state and providing increased revenues to local governments. The state highway fund lost $10.8 million in license plate revenues but this was offset by an additional $5.9 million in motor fuel tax revenues and an additional $4.9 million from the motor vehicle excise tax. Counties, municipalities, and townships were to split an additional $4.9 million available from motor vehicle license fees.

A fourth change adopted by the 1985 Legislature, which was not part of the S.D. Highway Users Conference proposal, established the county wheel tax law. Under this law a county could impose a tax of up to two dollars per wheel on each motor vehicle licensed in the county. The total tax could not exceed eight dollars per motor vehicle. County commissioners were given the authority to establish the means of distributing the revenue to the county and to the municipalities and townships located in the county. The proponents of this legislation advocated this would be another method counties could use to generate revenues for highway purposes.

Developments Since 1985

Motor Fuel Taxes

In 1988, motor fuel taxes were increased by five cents per gallon. Also, the number of gallons of fuel subject to taxation has been gradually increasing each year until just recently. These two factors have resulted in a significant increase in revenue to the state highway fund since 1985. Today each penny of tax results in just over $5.1 million available for distribution, and of this amount about $4.7 million goes to the state highway fund. In 1985, $57.6 million of motor fuel taxes were collected. In 1995, that amount was $92.7 million--an increase of $35.1 million. Of this increase $25.5 million is the result of the five-cent tax increase. The remainder of the increase is due to more gallons of fuel being consumed. The growth in motor fuel tax revenues is displayed in the accompanying chart.

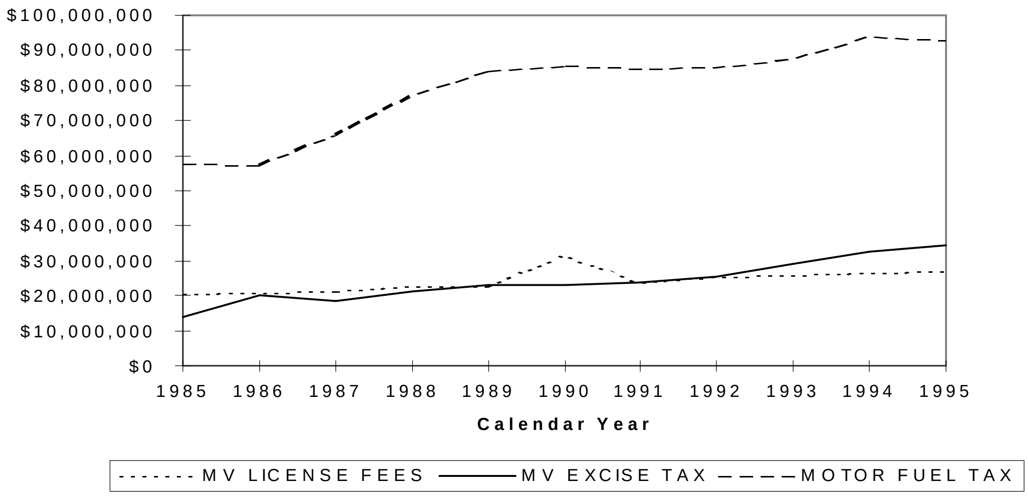
Motor Vehicle License Fees

These fees have not been increased since 1985; in fact, these fees have not changed since 1977. Total license fee collections have increased gradually over the last decade due to a rise in the number of motor vehicles registered in the state. In 1985 total license fee collections were $20.5 million compared to $27.0 million in 1995--an increase of $6.5 million. Six legislative sessions since 1985 have had bills to increase these fees and all have failed. The creation of the county wheel tax has made it much more difficult for any fee increase to succeed. Opponents to the license fee increases argue that, if the counties really need the money, the counties can impose their own tax. The decision to raise fees can thus be passed down to the county level. The growth in motor vehicle license fee revenues is displayed in the accompanying chart. The bump in revenues in 1990 is because of the implementation of the staggered registration system. Fees were collected in many cases for a period longer than a year, thus increasing the revenues for calendar year 1990.

Motor Vehicle Excise Tax

In 1985, $14.1 million was collected from the 3% motor vehicle initial registration. After the change to the 3% excise tax which went into effect in 1986, total collections increased to about $20 million that year. Since then, due to the increasing value of new and used motor vehicles, revenues from this source grew to $34.4 million in 1995--an increase of $20.3 million since 1985. The growth in motor vehicle excise tax revenues is displayed in the accompanying chart.

COMPARISON OF HIGHWAY REVENUES SINCE 1985



County Wheel Tax

The county wheel tax has experienced slow growth since 1985. Twenty-three counties, just over a third of the counties, have thus far established a wheel tax. In 1994, the maximum rate that a county could charge per wheel was raised from two to four dollars. The counties of Minnehaha, Day, McCook, Miner, and Union currently charge the maximum rate. Since 1985, there have been numerous unsuccessful legislative attempts to repeal the tax.

As indicated earlier, the county wheel tax has been a factor in motor vehicle license fees remaining unchanged. This is to the disadvantage of smaller counties. There are fifty-one counties which have less than ten thousand registered noncommercial motor vehicles. For these smaller counties it would be financially better to have motor vehicle license fees increased than to establish or increase a county wheel tax. In rural counties with low vehicle registrations, a county wheel tax does not generate significant revenues. These counties would benefit more from an increase in motor vehicle license fees at the state level because over half of the distribution formula for motor vehicle license fees is based on highway needs. These counties have few vehicles but many miles of highways and streets to maintain. Consequently, for every dollar of motor vehicle licenses fees paid by the citizens of that county, the county receives more than a dollar of revenue for distribution to the county and to the municipalities and townships located in the county.

Conclusion

The redistribution of highway revenues in 1985 met its objective of getting more money to local governments for highway purposes without affecting the state's revenues for highway purposes. However, a decade later, two other results from that change are apparent.

First, the state has benefited more from its funding sources than have local governments. Since 1985 revenues to the state from the motor fuel tax have grown over $35 million and revenues from the motor vehicle excise tax have grown over $20 million. This total increase of $55 million compares to the $6.5 million increase in motor vehicle license fee collections available to local governments. If you subtract the increase due to the five-cent increase in the motor fuel tax rate ($25.5 million), that means, since the change in 1985, that state revenues have increased just under $30 million. The state has benefited from funding sources which have experienced good growth and have the potential for continued growth. Counties, on the other hand, have a funding source which has not grown as much and the potential for growth is limited since it has become very difficult to get motor vehicle license fees increased by the Legislature.

Second, the county wheel tax has not been as great a benefit to local governments as originally envisioned. While counties have been given the authority to charge a county wheel tax to bring in additional revenues, the county wheel tax has become a factor in defeating attempts in the Legislature to increase motor vehicle fees. The wheel tax is an option which does not benefit all counties. It does not generate significant revenue for the counties with low vehicle registrations and, consequently, has been adopted in only one-third of the state's counties a decade later.

This issue memorandum was written by David L. Ortbahn, Principal Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.