South Dakota Legislative Research Council

Issue Memorandum 97-26

REVENUE SOURCES FOR HIGHWAY NEEDS

From the beginning of statehood until the early 1900s, the financing of road construction and maintenance in South Dakota was largely up to the local units of government. The principal burden of road construction and repair fell upon local property owners. As the state grew and the need for statewide highways developed, it became apparent that local units of government could not meet the increased demands for better highways. Subsequently, highway users were tapped for additional revenue to finance highway construction and repair. Today, the system of financing highway construction and repair has evolved beyond local property taxes to include local sales taxes and several forms of highway user taxes. This combination of highway user taxes and local taxes determines how many highway needs can be addressed each construction year. Issue Memorandum 97-25 (Highway Needs) discusses the backlog of highway needs and accruing highway needs that exist in the state. This issue memo will supply background information regarding the revenue sources which can be used in any discussion about funding these highway needs.

Highway User Taxes

Various types of taxes have been imposed upon highway users since 1919 to defray rising highway costs. These highway user taxes take the form of taxes on motor vehicle fuel and taxes on motor vehicles. To insure that revenues from these taxes could not be diverted for other uses, in 1940 the people of the state adopted an amendment to Section 8 of Article XI of the South Dakota Constitution which dedicated all revenues from these highway user taxes for highway purposes. That section of the constitution, with the amendment highlighted, reads as follows:

*No tax shall be levied except in pursuance of a law, which shall distinctly state the object of the same, to which the tax only shall be applied**, and the proceeds from the imposition of any license, registration fee, or other charge with respect to the operation of any motor vehicle upon any public highways in this state and the proceeds from the imposition of any excise tax on gasoline or other liquid motor fuel except costs of administration and except the tax imposed upon gasoline or other liquid motor fuel not used to propel a motor vehicle over or upon public highways of this state shall be used exclusively for the maintenance, construction and supervision of highways and bridges of this state**.*

This amendment to the constitution is perhaps the most important single development in highway user finance in South Dakota. Highway user taxes and fees are today the principal source of revenue for highway construction and repair. These revenues come from taxes on motor fuels, an excise tax on motor vehicles, annual motor vehicle license fees, county wheel taxes, and federal funds generated from federal taxes on highway users.

Motor fuel tax

In 1922, South Dakota joined a nationwide movement by adopting a tax of one cent per gallon on all motor fuel. Oregon was the first state to adopt a motor fuels tax in 1919, and within ten years all forty-eight states had adopted a motor fuels tax. The state motor fuel tax is today the primary source of state-generated revenue for highway construction in South Dakota.

The motor fuel tax rate was increased by one cent in 1923, 1925, 1927, 1951, 1957, 1969, 1975, and 1979. The tax rate was increased by three cents in 1980. The tax rate was increased by one cent in 1984 and in 1988 the rate was increased by five cents bringing the rate for gasoline and diesel fuel (special fuel) to 18 cents. A rate two cents lower than other motor fuels was established for LP gas in 1975 and that rate difference remains. A lower rate was established for ethanol blends in 1979. At first, the rate difference for ethanol blends was three cents and that difference was increased to four cents in 1980. In 1985 and 1986 that difference was reduced by one cent each year to get to the current two-cent difference.

A special session of the 1997 Legislature has temporarily increased the motor fuel tax by an additional three cents to raise revenue to repair road and bridge damage caused by last winter's blizzards and the spring flooding. Therefore, the current motor fuel tax rate temporarily stands at 21 cents per gallon for gasoline and special fuel and 19 cents for LP gas and ethanol blends. This rate will be reduced to 18 cents and 16 cents, respectively, on October 1, 1998.

The distribution of the bulk of motor fuel tax has undergone a few changes since 1922. All of the revenue initially collected from the tax in the early 1920s went to the State Highway Department for use on state highways. That was changed in 1927 when the one-cent increase of the tax was credited to the general fund. This distribution did not last long. In a special session of the Legislature in 1927 the distribution was changed so that a portion of revenue was transferred to a state highway bond interest and sinking fund and the remainder for use on state highways. The distribution of the tax was changed in 1933 so that a portion would be used to pay the principal and interest on Rural Credits bonds and warrants. That allocation continued until 1937 and was a major reason the constitutional amendment was adopted in 1940. The distribution of the motor fuel tax was also changed in 1937 to apportion one-eighth of the tax collected to the counties based on the assessed valuation in each county. That apportionment was in effect until 1963. That year the method of apportioning the one-eighth portion to the counties was revised to include mail route mileages and vehicle registrations in each county along with assessed valuation as equal factors used in apportioning the counties' portion among the counties. That apportionment continued until 1985 when the counties' portion of the motor fuel tax was transferred to the State Highway Fund as part of a swap for the state's portion of motor vehicle license fees.

Currently most of the motor fuel tax goes to the state highway fund. However, over the years the Legislature has also provided that a portion (about $800,000 a year) of the tax goes to the Parks and Recreation Fund based on the number of motorized boats licensed in the state and that a portion of the tax (about

$200,000 a year) goes to the Snowmobile Trails Fund based on the number of snowmobiles registered in the state. This distribution was to allow for the tax paid on fuel used in motor boats and snowmobiles. Also a portion (about $1 million a year) goes to the Coordinated Soil and Water Conservation Fund. While this might seem like a nonhighway use of the tax, this distribution represents the amount of unclaimed nonhighway agricultural motor fuel tax refunds each year and has been determined by the court to not be an unconstitutional diversion of dedicated highway funds. In addition, a portion (about $750,000 a year) of the tax goes to cover the administrative expenses for collecting the tax.

For fiscal year 1997, just more than $91 million in motor fuel taxes was collected and available for highway purposes. Each cent of the motor fuel tax generates about $5.1 million each year. The temporary increase of the tax until October 1, 1998, is projected to raise a total of $24 million.

Connecticut has the highest motor fuel tax rate in the nation at 36 cents per gallon. Georgia has the lowest at 7.5 cents per gallon. Even at the temporary level of 21 cents per gallon, South Dakota does not have the highest motor fuel tax rate in the region. Table 1 contains a comparison of our permanent motor fuel tax rates with the rates of our surrounding states.

Table 1

State	Gasoline Tax	Diesel Fuel Tax	Ethanol Tax	Vehicle Excise Tax
South Dakota	18.0 cents*	18.0 cents*	16.0 cents**	3 percent
Iowa	20.0 cents	22.5 cents	19.0 cents	5 percent
Montana	27.0 cents	27.75 cents	27.0 cents	2.5 percent
Nebraska	25.4 cents	25.4 cents	25.4 cents	5 percent
North Dakota	20.0 cents	20.0 cents	20.0 cents	5 percent
Wyoming	9.0 cents	9.0 cents	9.0 cents	4 percent
*21 cents until 10/1/98 ** 19 cents until 10/1/98				

Motor Vehicle Excise Tax

The excise tax on motor vehicles, which is really a sales tax on motor vehicles, was first established in this state in 1937 at the rate of 3% upon the first registration of a motor vehicle. At that time the tax went to the state general fund. The tax rate was reduced in 1941 to 2% and its distribution was made the same as other motor vehicle license fees because of the passage of the constitutional amendment in 1940. The decision was made by the 1949 Legislature to place all of this tax in the State Highway Fund. Legislation was passed in 1951 which provided that the excise tax on motor vehicles would automatically be the same as the retail sales tax. The rate became 3% in 1965 when the sales tax was raised. When the sales tax was raised in 1969 to 4%, the Legislature decided to keep the excise tax on motor vehicles at 3% and it has remained there ever since. The excise tax was expanded in 1985 to cover the sale of used motor vehicles.

The motor vehicle excise tax is the second largest source of state-generated revenues. In fiscal year 1997, $36.5 million was collected through this tax. This revenue source has almost doubled in the last ten years due to the rising prices of new and used motor vehicles. Sales and excise tax rates in other states range from 2% in Alabama to as high as 8.5% in California. Table 1 contains a comparison of our motor vehicle excise tax rate with the rates of our surrounding states.

Annual Motor Vehicle License Fees

Annual motor vehicle license fees were first established by state statute in 1913 at the rate of six dollars for each automobile five years of age or less and three dollars for those more than five years of age. In 1921 license fees were increased to $13 for vehicles 2,000 pounds and less, to $17 for vehicles of 2,001 to 3,000 pounds, to $20 for vehicles of 3,001 to 4,000 pounds, and to $35 for vehicles more than 4,000 pounds. While there have been numerous changes over the years as to how these fees are distributed, the amounts of the fees have not changed significantly since 1921. In comparison to the 1921 fees, the fees in 1997 are $20 for vehicles 2,000 pounds and less, $30 for vehicles of 2,001 to 4,000 pounds, and $40 for vehicles of 4,001 to 6,000 pounds. In 1997, more than 97% of all noncommercial motor vehicles are in these three weight categories.

The fees for noncommercial motor vehicles weighing 6,000 pounds or less are based on the vehicle's manufacturer's shipping weight including accessories. Noncommercial motor vehicles weighing more than 6,000 pounds and commercial motor vehicles are currently licensed on a graduated fee scale based on the vehicle's maximum gross weight it will carry. In addition, commercial vehicles five years of age or more are charged a license fee of 10% less than the regular fee while similarly aged noncommercial vehicles are charged a license fee of 30% less. Currently, 73% of noncommercial motor vehicles and 70% of commercial motor vehicles licensed at the county level are at least five years of age.

The distribution of annual vehicle registration revenues is established in a state statute and provides that 22.5% of the license fees collected (about $6.1 million statewide) be retained at the county level; 14% ($3.8 million statewide) be distributed to the townships of the county on the basis of the number of miles of maintained township roads within the townships; and 5% ($1.3 million statewide) be distributed to incorporated municipalities of the county on the basis of street mileage. The remaining 58.5% is sent to the state where 2%

($540,000) is credited to the Motor Vehicle Fund to cover the administrative costs of collecting the fees, 2.5% ($682,000) is credited to the License Plate Special Revenue Fund to be used to manufacture license plates, and the remaining 54% (about $14.6 million) goes to the Local Government Highway and Bridge Fund.

Prior to 1986 there was no Local Government Highway and Bridge Fund. The money that now goes to that fund previously went to the State Highway Fund. The new fund was created in 1986 to divert more money to local governments for use on their highway systems in exchange for counties giving up their portion of the state gas tax. Monies in the fund are divided among the counties, municipalities, and townships according to percentages established in a statute (§ 32-11-35). The percentages held the counties harmless from their loss of the motor fuel tax and was also based on highway needs identified in 1984 by a highway needs study conducted by the Department of Transportation. Counties receive about 77.1% of the fund with municipalities and townships receiving about 18.6% and 4.3%, respectively.

License fees for interstate motor carriers are distributed a bit differently. These fees are paid directly to the Division of Motor Vehicles and are distributed with 58.5% ($5.4 million) being retained by the state and 41.5% going to the counties. The 41.5% share distributed amongst the counties ($4.0 million) is done so by a formula based, pro rata, 25% according to truck registrations, 25% according to population, and 50% according to total road mileage. The amount that goes to each county is distributed with 54% going to the county, 34% to the townships in the county, and 12% to the municipalities of the county.

A total of about $36 million is collected each year from noncommercial and commercial license fees including fees on interstate motor carriers. A one-dollar increase in all noncommercial and commercial license fees would generate about $700,000. If noncommercial trailers, motorcycles, and snowmobiles are not included in an increase, the amount raised by a one-dollar increase would be about $550,000.

License fees are difficult to compare from state to state because there is such a variety of fees based on vehicle age, vehicle weight, or vehicle value, or combinations thereof. The only way a comparison can be made is by comparing how much it would cost to license a specific vehicle in each state. The Division of Motor Vehicles compiled the information contained in Tables 2 and 3 for the 1997 Legislature. These tables compare the fees paid in each state for an average type of motor vehicle which would represent the majority of vehicles registered. The comparison shows that South Dakota's fees are the lowest in the region.

Table 2

1997 Ford Taurus 3,046 pounds gross vehicle weight Manufacturer's suggested retail price $18,000			
State	**Flat Fee**	**Valuation Tax**	**Total Tax**
Nebraska	$59.00	$451.55	$510.55
Montana	$18.25	$412.50	$430.75
Wyoming	$15.00	$291.60	$306.60
Minnesota	$10.00	$225.00	$235.00
Iowa	$12.00	$180.00	$192.00
North Dakota	$50.00	$0.00	$50.00
South Dakota	$30.00	$0.00	$30.00

Table 3

1991 Ford Taurus 3,046 pounds gross vehicle weight Manufacturer's suggested retail price $13,000			
State	**Flat Fee**	**Valuation Tax**	**Total Tax**
Montana	$18.25	$162.50	$180.75
Nebraska	$59.00	$80.42	$139.42
Iowa	$12.00	$97.50	$109.50
Minnesota	$10.00	$98.00	$108.00
Wyoming	$15.00	$52.65	$67.65
North Dakota	$42.00	$0.00	$42.00
South Dakota	$21.00	$0.00	$21.00

County Wheel Tax

The wheel tax is the newest form of highway user tax. It was established in 1985 to allow counties to generate highway revenues rather than the Legislature increasing vehicle license fees statewide. At first counties were allowed to impose a tax of up to two dollars per wheel with a maximum tax of eight dollars per motor vehicle. In 1994 this was increased to four dollars per wheel with a maximum tax of sixteen dollars per motor vehicle. The legislation in 1994 requires that all revenue from a wheel tax in excess of two dollars per wheel be used to replace property taxes the county imposes for highway purposes. The county wheel tax benefits counties with a large number of vehicle registrations. There are, however, 51 counties in the state which have less than 10,000 registered noncommercial motor vehicles. Any county with a low number of registered motor vehicles but a large number of local roads to maintain would fare much better with an increase in motor vehicle license fees rather than to establish or increase a wheel tax because the distribution of license fees at the state level takes into consideration local highway needs.

As of September 1997, twenty-eight counties had implemented a county wheel tax. In calendar year 1996, $4.5 million was collected statewide by a wheel tax. Of this amount $2.1 million was collected in Minnehaha County. In 1996, 88.04% of the $4.5 million went to counties, 5.28% went to townships, and 6.67% went to municipalities.

Federal Funds

Federal funds are the most significant single source of revenue from highway users. These revenues come from federal taxes on motor fuel, tire tubes and tread rubber, parts and accessories, and lubricating oil and from excise and gross weight taxes on motor vehicles. These revenues go to the federal Highway Trust Fund and are dedicated for transportation purposes. The amount of federal funds received by the state are determined by Congress. Under the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), the state was authorized between $120 and $130 million of federal funds each year through October 1, 1997. However, the amount of federal highway funds the state actually receives is dependent on how much the federal government appropriates each year. That amount may be more or less. In 1995, for instance, the state received $134 million federal dollars for highway purposes. Of this total $116.8 million went to the state and the remainder went to counties and municipalities. The state has done fairly well under ISTEA receiving about $1.90 in federal funds for every dollar paid into the federal Highway Trust Fund by South Dakota residents.

ISTEA, however, ended in October without a new act in place. Our amount of federal funding for highways is in limbo with no new legislation expected to be passed by Congress until the summer of 1998. Congress did pass an extension of ISTEA which will supply the state with about six months of funding, but unless Congress acts quickly in 1998, construction projects planned for the 1998 construction season will have to be postponed. It is anticipated that the state will receive more federal funds under any new highway program that may be passed by Congress than the state received under ISTEA, because there is more money available in the federal Highway Trust Fund.

Property Taxes and Sales Taxes

As mentioned before, property owners financed the bulk of highway construction and repair around the turn of the century. Property taxes were used to finance both state and local roads. Statewide property taxes were authorized in 1917 to finance highway construction and maintenance, in 1919 to pay off highway bonds, and in 1921 to build bridges across the Missouri River. There have been no state property taxes levied for highway or bridge purposes since 1933. However, property owners continue to be taxed for highway and street expenditures at the local level.

At the township level property taxes are still the primary source of revenue for township roads. In 1995, around $16.6 million was spent by townships for road expenditures. Of this amount $9 million (54%) came from property taxes with the remainder coming from user fees. At the county level property taxes and special assessments on property owners are still a significant source of revenue for highways. In 1995, around $62.6 million was spent by counties for highway expenditures. About 40% of these expenditures came from property taxes and special assessments with the remainder coming from highway users.

Municipal expenditures for streets come from primarily local sources. In 1995, around $42.4 million was spent by municipalities for street construction and maintenance. Of this amount about 28% comes from highway users with the remainder coming primarily from property taxes and sales taxes. While information is not available to divide municipal revenues between property taxes and sales taxes, it can be assumed that a large portion of the municipal effort toward streets is funded by sales tax revenues.

Conclusion

It will take a significant increase in any highway user fee or tax to address the backlog of highway needs existing in the state as discussed in Issue Memorandum 97-25 (Highway Needs). According to the 1994 study of the backlog of state highway needs done by the Department of Transportation, a five-cent increase in the motor fuel tax would reduce the backlog on the state highway system from $526 million to $332 million in 20 years, a four-cent increase would reduce the backlog to $485 million in 20 years, and a three-cent increase would slow the growth of the backlog to $638 million in 20 years. With the exception of Wyoming, the current permanent motor fuel tax rate of 18 cents is below the rates in surrounding states and any modest increase would not put our rate out-of-line with the surrounding states. If the Legislature should decide to increase the motor vehicle excise tax to help reduce the backlog of needs, a 1% increase would result in about $12 million or a little more than a two-cent increase in the motor fuel tax. The only surrounding state with a lower motor vehicle excise tax is Montana, so an increase of 1% or 2% would still keep us comparable with the other surrounding states.

Regarding local highway needs, it will take a significant increase in motor vehicle license fees to make even a small dent in the more than one-billion-dollar backlog of needs. Ninety-seven percent of all motor vehicles licensed in the state weigh less than 6,000 pounds. To raise any significant revenues by a license fee increase, the fees on these vehicles would have to be increased. A twenty-dollar increase in motor vehicle license fees would raise about $11 million to be distributed to local governments. With the exception of North Dakota, our motor vehicle license fees for motor vehicles less than 6,000 pounds are significantly less than the surrounding states. County wheel taxes currently just bring in about $4.5 million, so these taxes would have to be increased dramatically to generate any revenues to address highway needs. In addition, it should be remembered that any county with few vehicle registrations will not generate much revenue with a county wheel tax.

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.