



# Analysis: Motor Vehicle Registration Tax Reduction Proposals

**Proposal:** Reduce the annual motor vehicle registration tax (commonly called "tabs").

Currently, the motor vehicle registration tax is made up of two portions: a \$10 flat fee and an additional tax. The additional tax is 1.25% of the base value of the vehicle, although the amount of base value subject to the additional tax is reduced as the vehicle ages. For the first two years of the vehicle's life, the additional tax is 1.25% times 100% of the vehicle's base value, for years 3 and 4, the tax is based on 90% of the value, and so on until the 10<sup>th</sup> year when the tax is based on 10% of the car's value. At the 11<sup>th</sup> and following years, the additional tax is set at \$25. The additional tax is never less than \$25, making the total minimum "tabs" fee \$35.

There are several proposals to reduce auto tabs. The three main approaches are:

1. **Cap the maximum amount auto tab amount.** The Governor's proposal (HF 2938/SF 2657) caps tabs at \$75, as does HF 3406/SF 2342 authored by Representative McCollum and Senator Wiger. Senator Knutson caps tabs at \$75 after initial registration in SF 3084.
2. **Lower the additional tax rate.** HF 3787/SF 2746, authored by Representative James Clark and Senator Fischbach, reduces the additional tax rate from 1.25% to 0.625%, and reduces the minimum fee from \$35 to \$17.50. HF 2964/SF 2327, authored Representative Pugh and Senator Metzen, also changes the additional tax rate to 0.625%. SF 2483 by Senator Day reduces the additional tax rate to 1%.
3. **Phase out the additional tax more quickly.** HF 3407/SF 2822, authored by Senator Doug Johnson and Representative Rest, phases out the additional tax more quickly, reduces the additional tax rate from 1.25% to 1.2%, and reduces the minimum fee from \$35 to \$30.

## What are the distributional effects?

The chart below breaks Minnesota's population into 10 groups called deciles (for example, the first decile contains the 10% of Minnesota households with the lowest incomes). The chart shows how much each decile pays in auto tabs and measures this tax as a percentage of income. In terms of dollar amounts, the amount of auto tabs paid increases as income increases. However, as a percentage of income, auto tabs places the heaviest burden on households in the middle deciles. Please note also that the chart measures total tabs paid by household; a household may have more than one vehicle.

Population Decile	Average Income	Average Tax	Tax as % of income
First	\$4,254	\$15	0.36%
Second	\$8,887	\$22	0.25%
Third	\$13,432	\$46	0.34%
Fourth	\$18,698	\$96	0.51%
Fifth	\$24,595	\$131	0.53%
Sixth	\$31,549	\$146	0.46%
Seventh	\$40,179	\$161	0.40%
Eighth	\$51,237	\$224	0.44%
Ninth	\$66,970	\$251	0.37%
Tenth	\$165,330	\$438	0.26%

Source: Minnesota Department of Revenue unpublished tax incidence study data for 1996.

## How Would These Proposals Affect Long-Term Funding Stability?

Auto tabs are a dedicated revenue source to the highway user trust fund; therefore reducing tabs fees means a direct reduction in funding for the highway fund. Most proposals to reduce auto tabs fill the gap

in highway funding by dedicating some of the sales tax on new motor vehicles into the fund. A constitutional amendment must be approved by the voters in order to dedicate the sales tax on motor vehicles into the highway fund.

Each proposal has a different cost. The Governor's proposal is estimated to cost \$265 million in 2001, Senator Johnson's proposal \$100 million, and Representative Clark/Senator Fischbach's \$233 million.

**What are the trade-offs?**

The legislature will weigh the cost of this proposal against other spending, savings, and tax cut possibilities. Some of the major tax cut alternatives include the House Republican income tax rate cuts (a little over \$1 billion for tax years 2000 and 2001), creating a Minnesota personal dependent exemption (\$847 million for 2000-01 biennium), the "1-2-3" rate compression of property taxes (\$309 million for fiscal years 2002 and 2003), reducing the sales tax by 0.5% (\$663 million in fiscal years 2001 and 2002).

**Who are the ultimate winners and losers?**

Under the Governor's proposal, only the 52% of cars paying more than \$75 would receive a tax cut. Under the other two approaches, most cars would have lower automobile tabs, although the 38.5% of cars paying the minimum see the largest reductions under the Clark/Fischbach plan.

**Examples:**

Type of Vehicle	Current law	Governor's plan	Clark/Fischbach bill	Johnson bill
Car paying minimum (\$35)	\$35	\$35	\$17.50	\$30
5 year old car, base value of \$15,000	\$151	\$75	\$80	\$118
New car, base value \$20,000	\$260	\$75	\$135	\$250