



## HANDBOOK FOR MINNESOTA CITIES

# Chapter 19 Sources of Revenue

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This material is provided as general information and is not a substitute for legal advice. Consult your attorney for advice concerning specific situations.



## HANDBOOK FOR MINNESOTA CITIES

# Chapter 19 Sources of Revenue

*Learn about major sources of revenue for cities you can consider in developing and implementing a city budget. Examples include state aid programs, charging for city services, license and permit fees, investment income, city enterprise funds, taxes, street and highway funding, and borrowing options.*

### RELEVANT LINKS:

See Handbook, [Property Tax Levy](#).  
LMC information memo [Budget Guide for Cities](#) contains current, comprehensive information on the property tax levy and other revenues and expenditures.

See MN Revenue Sales Tax Fact Sheet 164, [Local Sales and Use Tax](#).

[Minn. Stat. § 469.190.](#)

[Minn. Stat. § 297A.99.](#)

[Minn. Stat. § 273.1384.](#)  
[Minn. Stat. § 273.1384, subd. 1.](#)  
LMC information memos [Budget Guide for Cities](#).

## I. Taxes

Although city revenue sources are more diversified, the property tax accounts for approximately 30 percent of city revenues and remains the primary way to raise city revenues. A city's ability and process to levy property tax is discussed extensively later in the Handbook.

Property tax provides the greatest percentage of city tax revenue, but the Legislature has authorized Minnesota cities to levy and collect taxes on some utilities, gambling, and lodging as well.

A city may impose, by ordinance, a local lodging tax up to a 3 percent tax on the gross receipts of lodging in the city; 95 percent of the gross proceeds must be used to fund a local convention or tourism bureau for the purposes of marketing and promoting the city.

The Legislature has also granted some cities the authority to impose their own sales tax.

### A. Market value homestead credit

The state's market value homestead credit (MVHC) program reimbursed cities for a state-imposed reduction in property taxes enjoyed by property owners in the form of a credit. It was started in 2001 to replace homestead and agricultural aid (HACA), which was repealed in 2002. The residential portion of the MVHC program was repealed in the 2011 special session effective with taxes paid 2012. The residential MVHC program was replaced by the market value homestead exclusion. The final payments on the residential MVHC were in October and December of 2011.

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## RELEVANT LINKS:

[Minn. Stat. § 273.13.](#)  
MN Dep't of Revenue's  
[Explanation and Examples of  
the MVHE.](#)

[Minn. Stat. §§ 477A.013-  
.015.](#)  
See LMC information  
memos, [Budget Guide for  
Cities and Local Government  
Aid 101.](#) Additional  
[information on LGA](#) available  
on the LMC website.

See MN Dept. of Revenue's  
2019 [Certified LGA Amount  
information.](#) See [2018 Law  
Summaries](#) for city estimates  
for aid.

[Minn. Stat. § 273.1385.](#)

[Minn. Stat. §§ 69.011 to  
69.031.](#)

[Minn. Stat. § 69.021, subd.  
5\(a\).](#)

## B. Market value homestead exclusion

The market value homestead exclusion (MVHE) was passed in the 2011 special session, replacing the repealed residential MVHC, and was effective for taxes paid 2012. In many ways, the MVHE is similar to the MVHC. Under the MVHE, up to 40% of a residential homestead's market value is excluded from taxation. The greater the value of the house, the smaller the percentage of value is excluded. The exclusion is reduced to 0% for homes worth \$413,800 or more.

## II. Local government aid

Local government aid (LGA) is a state aid to local governments. LGA has undergone several changes since its creation in 1971. LGA has replaced most of the individual taxes, such as cigarette, liquor, bank excise, and gross earnings taxes, which the state previously distributed to local governments under various laws. LGA, like other aspects of the state tax system, is now manipulated by the Legislature annually.

Under current law, the LGA appropriation for all cities is \$534.4 million.

## III. PERA aid

This aid is intended to offset an increase in Public Employee Retirement Association (PERA) employer contribution rates made in 1997. The amount is equal to 0.7 percent of a city's PERA payroll from July 1, 1996, to June 30, 1997. It is paid in two equal installments on July 20 and Dec. 26. The amount of this aid remains the same from year to year. However, any significant decrease in payroll below fiscal year 1997 levels may result in a decrease in PERA aid.

This aid is currently scheduled to end as of June 30, 2020.

## IV. Fire and police state aids

Another important source of intergovernmental revenue is state aid for police and fire service. This money is apportioned as state aid to qualifying cities for fire and police retirement and relief. How the police and fire state aid must be used by the city will vary according to several factors, so the statutes must be consulted.

Fire state aid now equals 107 percent of the reported fire premium taxes paid to the state by insurers who write fire, lightning, sprinkler leakage, and extended coverage insurance on risks within the state.

## RELEVANT LINKS:

[Minn. Stat. § 69.021, subd. 5\(b\).](#)

[Minn. Stat. § 69.011, subd. 4.](#)

[Minn. Stat. ch. 353G.](#)

[Minn. Stat. § 69.011, subds. 2, 4.](#)  
[Minn. Stat. § 69.021, subd. 4.](#)

[Minn. Stat. § 69.021, subd. 7\(e\).](#)  
[Minn. Stat. § 69.031, subd. 5\(a\).](#)

Fire aid recipients will receive not less than 2 percent of this amount (minus audit and exam costs, and 1 percent of the premiums reported by certain small mutual insurance companies).

Police state aid is now equal to 104 percent of the reported premium taxes paid to the state by fire and casualty insurers who offer auto insurance policies written in the state. Corporate self-insurers pay a tax in lieu of the auto insurance tax.

### A. Fire state aid

In order to qualify for state aid for fire service, a city must have a city fire department that was organized at least one year before Dec. 31 of the year being reported, or have contracted with an independent, nonprofit firefighting corporation that either provides relief and pension benefits to its members or participates in the voluntary statewide lump-sum volunteer firefighter retirement plan. The fire department, whether a city department or an independent one, must meet a number of minimum requirements to be eligible for aid.

If retirement coverage is not provided by the voluntary statewide lump-sum volunteer firefighter retirement plan, a fire department must still meet minimum requirements to receive state aid. The clerk of a city with an organized fire department (or the secretary of an independent, nonprofit firefighting corporation) and the fire chief must jointly certify existence of the department or corporation that meets the minimum requirements for receiving state aid. The commissioner of Revenue determines qualified state aid recipients. Where retirement coverage is provided by the voluntary statewide lump-sum volunteer firefighter retirement plan, PERA must certify the existence of that coverage for each city and the city clerk or independent nonprofit firefighting corporation secretary, whichever applies, and the applicable fire chief must certify the fire personnel and fire department equipment as of the preceding Dec. 31.

Where the fire aid must go once received will depend upon whether there is a local relief association and whether the department has full-time firefighters with retirement coverage by the public employees police and fire retirement plan. If there is a local relief association, the aid must be forwarded to the relief association within 30 days if the relief association has filed a financial report with the city treasurer and has met all other statutory provisions pertaining to the aid apportionment. If the firefighters of the applicable fire department are members of the voluntary statewide lump-sum volunteer firefighter retirement plan, the aid will be paid directly to PERA by the state.

## RELEVANT LINKS:

See LMC information memo,  
[Budget Guide for Cities](#).

[Minn. Stat. § 69.021, subd. 7a.](#)

[Minn. Stat. § 69.031, subd. 5\(b\).](#)  
[Minn. Stat. § 423A.022.](#)

[Minn. Stat. § 69.011, subd. 2.](#)  
See [Key Reporting Dates for Relief Associations](#) at the OSA.

For questions, contact  
[PropTax.Admin@state.mn.us](mailto:PropTax.Admin@state.mn.us).

[Minn. Stat. § 357.021, subds. 6, 7.](#)  
[Minn. R. 6700.1800, subps. 4, 5.](#)  
POST Board (651) 643-3060.

[Minn. Stat. § 69.011, subd. 1\(g\).](#)

## B. Police state aid

To participate in the police state aid apportionment, the clerk of each city employing one or more police officers must file a certification of police officers. The Department of Revenue posts the required certification forms on its website in December.

The state calculates police state aid by the number of months and the number of employed full-time police officers. (The state does not include officers with fewer than 30 average hours per week in this calculation). If a city contracts with a county or another city for police service, the service agreement should determine what the city will receive for a proportionate amount of the state aid the county or city receives based on, for instance, the number of police officers providing the service under the agreement.

The city treasurer should disburse the police aids according to the current distribution formula.

## C. Filing police and fire state aid reports

March 15 is the due date for filing the fire equipment certification and certification of peace officers with the Department of Revenue. The city should file fire and police service contracts and service area apportionment agreements as soon as possible after negotiation. Audit reports and actuarial survey reports are due within 30 days after the relief association receives them.

Questions regarding the apportionment of funds to the city, filing contracts, fire service area apportionment agreements, or qualifying for fire or police state aid or funding requirements, should be directed to the Auditor/Treasurer Unit, Property Tax Division of the Department of Revenue.

## D. Peace officer training reimbursement

Funds are available to reimburse cities for some of the costs of their peace officers' training. The Peace Officer Standards and Training (POST) Board mails reimbursement forms to cities annually, and asks cities to report which officers received continuing education training during the past year. The cities eligible for reimbursement will then receive a share of the appropriated amount for peace officer training for the year. A peace officer must meet certain criteria in order to be eligible for the training reimbursements.

## RELEVANT LINKS:

[Minn. Const. art. XIV, §§ 8-12.](#)  
[Minn. Stat. § 162.09.](#)  
[Minn. Stat. § 162.11.](#)

[Minn. Stat. § 162.13.](#)

[Minn. Const. art. XIV, § 5.](#)

## V. Street and highway funding

The highway user distribution fund consists of revenues from two major tax levies: the state gasoline tax, and fees from motor vehicle registration.

### A. Cities with populations over 5,000

The Minnesota Constitution requires state gasoline and motor vehicle registration fees to provide funding for certain city, county, and state roads. Under current law, 100% of the revenue from state sales taxes on the sale of a new or used motor vehicle must be used for the transportation purposes.

As a group, cities with populations over 5,000 receive 9 percent of the highway user taxes. It is apportioned among them on the basis of two factors:

- 50 percent is distributed on the basis of money needs, as defined by law;
- 50 percent is distributed on the basis of population in relation to the total population of all the other cities receiving this aid, as established by the latest federal census.

For further information, contact the Municipal State Aid Needs Study Section of the Office of State Aid, Dept. of Transportation at (651) 296-1662.

### B. Cities with populations under 5,000

#### 1. Construction of state-aid roads

Smaller cities (those with populations under 5,000) are not eligible for the direct state aid program. However, smaller cities do have access to state funding for certain county and state roads that pass through their communities.

Counties, like cities, are constitutionally guaranteed a portion of the highway user distribution fund.

Twenty-nine percent of the fund is dedicated for certain county roads and highways. The remaining 62 percent is dedicated to the state trunk highway system.

When preparing their budgets, cities with populations under 5,000 should check with their county board to determine if the county plans to undertake any improvement projects within their limits.

## RELEVANT LINKS:

[Minn. Stat. § 162.08, subd. 9.](#)

[Minn. Stat. § 174.24.](#)

See Handbook,  
[Environmental Regulations.](#)

Construction of state aid roads may mean additional expenses for the city, such as curb and gutter construction along the new route. These expenses may have to come out of the city's general revenue if the city has not specially assessed them to the benefited property.

## 2. Maintenance of state aid roads

The county may use up to 40 percent of its allotment (or more with the approval of the transportation commissioner) for maintenance of the state aid road system. Some counties maintain routes through the smaller cities. Other counties have some or all small cities do the maintenance under agreements that include provisions for county reimbursement. For budget purposes, finance officers of smaller cities should check with their county highway department in order to determine the amount of maintenance money, if any, they will receive.

## C. Mass transit aid

Public transit systems may be eligible for financial assistance from the state public transit participation program.

## VI. Federal and state grants-in-aid

Intergovernmental grants and aids are another form of local financial assistance. In Minnesota, there are certain limitations on usage. Cities can generally get federal assistance (when available) if the city is willing to plan each project carefully in consultation with Minnesota planning offices. Because there are usually no population prerequisites, all cities are eligible to participate in these programs.

Most federal grants fall into two categories: those that the federal government provides and administers exclusively, and those that the federal government provides, but state agencies administer.

Any city wishing to determine whether a federal grant may be available for a particular purpose or project, should contact its regional development commission or the Dept. of Employment and Economic Development (DEED).

## VII. Charges for services

As a general rule, the people benefiting from a particular service should bear the cost of providing the service. General revenues should fund services of direct and essential benefit to the city as a whole, and for which the city cannot equitably apportion costs. Police and fire protection are functions of this nature.

## RELEVANT LINKS:

See LMC information memo, [Special Assessment Toolkit](#), for information about special assessments.

See Handbook, [City Licensing](#).

Cities can finance many capital improvement costs, such as the construction of streets, improvement of parks and installation of sewers, by levying charges against the benefited property owners. These charges are called special assessments.

### **A. Establishing charges for city services**

Fees and service charges should depend strictly on the costs involved in providing the program. The general formula is that income from fees should equal total costs, minus any appropriation from the general fund. In turn, costs should include both operating and capital expenditures.

The general fund should supplement the income from fees and service charges only if the city as a whole derives some benefit from the service program. In operating a city marina, for example, virtually no benefit accrues to the city as a whole; hence it would be difficult to justify an appropriation from the city's general fund. On the other hand, if the city owns and operates a hospital, some benefits do accrue to the city as a whole from the availability of medical facilities. In that instance, it is easier to justify a regular appropriation from the general fund.

If a program provides a general city benefit, the city should use the following formula in determining the amount of the general fund appropriation: the total amount of the city appropriation, divided by the total income from fees, should be equal to the benefits accruing to the general public, divided by the benefits to private users. The proportion of operating costs the city treasury bears should equal the ratio of public benefit to private benefit.

When a city extends a service that receives funds in whole or part by service charges to non-residents, the city should charge non-residents a higher fee than the residents.

Such differential pricing is, in most cases, the only means of ensuring equitable treatment for all concerned, and is often used when establishing utility rates and user fees for park and recreation facilities. However, higher license fees for non-residents have generally been more difficult to justify.

With the exception of municipal liquor stores and some city-owned utilities, city service programs should not make a profit. Service charges should enable the program to operate in an efficient manner without accumulating large surpluses or sizable deficits over a period of several years. There is no statutory authority to have a deficit in an enterprise without specific council action to appropriate funds to cover the deficit.

## RELEVANT LINKS:

See Handbook,  
*Comprehensive Planning,  
Land Use and City Owned  
Land.*  
Handbook, *Community  
Development and  
Redevelopment.*  
Minn. Stat. § 462.353, subd.  
4a.

Minn. Stat. § 326B.145.

Service programs should reimburse the city for indirect expenses they incur. For example, the general fund should be reimbursed for the efforts of the clerk and the clerk's staff in matters relating to the program. Reimbursement should, however, be in the form of a lump sum amount set in advance of the budget year. A residual profit, transferred to the general fund at the close of the budget year, is not a satisfactory way to handle this item.

Establishing rates for city-owned utilities involves controversial questions. Most people agree the rates should be high enough to pay all costs of operation and maintenance; to make all debt payments; and to accumulate reserves for replacements, extensions, and improvements in the utility's facilities.

However, many people question whether rates should be high enough to provide cash allowances for the payment of taxes, for the accumulation of reserves for major improvements, and for financial contributions to other city departments. While there is a difference of opinion regarding this matter, cities are advised not to include such taxes in utility operating costs unless the city makes adequate payment for services it receives.

The council may allow for the accumulation of reserves for major utility improvement to avoid debt for meeting the cost of these improvements. Financial contributions from the utility to other city departments over and above a reasonable charge for services rendered are, in effect, a charge on the utility user for the benefit of the taxpayer and open to serious question.

Because the primary purpose of municipal liquor dispensaries is control of liquor traffic, a profit is desirable unless it becomes the primary concern of those who establish operating policies. Profit considerations should be subordinated to regulatory considerations when operating such stores.

The establishment of fees to process land use applications must generally be established by ordinance, and state law governs how these fees must be determined. A statutory exception allows cities that collect an annual cumulative total of \$5,000 or less of planning and zoning fees to adopt a fee schedule by resolution after providing notice and holding a public hearing.

Cities that collect an annual cumulative total that exceeds \$5,000 of "construction and development-related fees" from "developers, builders, and subcontractors" must file a report with the Building Codes and Standards Division of the Minnesota Dept. of Administration by June 30 of each year.

## RELEVANT LINKS:

[2007 Minn. Laws, ch. 140, art 13, § 3 repealing Minn. Stat. § 16B.665.](#)

[Country Joe, Inc. v. Eagan](#), 560 N.W. 2d 681 (Minn. 1997).

See Handbook, [City Licensing](#).

The 2007 Legislature repealed a law limiting permit fees to \$15 for minor residential improvement, installation, or replacement of a residential fixture or certain appliances. Cities may now set reasonable fees for such minor permits.

## B. Allowable service charges

Besides fees for public service enterprises, including utilities, many cities commonly charge fees for the following:

- Fire protection to areas outside the city limits.
- City garbage and refuse disposal.
- Collection of recyclables.
- Street lighting.
- Police escort.
- Duplication of traffic accident reports.
- Sewer maintenance.
- Non-city use of the city hall and other equipment.
- The use of city-owned recreation facilities, such as youth centers, swimming pools, golf courses, and marinas.
- The use of facilities in local parks and picnic grounds.

It's important to note that while the above fees are authorized in a variety of ways, cities do not have unlimited authority to impose fees. Whether a proposed fee is authorized is not always clear, so cities must rely on the advice of their legal counsel with respect to fees.

## VIII. Regulatory services

Generally, cities may not use regulatory ordinances for revenue-raising purposes. Regulatory revenues are a byproduct of the city police power to preserve the public welfare.

However, revenue adequacy should play a role in the establishment of license and permit fees. Charges should reimburse the city for the entire cost of regulatory programs. For example, dog license fees should finance the canine control program.

Likewise, a retail, on-sale intoxicating liquor license fee is intended to cover the cost of issuance, inspections, and other costs directly related to the cost of enforcing the regulations.

## A. License and permit fees

A complete discussion of the problems and legalities of establishing license and permit fees is found in Chapter 11 of the Handbook.

## RELEVANT LINKS:

[Minn. Stat. § 609.02, subd. 3, 4a.](#)

[Minn. Stat. § 412.871.](#)

[Minn. Stat. § 465.03.](#)  
[Minn. Stat. § 465.04.](#)  
[Minn. Stat. § 471.895.](#)

[Minn. Stat. § 276.131.](#)

Care should be taken when establishing these fees.

### **B. Fines**

When councils pass regulatory ordinances, they should include penalties for violations. These penalties for a misdemeanor may include a maximum fine of \$1,000 or 90 days in jail, or both. The penalty for a petty misdemeanor is a maximum fine of \$300. The ordinance may, but usually does not, provide for a fixed minimum fine upon conviction. A provision for an arbitrary fixed fine, however, even if legally defensible, is usually not a good idea because it removes all opportunity for judicial discretion.

Beyond establishing where an ordinance violation is a misdemeanor or petty misdemeanor, councils have no control over city revenues from this source. A judicial officer (district court judge) imposes and collects fines for ordinance violations. Only a portion of the fine goes to the city. The treasurer receives duplicate receipts for the money and must file one with the city clerk.

### **IX. Gifts**

Cities may accept gifts of real or personal property, including money, and use them in accordance with the terms prescribed by the donor. A city may not, however, accept or use gifts for religious or sectarian purposes.

A resolution accepting the gift and the donor's terms must receive an affirmative vote of two-thirds of the members of the council. Under the state gift ban law, an individual officer or employee of a city may generally not accept a gift.

### **X. Interest income**

As part of their tax settlement, cities receive interest and penalties on delinquent general taxes and special assessments. Penalties and interest collected on special assessments should go into the local improvement fund. Penalties collected on delinquent property tax are distributed to counties and school districts, not cities.

Cities get a share of the interest on delinquent property tax if the taxes have been delinquent for a period of more than one year.

### **XI. Enterprise funds**

Certain city "enterprises" often pay additional income into the city's general fund.

## RELEVANT LINKS:

[A.G. Op. 59-b-10 \(Oct. 3, 1962\).](#)

[Minn. Stat. § 412.271.](#)  
[Minn. Stat. § 412.141.](#)  
[Minn. Stat. § 426.19.](#)  
[Minn. Stat. § 447.045.](#)  
[Minn. Stat. § 426.20.](#)

[Minn. Stat. § 412.371.](#)

[Minn. Stat. ch. 118A.](#)  
See LMC information memo,  
[City Deposits and Investments.](#)

Enterprise funds are like city businesses that operate on the revenue generated by the products they sell, such as water and sewer services or mass transit.

Cities can generally transfer surplus earnings from an enterprise fund to the general fund provided the money is not pledged to outstanding obligations or otherwise imprest with a specific trust under the law.

A city may generally use municipal liquor store profits for any legitimate municipal purpose. Specifically, a city is authorized to use municipal liquor store profits for the construction, operation, repair, and maintenance of sewers, water, buildings, and the payment of bonds. Municipal liquor store profits may also be used for a community hospital under certain circumstances. (A city generally cannot transfer funds into the municipal liquor store fund without holding a public hearing).

Similarly, a statutory city that has a city utilities commission, may receive surplus utility funds into its general fund. Most city charters contain similar provisions.

## XII. Investment of idle funds

City officials sometimes overlook another significant source of interest income—proceeds from the investment of idle city funds. The term, “idle funds,” refers to the money in the city treasury the city does not need to meet current demands for cash payments. The statutes specifically authorize the investment of such funds in interest-earning securities. All city investment practices must conform to state law.

Not all investments available to private investors are available for the investment of public funds. Recent experiences have demonstrated the difference between legal investments and wise investments.

A key factor in the success of any investment program is determining which idle funds are available for investment.

Cities should invest as much money as possible, thereby maximizing their interest income, but they should not invest so much that it hampers their administrative operations. Determining when and how much money to invest requires a cash forecast.

The city must consider the annual city budget, prior years’ financial statements, departmental budget requests, engineering and construction timetables, expenditure plans, and other data when preparing a forecast.

**RELEVANT LINKS:**

See Handbook, [Debt and Borrowing](#).

### **XIII. Borrowing**

Care should be taken to follow the law when borrowing money or issuing debt.

### **XIV. How this chapter applies to home rule charter cities**

All of the sources of income in this chapter are available to charter cities.