

# MINNESOTA · REVENUE

March 28, 2011

Representative Greg Davids  
585 State Office Building  
100 Rev. Dr. Martin Luther King Jr. Blvd.  
St. Paul, Minnesota 55155-1606

Dear Representative Davids:

We are writing to highlight several of the key tax policy implications contained in HF42, the House Omnibus Tax Bill.

The major provisions of HF42 include a three-year phase-in of income tax rate reductions to the bottom and middle income tax brackets, reductions to local government aids and credits of \$692 million for FYs 2012-13, conversion of the market value homestead credit to a reduction in net tax capacity, reductions to the property tax refund program for renters by reducing the rent assumed to be property tax from 19% to 12%, and applies levy limits for two years. In addition, HF42 repeals the sales tax refund requirement for capital equipment, reduces the statewide business property tax levy, eliminates the Sustainable Forest Incentive Act, modifies the Green Acres program, enhances the Research and Development Credit, creates a dedicated income tax withholding for science and technology, establishes a local redesign grant program, and includes sales tax conformity provisions and various other changes to tax laws.

According to our analysis of HF 42, the major provisions in the bill would have the following impacts:

- Increase property taxes by \$859 million over the next three years as a result of local aid reductions and, if combined with the reductions in property tax refunds paid to renters, would total \$1.2 billion of increased property tax and reduced property tax relief over the next three years.
- The reduction in the proportion of rent assumed to be property tax for renters from 19% to 12% will make the tax system more regressive. The proposal will reduce the total amount paid in refunds by about 50%, dropping the average refund paid by \$300 from \$643 to \$343. Approximately 38,000 renters, or about 12% of recipients, would no longer receive a refund.
- Net property taxes would increase for all classes of property, including farmers, homeowners, and businesses. Business taxes would increase \$63 million statewide next year despite the proposed reduction in the statewide business levy.
- Property taxes would increase by an estimated 4.3% statewide, including 3.7% in the metro area and 5.3% in greater Minnesota.
- The difference between planned local aid reductions and expected property tax increases—about \$230 million per year—is the anticipated amount by which local governments would reduce costs and services.

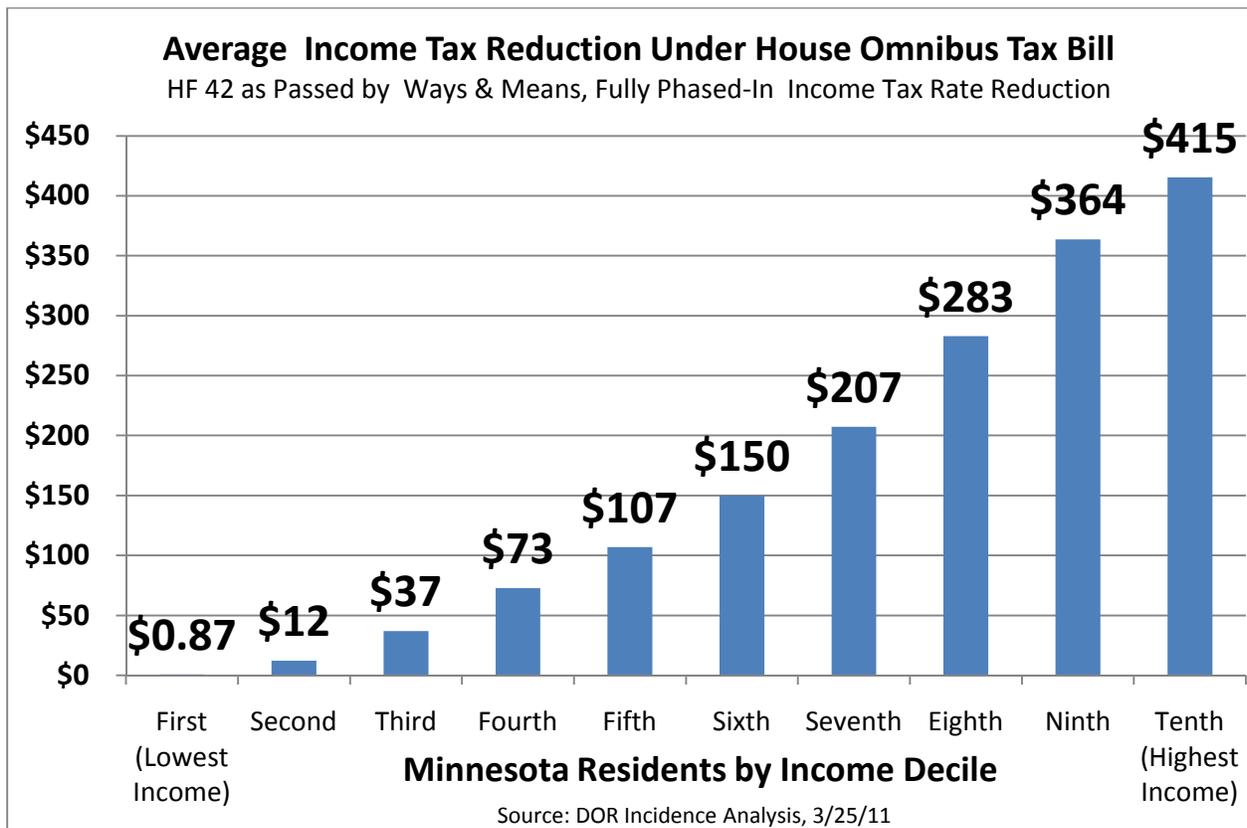
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- In tax year 2014, the first year the income tax rate reductions would be fully phased in, income tax revenue would fall by \$459 million (or 5.3 percent).
- The income tax cuts would shrink the income tax share of total state and local tax revenue, dropping it below the property tax share. This reverses the pattern that held every year from 1997 through 2008, when the income tax share exceeded the property tax share. Under the February forecast, that historic relationship was projected to hold once again in 2013 and later years.

As summarized in the chart on the following page, although the income rate cuts are limited to the first two rate brackets, much of the tax reduction goes to high-income taxpayers. About half of the tax cut goes to those with incomes over \$100,000, and one-quarter goes to the top 10 percent. More specifically,:

- Average income tax relief under HF42 is 3 times greater for the top 20% than for the middle 20% and 60 times greater than for the bottom 20%; and
- Nearly 47% of the total income tax relief will go to the wealthiest 20% of households.



**A More Regressive Tax System Under HF42**

The property tax is a very regressive tax and HF42 would result in even greater reliance on local property tax. Based on our analysis of HF42, the regressive nature of the local property tax increases and the reductions to renter property tax refunds will out-weigh the proposed income tax reductions resulting in a more regressive overall tax system.

While HF42 proposes to phase-in reductions in the lower and middle income tax brackets, reductions for the wealthiest Minnesotans are substantially greater than for average Minnesotans. As a result, the increased property tax burdens and renter refund reductions out-weigh improvement in progressivity that would otherwise result from reductions to the lower and middle income tax brackets.

Population Decile Suits Index, All Taxes	
1990	-0.007
1992	-0.017
1994	-0.011
1996	-0.017
1998	-0.040
2000	-0.031
2002	-0.018
2004	-0.024
2006	-0.059
2008	-0.054
<b>2013 Est.</b>	<b>-0.047</b>
<b>2013, HF 42</b>	<b>-0.050</b>

Source: DOR Incidence Analysis, 3/25/11

The table below summarizes the estimated tax incidence of HF42. The complete analysis is available on the Department’s website at:

[http://taxes.state.mn.us/legal\\_policy/Revenue\\_Analyses/HF0042%20Incidence%20Analysis\\_1.pdf](http://taxes.state.mn.us/legal_policy/Revenue_Analyses/HF0042%20Incidence%20Analysis_1.pdf)

2013 Population Decile	Income Range	Current Law Tax Burden as Percent of Income	Net Change in Minnesota Tax Burden as Percent of Income
First	\$ 11,298 & under	30.46%	1.23%
Second	\$11,299 to \$18,732	12.10%	0.59%
Third	\$18,733 to \$26,788	11.02%	0.34%
Fourth	\$26,789 to 35,561	11.55%	0.15%
Fifth	\$35,562 to 46,044	12.06%	0.00%
Sixth	\$46,045 to 59,437	12.10%	-0.13%
Seventh	\$59,438 to 76,276	12.07%	-0.19%
Eighth	\$76,277 to 99,386	12.30%	-0.22%
Ninth	\$99,387 to 142,225	11.89%	-0.21%
Tenth	\$142,226 & over	10.36%	-0.06%
All		11.47%	-0.07%
Top 5%	\$200,907 & over	10.07%	-0.02%
Top 1%	\$472,626 & over	9.68%	0.04%

Thank you for your willingness to work with the Department on various provisions. We look forward to continuing to work with you in the coming weeks as you develop a final legislative tax bill.

Sincerely,



Daniel A. Salomone  
Acting Commissioner



Matt Massman  
Assistant Commissioner – Tax Policy

Cc: Representative Paul Thissen