



**Institute on Taxation &
Economic Policy**
1311 L Street, NW
Washington, DC
202/626-3780

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CONTACT: Tyson Slocum
Michael Ettlinger
202/626-3780

New Study Finds Shift in Minnesota Taxes—Away from Businesses and Onto Individuals

Businesses have paid lower shares of key Minnesota taxes in recent years, leading to a shift in the tax burden onto Minnesota's individual taxpayers. A new study by the Washington, D.C. based Institute on Taxation and Economic Policy (ITEP), which takes a wide-ranging look at the Minnesota economy and tax system, also finds that:

- # Minnesota ranks high among the states in taxes and government spending.
- # The state's relatively high level of government spending has coincided with Minnesota being one of the nation's leaders in most important economic and social indicators.
- # Minnesota's overall tax system is slightly regressive, but less regressive than most other states.
- # Regressive sales and excise taxes have provided an increasing share of tax revenue in recent years.

"Minnesota faces the pleasant task of deciding what to do with its current budget surplus," said Tyson Slocum, a policy analyst at ITEP and co-author of the study, *Tax Strategies for a Strong Minnesota*. "The choices made, however, will be of great importance to the future of the state. This study offers a framework for making these decisions, as well as other tax policy choices in the future."

In dealing with current budget surpluses, the study invites state policy leaders to consider recent trends in state and local taxation and to evaluate the full range of options, including:

- ▶ Increased government investments in programs and facilities, and
- ▶ Targeting warranted tax cuts to those most in need.

The Tax Shift Away from Business

Since 1990, the share of Minnesota property taxes paid by business has fallen from 56 percent to 49 percent. In that same period, the share of property taxes paid by homeowners has grown from 32 percent to 41 percent. (See charts 1 and 2.)

Similarly, corporate income tax revenues have declined as a source of revenue. In 1979, corporate income taxes were 0.82 percent of Minnesota's gross state product (GSP) and represented seven percent of Minnesota state and local tax collections. By 1994, corporate income taxes had fallen to 0.46 percent of GSP, representing five percent of revenue. (See chart 3.)

In 1997, permanent changes in the state's property tax "class rates" further shifted the property tax burden from businesses to homeowners. In addition, target class rates were set for the future. If the target rates are achieved, property taxes paid by business will decline even further—with homeowners making up the difference (See chart 4.)

In the short-run, the class rate shift has been offset by separate tax breaks for homeowners. The homeowners savings, however, are either temporary, designed to erode over time, or subject to the biennial appropriations process.

"Last year's legislation has accelerated the decline in business taxation in Minnesota," said Michael Ettlinger, tax policy director at ITEP and co-author of the study.

The 1997 legislation dedicated a portion of future budget surpluses to property tax relief with preference given to business property tax cuts. The study notes that only eight percent of the 1998-99 budget surplus can be clearly identified as coming from businesses. "If a major portion of the surplus is used for business property tax relief this year, it will cause a substantial redistribution of the tax burden," said Ettlinger. "Higher tax collections from families and individuals would be paying for business tax cuts."

Shift to Regressive Consumption Taxes

In addition to the recent shift in property and income taxes away from businesses and onto families and individuals, there also has been an increased reliance over time on sales and excise taxes, which burden middle- and low-income families the most. In 1978, regressive sales and excise taxes equaled 27 percent of all Minnesota state and local taxes. In 1996, they comprised 31 percent. "Lower business taxes and higher sales and excise taxes threaten to turn Minnesota's slightly regressive tax system into one where middle- and low-income families face substantially greater tax burdens than the well-off," said Slocum. (See charts 5 and 6.)

High Ranking in Total Taxes

Although Minnesota ranks 10th in the nation in taxes as a share of personal income, its taxes are only ten percent above the national average—and are twenty percent below the highest tax state. "Minnesota's relatively high ranking in tax burden has not prevented the state from having strong economic growth," said Slocum. "On the contrary, the government services those taxes have bought have probably helped improve the state's competitive position."

Options Presented

The study concludes with analyses of 18 tax options—including potential tax cuts, tax increases and revenue-neutral changes. The list represents a variety of tax policy possibilities for the present and the future—including both progressive and regressive alternatives. The analyses include charts showing the effects that the various options would have on families at different income levels. Also noted is the often substantial impact on Minnesotans' federal tax liability of the various options. Federal tax payments are affected by state tax law changes because itemizers can deduct their state personal income tax and property taxes on their federal tax returns.

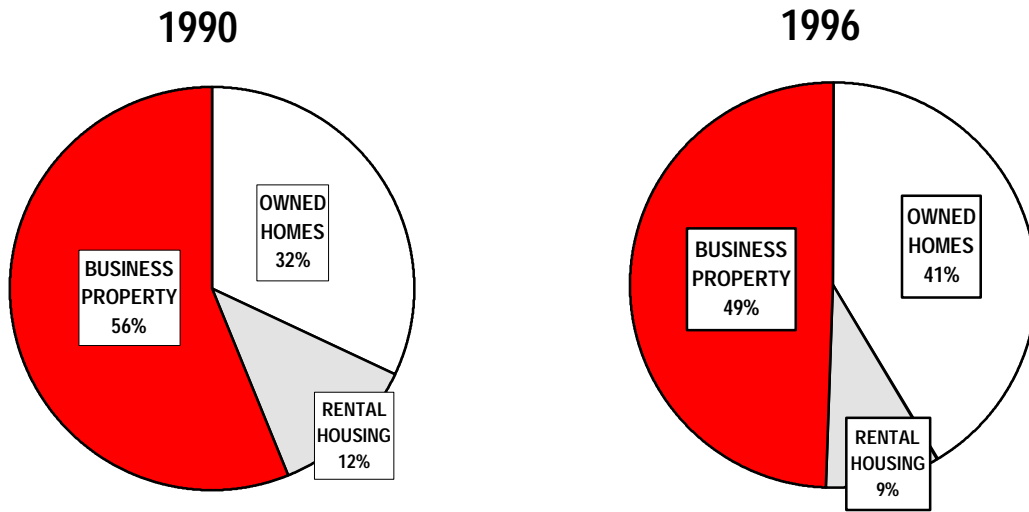
The options include:

- ▶ Targeted property tax relief that benefits middle- and low-income groups.
- ▶ Reductions in the personal income tax rates in the lower brackets.
- ▶ High income tax hikes.
- ▶ Sales tax increases and decreases.
- ▶ Elimination of the state's rate-structure marriage penalty.

Six charts illustrating the results of the study are attached.

THE INSTITUTE ON TAXATION & ECONOMIC POLICY has engaged in research on tax issues since 1980, with a focus on the distributional consequences of both current law and proposed changes. ITEP's research is relied on by the public and policymakers, and ITEP is frequently consulted by government estimators in performing their official analyses.

Chart 1. Sources of Minnesota Property Taxes



SOURCE: Minnesota Department of Revenue, Tax Research Division. Totals include homeowner and rental refunds.

Chart 2

Minnesota Property Tax Collection Trends: 1982-96 (after property tax refunds) in millions of constant 1996 dollars

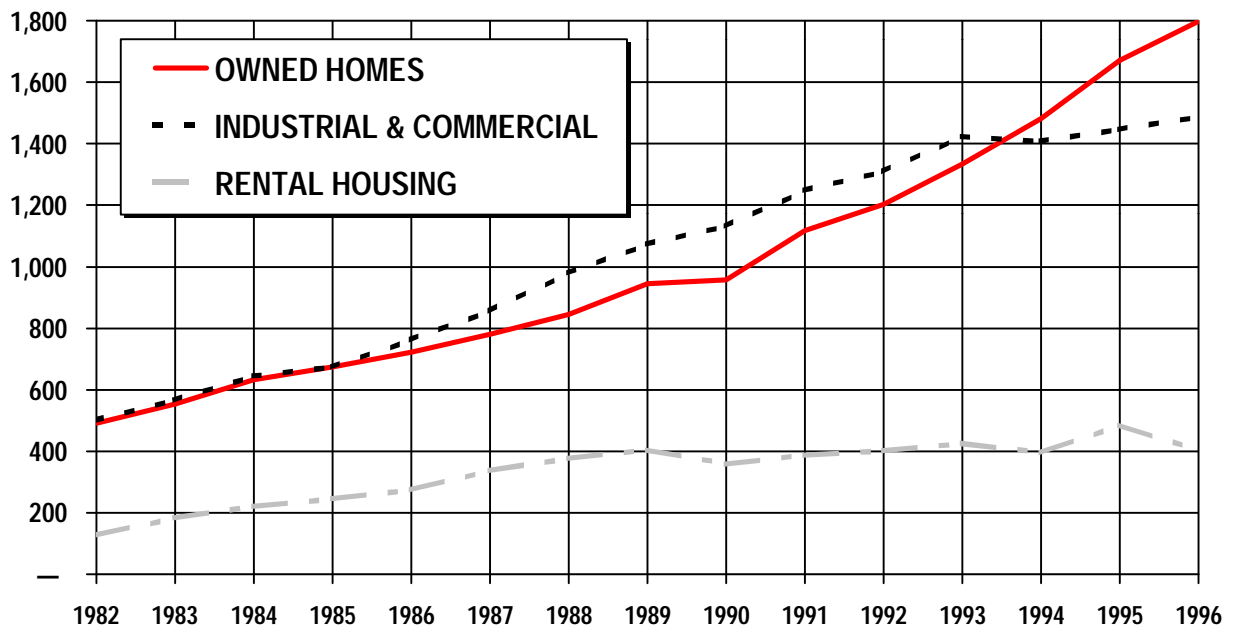


Chart 3
Minnesota Corporate Income Taxes as a Share of Minnesota Gross State Product, FY 1978 to 1994

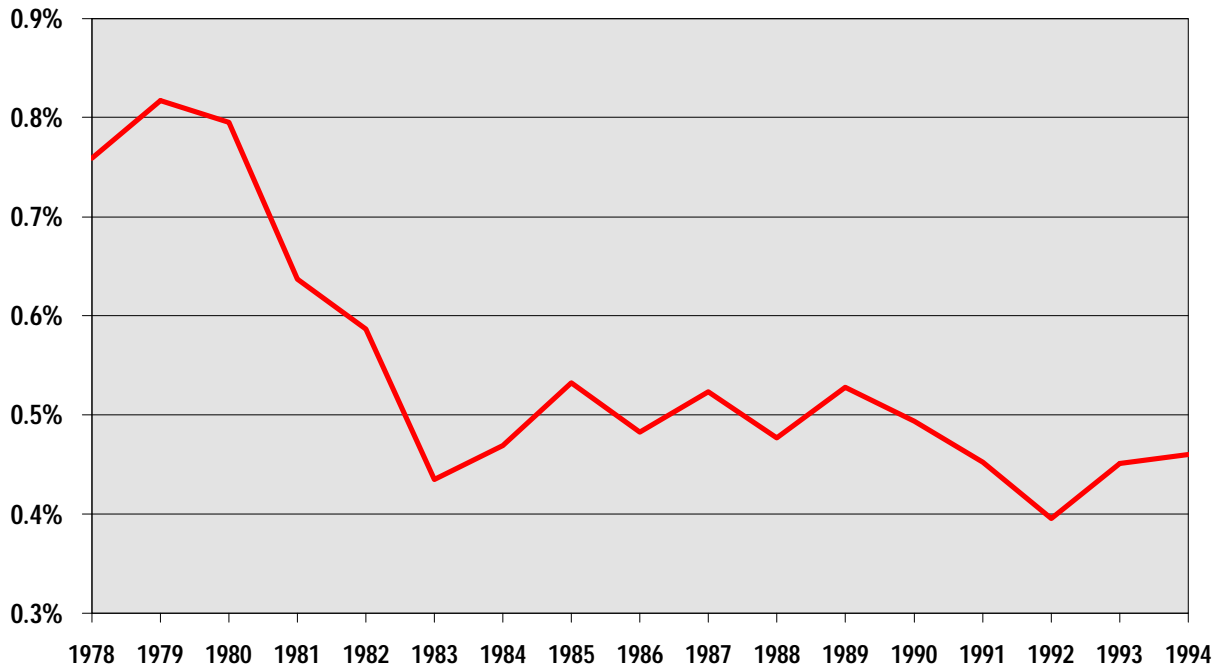


Chart 4.

Changes in Minnesota Property "Class Rates"	1997	1998	"Target"
1a Residential Homestead			
Market value < \$72,000	1.0%	1.0%	no target
\$72,000 - \$75,000	2.0%	1.0%	no target
\$75,000+	2.0%	1.85%	no target
2a Agricultural Homestead			
House, garage and 1 acre	— same as 1a —		
Remaining Land:			
Market value < \$115,000	0.5%	0.4%	no target
\$115,000+ (< 320 acres)	1.0%	0.9%	no target
\$115,000+ (320+ acres)	1.5%	1.4%	no target
3a Commercial, Industrial and Utility Property			
Market value < \$100,000	3.0%	2.7%	2.5%
\$100,000 - \$150,000	4.6%	2.7%	2.5%
\$150,000+	4.6%	4.0%	3.5%
4a Apartments (4+ units)			
	3.4%	2.9%	2.5%
4bb Single Family Rental Residential			
Market Value < \$75,000	na	1.9%	1.3%
\$75,000 +	na	2.1%	1.9%

Class rates are multiplied by assessed market value to produce the taxable amount by which property tax rates are multiplied to calculate property taxes due.



Chart 5
All Minnesota Taxes
As Shares of Family Income

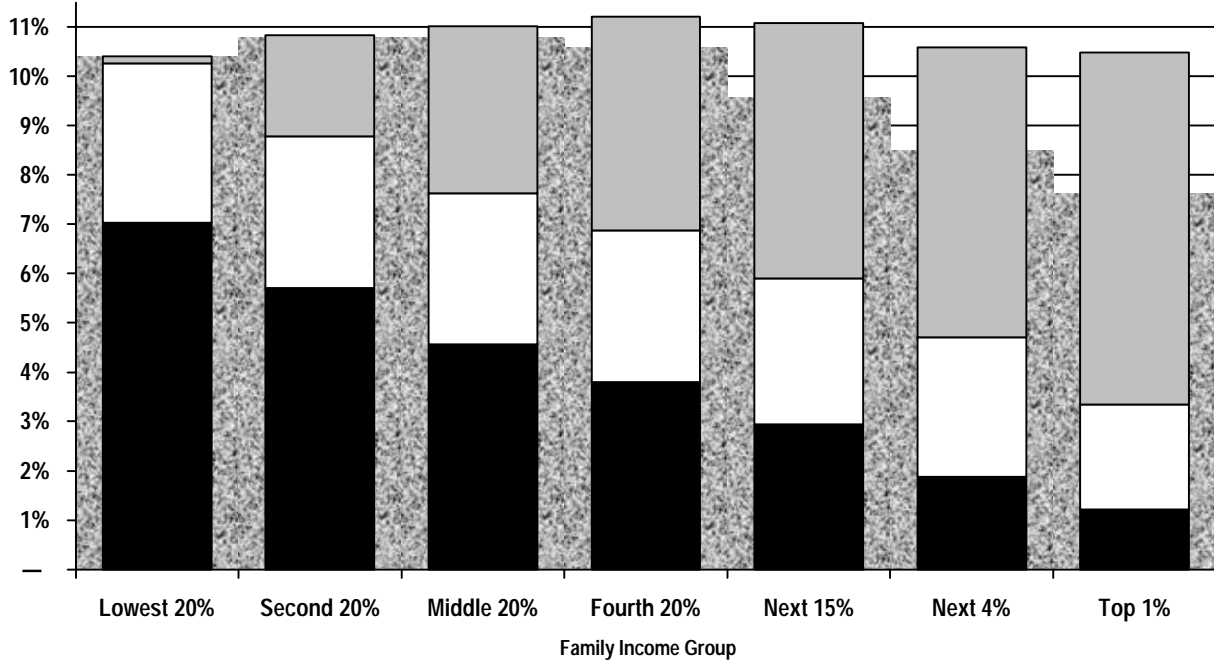
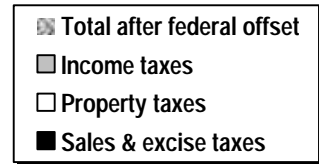


Chart 6. Minnesota Sales & Excise Taxes As Shares of Family Income

