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In This Issue:

Reaping the Whirlwind of a Misguided Tax Debate

A shanghaied conformity debate, a veto based on the presumptive ability to lay claim to income earned around the globe, and the lost art of compromise combine to create a tax filing season in 2019 ranging from annoying to exasperating.

Back in February, the first two House Tax Committee hearings of the 2018 session focused, unsurprisingly, on the federal tax reform enacted in December. A familiar lineup of Department of Revenue, House Research, and House Fiscal staff provided an overview of the TCJA provisions and insights into their implications for state taxes. This testimony was delivered in the trademark restrained, reserved, "just the facts, ma'am" manner of agency and professional staff. Nevertheless, observers didn't have to work hard to grasp the unspoken message delivered between the lines – failing to adopt some type of federal conformity plan in 2018 would be a huge problem, if not nightmare, for both the Department and taxpayers.

Four months and a vetoed tax bill later those fears have come to fruition, and a tax filing season promising considerable aggravation looms in Minnesota's future. How we arrived at this point and the implications going forward is the cherry on top of the sundae of dysfunctional government Minnesota has experienced for some time now.

"You Had One Job"

Absent the TCJA, the 2018 legislative session held the promise of an undramatic but productive affair. With a budget surplus of "only" $329 million, major tax relief and large new spending ambitions would automatically be held in check. At the same time, that sum seemed perfectly suited to throw one-time resources at bipartisan concerns demanding immediate attention prior to the next two-year budget cycle – like school safety, opioid abuse, transportation, and senior care.

In theory, this session outlook didn't need to change with the passage of the TCJA except for one thing: a conformity bill now was absolutely necessary. To ensure that happened, policymakers could have segregated federal conformity from the supplemental budget / surplus debate and systematically analyzed the federal changes using standard tax policy and budgeting principles within a revenue neutral framework. They then could have decided whether to conform to each change on a case-by-case basis, and when necessary just how to deviate to mitigate potentially large tax increases and serve tax fairness. Ideally a "clean" conformity bill would have been assembled cooperatively, perhaps even with the assistance of a fast-tracked blue-ribbon commission or working group which the state is famous for putting together. As last year's blue-ribbon pension commission proved, the political cover these outsider dives into contentious topics offer is often far more valuable than the recommendations themselves.

This scenario was blown to smithereens with the announcement of the governor's tax proposal about a month into session. The proposal appeared to be driven by three political objectives: 1) ensure that nothing could be interpreted as validating the federal tax reform effort or its motives; 2) correct for the perceived distributional sins of federal reform at the state level; and 3) box the Republican-controlled legislative bodies in using their own tax agenda. This was accomplished by what might be viewed as an "anti-conformity" agenda: preserve nearly every single deduction and exclusion under prior federal law within the state tax code to protect the status quo. Tacking on a quarter-billion of tax relief to low- and middle-income families – all paid for by conformity-related revenue raisers – immediately transformed how conformity would be discussed.

Republicans immediately found themselves in a dilemma. They could pursue a conformity response focused on revenue system integrity and the objective of simpler and efficient tax administration. But that could cause some filers, based on their particular set of circumstances, to pay more versus the status quo, with the inevitable campaign literature to follow. Or they could also make protecting as many taxpayers as possible from any state tax increases priority one, grant additional relief where they could, and focus the political debate on who did all this better.

Not surprisingly the latter was chosen and federal conformity quickly became a supporting actor in a much larger and complex tax relief and budget drama in which major new characters, like $138 million in emergency education aid, were introduced in the final act.

Ironically, it was in the one thing "they had to do" that featured some of the strongest areas of agreement between the governor and the legislature. With one big notable exception, both sides reached general consen-

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sus on how to structure Minnesota's individual and corporate tax bases in a post-TCJA world. That included adopting an adjusted gross income starting point, preserving pre-TCJA itemized deductions and personal exemptions as Minnesota provisions, choosing not to conform to the TCJA's controversial 20% pass through exclusion, but conforming to the majority of the other TCJA business provisions. This conformity approach could be considered suboptimal in that policymakers passed on the change to significantly simplify and rationalize the state's individual income tax system (for example, using an enhanced state standard deduction to eliminate state only itemized deductions which are now considerably more trivial economically). But it was consensus and in the current political environment, that currency alone is worth a lot.

Revenue and distributional consequences, rather than administrative and tax filing considerations, were the engine pulling the conformity train.

The notable exception concerned foreign earnings. The governor proposed fully conforming to new foreign income provisions which translated into $400 million in FY 20-21 from both the corporate franchise tax and individual income taxation related to pass throughs. The legislature settled on less than one-fifth of that total by choosing to conform only to one-time deemed repatriation income on a net basis. Not only are there significant unsettled constitutional and legal questions surrounding the ability of states to tax foreign earnings, there are also questions about the accuracy of federal estimates on which state revenue estimates are based. Strangely, for being such a critical fiscal foundation for the governor's plan, there was remarkably little – if any[1] – public testimony in the tax committees of these issues, the fiscal risks accompanying a reliance on them, or their administrative implications and costs.

The uncertainty (or perhaps conversely as a result of some due diligence done internally by the Department on these matters) may have influenced the Governor's final compromise offer to strip out the GILTI and FDII foreign income provisions. That plus some additional concessions put an additional dent in the difference between each side's conformity elements. But the revenue and distributional consequences, rather than administrative and tax filing considerations, were the engine pulling the conformity train. According to an analysis by House Research of the revenue effects on the last year of the forecast window (FY 21) the two sides were about $220 million apart. Removing temporary provisions (one-time base expansions and those set to expire) the gap declines to about $145 million. No less importantly, the governor was insistent that individual income tax relief accrue to lower income households while the GOP majorities insisted that relief be directed somewhat more in proportion to total income tax burdens. As a result, it was a conformity train trying to head down two tracks at once resulting in derailment.

In his press conference following the tax bill veto, the governor acknowledged its implications for the functionality of the tax system stating that failing to conform was clearly not ideal and should have been avoided. However, in response to the Department of Revenue's assurances that the agency is prepared to handle the fallout, the governor stated "the sky is not falling" with respect to state tax administration and has expressly stated he will not call a special session to deal with the issue.

Despite these assurances, no one should underestimate the challenge this presents to the Department. If federal tax conformity wasn't that big of a deal, the Department wouldn't have sought a $4 million appropriation over the next two years (also a casualty of the veto) to implement it. Now the Department faces the prospect of managing non-conformity, an almost assuredly more expensive proposition, with no additional resources. For that reason, some have speculated that despite the governor's conviction, a late year special session dealing with conformity may ultimately be necessary. The problem with that idea is that it would entail a completely unworkable compressed timeline for managing the conformity given the realities of what goes into updating tax filing systems. For practical as well as political reasons, the conformity door has closed for tax filing in 2019, and filers of all types must brace for the repercussions.

Will the Tax Increases Really Materialize?

One repercussion on everyone's mind is the prospect for higher state income taxes. According to the governor's supplemental budget documentation, "Budget for a Better Minnesota," presented early this session, if the legislature did nothing to respond to the TCJA individual state income taxes "will increase $59 million for over 300,000 Minnesota families, costing an average of $200 per year."

To try to obtain more detail and a better understanding of the nature and distribution of tax burden impacts, we modeled the impact of non-conformity again using our household profiles from our Multistate Individual Income Tax Comparison Study. As a reminder, these profiles let us model federal and state income taxes on an "average Minnesota taxpayer" for different filer types at various incomes[2].

The accompanying table presents our comparison of 2017 actual versus projected 2018 under non-conformity for several household types – including many of primary concern to the governor. As the results show, in most cases burdens decline – primarily because

[1] If there were public testimony or committee discussion on these issues, we do not recall them.

[2] Usual caveats apply:

- The taxpayer information we have is specific to tax year 2014. Our analysis assumes that taxpayer attributes at various combinations of incomes and filing statuses have not changed dramatically over the interval between 2014 and 2017/2018, and therefore we modeled "2017 actual" taxes and "2018 projected" using this 2014-specific taxpayer information.
- Any particular taxpayer at these income levels can have a very different tax burden than the "average" taxpayer we model. The most important factors in any variations include 1) the number of dependents claimed, 2) whether the filer itemizes deductions or claims the standard deduction, 3) the total amount of itemized deductions a filer claims if itemizing, and 4) the use of any "above the line" deductions (i.e. income subtracted in the calculation of federal adjusted gross income.
- Our modeling assumes the most common scenarios for dependents; that married-joint filers have two children and head of household filers have one child.

tax brackets, maximum credits, and other inflation-adjusted features of the tax system are assumed to increase by 2%. Absent these minor year on year structural adjustments, taxes would remain the same for filers whose income does not change for a very understandable reason – Minnesota's tax code remains unchanged between 2017 and 2018.

Minnesota Income Tax Burdens on Selected Income/Filer Type Combinations: Actual 2017 Versus 2018 Projected

Filing Status	Household Income	2017 Actual Tax	2018 Projected Tax	Change for 2018	
				Amount	Percent
Married-Joint	$35,000	($1,540)	($1,608)	($68)	(4.4%)
Married-Joint	$50,000	724	686	(38)	(5.2)
Married-Joint	$100,000	3,828	3,773	(55)	(1.4)
Married-Joint	$150,000	7,283	7,349	66	0.9
Head of Household	$20,000	(957)	(1,000)	(43)	(4.5)
Head of Household	$35,000	589	562	(27)	(4.6)
Head of Household	$50,000	1,632	1,610	(22)	(1.3)
Head of Household	$75,000	3,300	3,309	9	0.3
Single	$20,000	486	472	(14)	(2.9)
Single	$35,000	1,252	1,239	(13)	(1.0)
Single	$50,000	2,225	2,199	(26)	(1.2)
Single	$75,000	3,896	3,912	16	0.4

So where does the governor's supplemental budget estimate of $59 million in higher state income taxes on 300,000 filers come from? That is a function of the increase in the federal standard deduction, Minnesota's continuing use of pre-TCJA federal tax law, and state law governing election of standard or itemized deductions. Under the TCJA, many filers who have itemized in the past will find it in their economic interest to take the more generous federal standard deduction in 2018. For a subset of these filers – those whose potential itemized deduction amounts are higher than the previous standard deduction but lower than the new standard deduction – this filing election lowers their federal tax burden but penalizes them at the state level, since the state standard deduction (calculated under pre-TCJA law) is less than what they could claim if they itemized. Most of the tax increases from non-conformity are due to this election issue, since the state does not permit individual filers to claim the standard deduction at the federal level and itemize for state purposes or vice versa. It's difficult to identify exactly which taxpayers will be hit the hardest by this issue, but our best estimate is that they will fall in the $90k-$160k income range for married-joint filers and the $70k-$100k income range for other filers.

But the story may not end there. State law governing the itemized/standard deduction election is not crystal clear,[3] and taxpayers' inability to make different elections for state and federal purposes results from the Department of Revenue's interpretation of those statutes. However, many tax attorneys believe the Department's interpretation is incorrect and would not stand up to a court challenge. If the agency alters its position and chooses to allow differential filing elections next year, little, if any, of the tax increase from non-conformity would materialize. At a recent meeting of the Minnesota Chamber of Commerce fiscal policy committee, Department officials said "[they] are looking into this." [4] Given the demographic profile of those likely to pay more, contemplating the potential interaction of Revenue's decision with the potential political ramifications is irresistible.

Remaining Questions

Even though the end of session brings closure to the conformity debate for 2018, some questions remain:

Will there be any political fallout from this? If so, who gets it and what will it look like?

One of the reasons why policy makers focused so intently on providing income tax relief, or at a minimum holding as many taxpayers as harmless as possible, is that any incidental conformity-related tax increases on any subset of filers – regardless of size – would likely become a campaign issue. During the tax debate it seemed for every article highlighting the implications for tax administration and filing costs, another five heightened citizens' sensitivity to potential tax changes.

Administrative issues may get their moment in the sun during the 2019 tax filing season as the hassle, cost, effort, and confusion relating to our failure to conform becomes much more tangible. Then again, it's likely the business community, rather than individual filers, who will feel the most detrimental effects of non-conformity, and the number of "voting businesses" (a.k.a. persons owning "pass-throughs") as a percentage of the voting population is small. And given that the next election takes place before the 2019 filing season opens, it's doubtful there will be any repercussions for most candidates this year. Whether any fallout impacts the 2020 races will likely depend in large part on whether and how the state manages to conform between now and then.

What kind of collateral damage will be inflicted on the Department of Revenue?

In the aftermath of the veto Commissioner Bauerly offered encouraging words that the agency and its staff are committed to ensuring all the information, education, and services needed to help taxpayers meet their obligations next year will be available. But as highlighted earlier, nonconformity represents an unprecedented challenge for the Department. Resources will be stretched to the limit, stress levels will rise, and come 2019 the agency's reputation will be in the spotlight.

Revenue faces the dual challenge of ongoing retirements of very experienced professionals while attracting and retaining younger talent. The stress of preparing for the next tax season during 2018 will likely be exceeded by the stress of dealing with a lot of confused and frustrated taxpayers dur-

3 Minn Stat §290.01 subd. 19, referencing IRC §63.

4 At the same meeting, it was noted state interpretation of the accounting reform provisions for small businesses under the TCJA – a major potential source of non-conformity stress – is also under reconsideration.

ing 2019. It's not questioning the dedication of Revenue's staff to wonder whether nonconformity and its fallout will take a special toll on the agency over the next year. It's also fair to wonder just who would be willing to take on the agency's leadership responsibilities with the change in administrations and dive headfirst into this context.

How, if at all, will the 2019 debate be any different?

The one thing we can be certain of is that the 2019 debate on tax conformity will feature at least one different player with the retirement of Governor Dayton. Given what happens in the 2018 elections, the players on behalf of the state House could change, and in the (somewhat unlikely) circumstance that the DFL picks up Sen. Michelle Fischbach's vacant seat, the Senate players could change as well. Given the acrimony on tax issues over the last four years – when only one tax bill was signed into law, under protest – the atmosphere at the capitol is almost certain to improve.

In the event of one-party control of the legislature and governor's mansion, 2019 will probably feature a spirited debate on conformity that results in the issue being wrapped into a low-drama omnibus tax bill, with conformity-related revenues raised and spent on ideological grounds. The more likely scenario, though, is continued divided government. In that case, legislators and the new governor will need to decide quickly whether they want to treat conformity separately from other tax and spending issues, or whether they want to continue to weaponize the issue. If the former prevails, expect the tone and substance of the debate to change. If the latter prevails, the productivity of the debate will depend largely on how well the parties can work together.

That last point is an important one. What's most disturbing about this year's tax conformity failure isn't the challenging filing season that individual and business filers are about to experience. Rather, it's that this is only one of many examples of dysfunctional governance in Minnesota. For whatever reason, the arts of negotiation and compromise don't seem to be practiced as effectively as they used to. 2019 offers the opportunity for a fresh policymaking start – and the conformity debate will be an important signal for whether those arts have been rediscovered or not. ■

Pensions: We're Not Done Yet

The celebration over this session's primary political achievement shouldn't distract from the fact it's not a solution to our biggest fiscal challenge.

"However, as our panel's final recommendation indicated, more work remains to be done. This year's actions are vital to help stabilize the plan's financial condition, but real and considerable long-term risks remain with respect to younger public employees, future taxpayers, and the delivery of future government services. These include both structural and accounting changes to better support transparent and fiscally responsible pre-funding of our pension promises. We should look at the reform bill passed by the Senate as a vital step in Minnesota's journey for pension reform."

"Sacrifice together, make good on Minnesota's public pension promises"

— Op-ed letter from the members of the Governor's Blue-Ribbon Pension Commission Duluth News Tribune, May 6, 2018

In a legislative session marked by acrimony and unproductivity, the unanimous passage and governor's signature on the omnibus pension bill was an example of textbook lawmaking. It wasn't easy. Three years in the making, the omnibus pension bill featured plenty of its own political drama and frustration. To help things along, the governor created a blue-ribbon panel on pension reform in 2016 comprised of some of Minnesota's top finance and legal minds to vet proposals, offer recommendations, and (most importantly) provide needed political cover for some tough decisions. With its enactment, sorely-needed stabilization measures have now been put in place.

The stabilization plan that was just enacted can best be described as enabling a high wire act of perpetually managed underfunding.

The reaction among stakeholders and political players was one-third parts joy, relief, and hyperbole. The joy and relief reflected the importance of this issue to public workers and a recognition both of the challenges these plans face and the need to take corrective measures. The hyperbole centered on just what was actually accomplished. Public unions cheered the news, telling members the pension bill was "securing public retirements for decades to come." Legislators and stakeholders fawned over the "historic" and "unprecedented" accomplishment arguing Minnesota is a model for the rest of the nation. And at a post-session rally of public sector workers, MMB Commissioner Myron Frans told the audience that when he sells state bonds this summer and rating agencies ask whether the state has solved its unfunded liabilities, "I'm going to say, 'Yes!"

Some exaggeration can be excused in light of the enthusiasm over something fought for so long and hard. But that messaging becomes a liability if it detracts from the work that still needs to be done. That work was captured in the overlooked final recommendation of the blue-ribbon panel ("Support Study of Reform Strategies to Mitigate Pension Risk") and in the quote above. "Stabilization" should not be confused with "solution."

What Was Done…and What Hasn't Been Done

The pension bill's substance itself should have been very familiar to anyone who has followed this topic for a while. It contained the usual "shared sacrifice" elements of employer and employee contribution increases, state aid increases, temporary cost of living cuts, and last, but certainly not least, the critical fresh 30-year reset for paying off unfunded liabilities. That last change is crucial to be able to bend the PowerPoint presentation graph lines in the right direction and publicly claim the existence of that fiscal unicorn: the "path to full funding." (For reference, the Government Finance Officers Association's Code of Best Practice on pension amortization states that pension plans should "use closed periods (i.e. no resets) that never exceed 25 years, but ideally fall in the 15-20 year range".[5])

5 GFOA Best Practice: Core Elements of a Funding Policy; *http://www.gfoa.org/core-elements-funding-policy*

One new significant cost saving tweak was added, making a part-public service career more likely to be a losing proposition from a retirement standpoint. According to the actuaries, the overall result of the bill is a modest 20% bite out of the $16.9 billion unfunded liability reported in the 2017 valuations for these pension plans.

The most controversial change was reducing the pension plans' assumed rate of investment return from 8.0% to 7.5% per year, which was the blue-ribbon panel's primary recommendation. Lowering the expected investment return raises the contribution rates deemed necessary to fund the system, but Minnesota's aggressive return assumption was a national outlier and deemed out of touch with today's low interest rate environment and economic conditions.

While that assumption change was an important step in the right direction, two problems remain. First, a 7.5% expected return on investment assets is still considered high. In a memo to MSRS and PERA officials accompanying their respective valuation reports, the plans' actuary recommended "an investment return assumption in the range of 6.85% to 7.68%" but also noted, "the selection of an investment return assumption at the upper end of this range results in a higher risk of increased actuarial contributions in the future, as the rate must be reviewed each year for reasonability based on actuarial standards. A rate near the bottom of the range, such as 7.0%, would be more likely to be sustainable for a longer period."

The other and much more disturbing problem is the continued use of the investment return assumption as the discount rate for determining the present value of future pension cash flows. Beside violating every precept of financial economics, there is a profound practical implication. A pension system based on discounting future pension benefit cash flows at a rate of 7.5% functions as a pension system that must make sure adequate revenues are always available to support a 7.5% annual growth rate in liabilities

- regardless of actual investment performance,
- regardless of recessions and stressed budgets, and
- regardless of the fact that in a significantly underfunded situation (as exists today) smaller pools of assets actually have to grow ***faster*** than 7.5% just to keep up with the larger pool of liabilities.

For all the praise showered on it, this pension bill does little, if anything, to stop the ongoing export of billions in current financial obligations onto future taxpayers (who will have their own public sector retirement obligations to pay for). It does not adequately mitigate the accompanying risks to future taxpayers and public services or the opportunity costs and crowd out effects for future state and local services. It does ensure government will continue to promise new benefits that won't be properly funded. The stabilization plan that was just enacted can best be described as enabling a high wire act of perpetually managed underfunding. And a concise summary of state pension sustainability strategy is "do ya feel lucky?"

A study by the Urban Institute concluded that Minnesota teachers hired after June 30, 1989 have to work 34 years to break even on their own pension contributions.

The Prospects for Change

Irrespective of the blue-ribbon panel's final recommendation, there is likely to be zero interest or appetite for doing anything more on public pensions anytime soon. Stakeholders view the results of this session as a destination, not a first step as part of a bigger reform journey. Legislators will not want to dive right back into the political slog of the past three years. Organizational representatives of cities, county and school district employers – perhaps the closest thing that exists to taxpayer advocates in the world of public pensions – still appear remarkably sanguine and supportive about the state of pension affairs, suggesting their advocacy decisions are more about keeping the peace than tax pressures and budget exposure. And unless something disastrous happens in the next couple of weeks, FY 18 will prove to be another strong year for investment markets, further mitigating any urgent sense of need to do something more.

If internal pressure for faster change ever materializes it ought to come from the individuals most harmed by the status quo – younger government workers. That's a function of the extraordinary cross subsidization of older employees and retirees by younger workers that occurs in defined benefit plans. Defined benefit plans are intensively backloaded, meaning most of the pension wealth is created in the last few years on the job. Several studies have examined how long public employees must work until their retirement benefits are worth more than just their own contributions. The findings are nothing short of stunning. A study by the Urban Institute[6] concluded that Minnesota teachers hired after June 30, 1989 have to work 34 years to break even on their own pension contributions. Another report[7], this time from 2017, concluded Minnesota teachers would ***never*** reach a point where their retirement benefits would be worth more than their own contributions – leading the authors to conclude, "It's not unfair to say current pension systems treat younger employees as sources of revenue for other people's pensions rather than valued employees in their own right."

Moreover, every cost saving tweak and adjustment the state has implemented, including this year, to protect retirees and long-term employees exacerbates this problem by imposing large costs on those who may not want to commit to a lifetime of work in the public sector or want to leave "too early." The human capital impacts are real, and if younger workers invested in understanding the economics (and future risks) of the state's defined benefit plan structure as currently designed it would likely transform from an "attraction tool" to a repellant overnight.

For all the congratulatory messages being offered around the state regarding this year's

6 *Negative Returns: How State Pensions Shortchange Teachers*, Urban Institute, September 2015

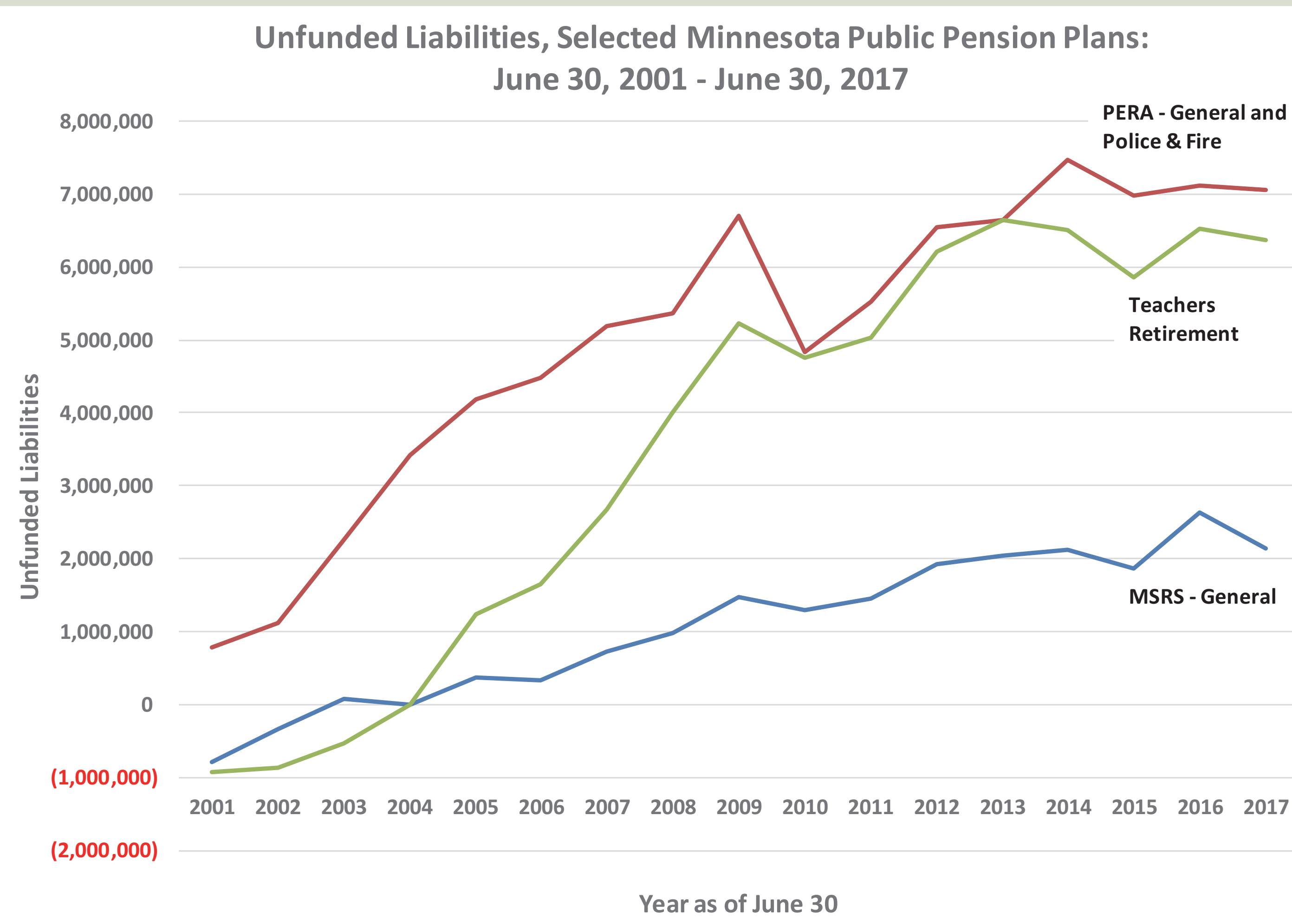
7 *(No) Money in the Bank: Which Retirement Systems Penalize New Teachers*, Thomas Fordham Institute, September 2017

A Cautionary Tale From Stabilizations Past

Pension policy is dictated by assumptions about the future, but pension health is determined by actions of the past. With so much focus on all the things this year's pension bill will accomplish if everything behaves like we want it to, we thought it important to take a look at how past stabilization efforts have fared.

Our starting point is the beginning of FY 2002, when pension plans were near or at full funding thanks to the wake of the internet bubble (with a five-year smoothing period for investment gains and losses, some plans maintained full funding through 2004). Since that time we have completed two rounds of sustainability measures. In the 2004-2006 timeframe legislators enacted a round of contribution increases. Following the Great Recession, in 2010-2011 a more comprehensive package of reforms was put in place. Specifics differ by plan but they included employee and employer contribution increases, reductions in retirees' annual cost of living adjustments, changes to vesting periods, adjustments to early retirement provisions, reductions in the interest rate applying to refunds of contributions, augmentation reductions, and a 30-year reset for amortizing unfunded liabilities. The graph below tracks the history of reported unfunded liabilities through this time period.

Two disturbing thoughts come to mind when considering the lines on this chart. The first is that while these sustainability measures undoubtedly kept things from getting worse than this chart indicates, they seem to have done very little to improve the situation over time, as these funds are near all-time highs when it comes to unfunded liabilities. The second is that, according the National Bureau of Economic Research, we have just finished a ninth consecutive year of economic growth – the second-longest period of such growth in American history, and markets are orbiting all-time highs. If we have such trouble taming unfunded liabilities during relatively good economic times, it's frightening to think what will happen when the next recession hits.



pension bill, it's important to keep in mind that the fundamental challenges the design of the pensions themselves posed – as we've outlined above – are still in play. Chronic underfunding, unsuitable measurements of risk and the failure to appreciate how the aging of the system is fundamentally changing the nature of financing these plans are still major problems. The 2018 legislative session provided a "feel good" moment in traveling down the road toward retirement system health and sustainability. But this

From The Director: Experiencing "Tax Rules for Realists"


Mark Haveman

There's textbook principles of good tax policy, and then there's the rules that dictate how tax policy really works.

One of my favorite tax policy observers is Billy Hamilton, a columnist for State Tax Notes who in his spare time moonlights as the executive vice chancellor and CFO for Texas A&M. Most of the time Hamilton writes about interesting intersections of tax policy and politics taking place around the country, but occasionally he takes a step back and offers perspective and reflection on the nature of tax policy discourse in today's society – all in his trademark droll and entertaining manner.

Such was the case recently when his column "Tax Rules for Realists" auspiciously landed on my desk right after the governor vetoed the tax bill. Hamilton's premise for his commentary is based on the 2016 book *Democracy for Realists*. The book contrasts how democracy is supposed to work (according to 8th grade civics classes) with how it really works (based on the fact that people are too busy with their lives to give political issues the attention they deserve and must rely on social identity and partisan loyalties to establish their positions on issues). Or as Hamilton describes it, it's "a 400-page explanation of why no argument will convince your brother-in-law that his politics are dumb – and why he can't convince you of the same thing."

In his column, Hamilton ran with this idea noting that tax policy is also framed by generally agreed upon principles and textbook ideas on what is supposed to constitute a "good" tax system, but in practice policymakers are guided by other, far more influential concepts. His 35 "tax rules for realists" cover general concepts (Rule #3: Taxes are the price someone else pays for a civilized society), tax legislation (Rule #13: Major change comes only with major crisis), and tax administration (Rule #28: The state's considered guidance may be a taxpayer's detrimental reliance).

Hamilton acknowledges these tax rules for realists "might easily be called rules for cynics", which is why they probably resonated with me in the aftermath of this legislative session. It's tough not to be deeply cynical watching critical public policy like federal conformity get so completely subordinated to politics. When considering: 1) 3 of the last 4 sessions ended without a tax bill; 2) the session that did result in a signed tax bill also came with a defunded legislature; and 3) the frustrating and occasionally ridiculous context surrounding tax bill failures (1,000-page omnibus spending bills, the use of an incorrect conjunction, transportation finance lockjaw, etc.) jaundice deserves to be the default condition.

So in recognition of the 2018 session, here are four more rules for the realists' canon:

Intellectual consistency is the first casualty of tax policy advocacy. A recent op-ed justifying the governor's veto of the tax bill veto claimed it "needed to be considered in the context of the federal Tax Cuts and Jobs Act". The belief that the tax burdens the federal government imposes deserve to be considered when developing state tax policy is especially interesting because for years these same advocates have steadfastly demanded our never-ending tax fairness debate exclude any consideration of federal income taxes Minnesotans pay. Suddenly, that mythical state/federal firewall collapsed and tax fairness now urgently needs to be informed by what new federal tax burdens look like.

Evidence-based policy making always serves a faith-based initiative. Hamilton's Rule #5 – "All statistics conceal a lie" – is based on the recognition that 1) numbers often fail to tell the complete story, and 2) data can be framed, shaped, and manipulated into fiscal origami to tell the political story that wants to be told. This rule expands on Hamilton's idea by recognizing that the use of facts and data in policy development – as important as that may be – serves a wide variety of belief systems such as the ability of tax cuts to pay for themselves and the everlasting attractiveness and value proposition of Minnesota government spending regardless of the associated tax burden.

The impact of taxes on behavior is inversely proportional to the scale of behavior affected. Considerable political skepticism abounds regarding the idea that tax policy has the ability to attract or repel talent, influence siting decisions, and affect other large scale economic behaviors. But there is near universal belief that there is no individual or household behavior, however small, that won't be encouraged, enhanced, or preserved by a tax deduction, exemption, or exclusion.

If it doesn't offer a political payoff, it ain't going to happen. See federal conformity.

It's too much to ask that textbook ideas of tax and public finance policy will ever supplant the rules for realists. However, we can hope they can regain some traction in a new political environment. In that respect, the November elections can't come soon enough since it's clear the mix of players and personalities we have right now just isn't working. We need to come to a recognition that compromise on almost any issue should be embraced if the result is better than what currently exists. Whether that is even possible in today's hyperpartisan world is a looming question.

Or as stated in Rule #24: Tax policy compromise is a dying art form.

— M.H.

year's pension bill is a run flat tire – it'll keep you going for a while but ultimately you will have to make a change. ■

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