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March – April 2018 Volume XXXIX No. 2

In This Issue:

The Enormity of Conformity

All eyes are on the tax committees and the Governor as the headline issue of the 2018 session heads to its climax.

When the federal Tax Cuts and Jobs Act (TCJA) was signed into law last December, MCFE and others called it a "once in a generation" opportunity for state tax policy. That description reflects an objective assessment of the reality of the situation, rather than a subjective evaluation of the TCJA's merits. Whatever one thinks of the wisdom of the federal reform, major federal tax changes create a rare and unique window of opportunity for states to critically reexamine their revenue systems and pursue reforms to improve their design, function, and performance.

It's a challenge substantively, procedurally, and politically – especially in this year's shortened legislative session. As of this writing two of the three players have offered their tax proposals which include their federal conformity plans. With just a few weeks to go in the 2018 session we take a look at where we stand and how well we are taking advantage of the opportunities being presented.

Rhetoric Flipped on its Head

The politics of this year's tax bill have been influenced by the squabbles of tax debates past. For years Republicans interested in lowering state tax burdens and reducing the growth of government have been bedeviled by two influential forces: the forecast for state spending and revenues based on current law and findings from the Department of Revenue's *Tax Incidence Study*. Each frames state tax and spending debates in a powerful way that make both of those objectives more challenging to accomplish.

The former, the foundation of the state economic forecast, answers the question, "what will the fiscal situation look like if we don't change anything" and therefore captures spending increases due to projected demographics, caseload increases, and some inflationary pressures (despite erroneous suggestions that the forecast ignores inflation). As a result, current law establishes a much higher baseline for evaluating the growth of state government and creates the situation where significant biennial spending increases can be portrayed as spending cuts. The latter is the official word on the fairness of Minnesota's tax system – the sine qua non of state tax policy. Due to the incidence of Minnesota business taxation, the incidence study has remained a Sisyphean rock of reported tax regressivity even though policymakers have created the most progressive individual income tax system in the nation.

Republican lawmakers have been bludgeoned by this issue framing for a very long time. So in this most unusual year for tax policy, the planets realigned. Republicans found themselves suddenly able to use both the future effects of current law and a tax incidence analysis to their own rhetorical advantage for a change, which they did with considerable aggressiveness and relish.

House Republicans were more than pleased to point out that according to the Department of Revenue's own calculations, relative to the projections in the most recent *Incidence Study* for 2019 (which are based on current law) the governor's tax proposals would increase the regressivity of Minnesota's tax system due to the proposed elimination of the provider tax sunset. In response, the administration argued that considering the effect of reimposing an existing tax is an "academic" way to think about the issue. Besides, as DFL committee members pointed out, the regressivity of the provider tax itself is offset by the progressivity of the spending it finances – health services for people at lower income levels. The idea that systematic thinking about tax progressivity should also account for spending and transfers is a valid and important point. Curiously, however, this habitually overlooked point never seems to get acknowledged when the release of the *Incidence Study* elicits debates on tax fairness.

The governor's response to this representation of his proposal was unsurprisingly and unsparingly harsh – even requiring the help of the 7 second delay on a radio interview. Once again collegiality between the governor and legislators in developing a tax bill appears to be in short supply. Regardless, one person's "excrement" will always be someone else's political spin, and both sides have proven to be quite adept at that. What ultimately matters is the substance and the implications of the proposals themselves and the prospects for reconciliation.

The Common Ground – Important (But Expensive) Administrative Conformity

Doing nothing this session on the tax front has been properly recognized as a "non-option" because of the resulting administrative complexities and burdens that would create for both taxpayers and tax administrators. For individual filers non-conformity would

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The Minnesota Center for Fiscal Excellence is a non-partisan, non-profit corporation founded in 1926 to advance economy and efficiency in government.

Fiscal Focus is published bimonthly for $150 per year by the Minnesota Center for Fiscal Excellence, 85 East Seventh Place, Suite 250, St. Paul, Minnesota 55101. ISSN # 1042-847X. UPS #519130. Periodical paid at St. Paul, MN 55101.

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be a hassle, but the really problematic provisions are on the business side – especially any non-conformity with federal depreciation/cost recovery (Section 179 expensing) and accounting rules. A return to full federal conformity to Section 179 expensing is long overdue, especially when conforming to new federal limits on interest deduction. Conformity to the TCJA's expansion of the use of cash-based accounting methods for small businesses is a practical must.

Banking on these revenues is a fiscally questionable exercise.

Passing a conformity bill that resolves those issues is a high priority and Governor Dayton and the House have found common ground by including them in their respective proposals. The problem is the near term price tag. Together these two administrative provisions represent a $187 million reduction in general fund revenues for the current biennium, or nearly half of the $387 million that "auto conformity" to the TCJA and other federal provisions would raise. Like the proverbial pig in the python, the revenue impacts would level out over time (the combined total declines to $155 million for the FY 20-21 biennium) but it nevertheless throws a budgetary monkey wrench into everyone's wishes and expectations. Essentially lawmakers would have only $200 million "available" from auto conformity plus the $329 million surplus from the February forecast to accomplish other tax and supplementary budget objectives. That list includes:

- Reducing taxes / tax rates
- Holding as many taxpayers as harmless as possible through conformity actions
- "Balancing" the distributional benefits of the TCJA at the state level
- Increasing spending on a variety of public goods and services

That's a lot of conflicting ambitions chasing very little money, and the clashes among these priorities remain the source of tension heading into the final days of the 2018 session.

Contrasts in Substance and Purpose

If this brief foray into the state corporate income tax implications of the TCJA has accomplished nothing else, we hope that it has proven beyond a reasonable doubt the truth of our introductory observations: that, "the complexity of the changes embodied in the TCJA raise many technical and challenging issues at the state level, particularly with respect to foreign source income"; that our discussion "may best be viewed as a preliminary effort to identify the issues along with an exploration of some of the controversies they may spawn" ; and that readers should "stay tuned for further developments in this domain."

— "State Corporate Income Tax Consequences of Federal Tax Reform" Special Report, *State Tax Notes*, April 16, 2018

This is the conclusion of Walter Hellerstein – Distinguished Research Professor Emeritus, winner of the National Tax Association's Holland Medal for outstanding lifetime contributions to the study and practice of public finance, and a legend in the study and practice of state tax law – in an 18-page, 128 footnote "overview" of the many legal issues, constitutional questions, and looming controversies embedded in state conformity actions with respect to the federal corporate income tax changes. (Any readers of this special report like us, who are not tax attorneys or tax practitioners, may have come to the conclusion we did: the Minnesota State Board of Investment should immediately figure out a way to establish large private equity stakes in tax law and accounting firms to prop up struggling state pension funds.)

The overarching message is clear: there is extraordinary complexity and uncertainty surrounding the TCJA's implications on state corporate income tax systems and collections, and banking on these revenues is a fiscally questionable exercise – especially with respect to the TCJA's international provisions. Yet this is the foundation on which Governor Dayton's tax conformity plan resides.

The governor seeks to hold most, if not all, individual income tax filers harmless from federal conformity actions, while at the same time revamping state tax policy to provide additional benefits specifically to taxpayers deemed underserved by the TCJA. This includes a new personal and dependent credit exemption (about $233 million/year) on top of preserving the old federal personal exemptions and enhancement of the Working Family Credit ($52 million/year). The governor has also included several notable spending proposals in his supplemental budget such as a special education aid funding increase, expansion of the Voluntary pre-K and School Readiness Plus program and pension aids. The price tag for these actions is prompting the governor to also call for modifying tax relief measures he opposed in last year's tax bill – reinstating the inflator in the state general levy and on the cigarette and moist snuff tax rates, increasing the tax rate on premium cigars back to $3.50 per cigar, and freezing the estate tax exclusion at its current level – along with other revenue enhancers.

Nevertheless, the lead draft horse pulling the governor's tax wagon is state corporate income tax conformity, which is estimated to raise $270 million in the current biennium and $508 million in the out-biennium. But as the Hellerstein analysis illustrates, the possibility exists of this horse pulling up lame. The TCJA is a thicket of legal (can we really tax this stuff) and fiscal (can we really rely on this stuff) risks for state corporate income tax policy. In addition, the state corporate income tax is already the most notoriously volatile revenue source in the state's portfolio. For the governor to build permanent individual income tax relief and spending changes on this foundation seems to conflict with the self-proclaimed number one priority of his last budget – maintaining the fiscal integrity of the state.

The proposal's primary (and perhaps most treasured) asset is its political shrewdness, especially in an election year. It co-opts the Republicans' lower taxes / "hold harmless" platform while striking powerful fairness themes by having the state step in to "correct" some of the distributional impacts of the TCJA.

That has presented a bit of a strategic and public relations challenge for the Republican controlled legislature. Unsurprisingly, the House response also placed a heavy emphasis on protecting as many potential voters as possible from state increases but features two major strategic differences.

First, the House bill features substantially less reliance on taxation of international business income. The House bill captures only about one-third of the deemed repatriation income as the governor's bill does by choosing not to add back the participation exemption. The House also does not conform with either the federal global intangible low-taxed income (GILTI) or foreign derived intangible income (FDII) provisions.

Second, the House places a much stronger emphasis on what might be called "bucket integrity." In contrast to the governor's proposal which uses large amounts of business tax revenues to pay for individual income tax relief, the House features substantially less redistribution and approaches conformity by keeping revenue generated by a particular tax within that tax area. That includes phased-in tax rate reductions (ultimately down to 6.75% for the second tier of the state income tax and 9.06% for the corporate income tax) in response to the broader bases created in both the individual and corporate income tax systems. But as in the governor's proposal, some questions about fiscal sustainability can be raised as some ultimately defined amount of repatriated income is being used to help fund permanent rate cuts.

An Opportunity Missed?

It's been said the difference between tax relief and tax reform is that true tax reform requires someone to be a "loser." Ironically, the strongest point of agreement between the House and Governor Dayton's proposals – minimizing the number of taxpayers whose state individual income taxes increase as a result of Minnesota's response to the TCJA – comes at the expense of reform opportunities that could improve the efficiency and function of Minnesota's income tax system.

One example is the retainment of itemized deductions and other exclusions and subtractions for state income tax filers – a feature of both the governor's and House proposals; although the governor's proposal takes it to the extreme. Not being able to itemize on state returns isn't that unusual – prior to the enactment of the TCJA 12 of the 37 states using federal adjusted gross income as the starting point of individual income returns did not allow itemized deductions.[1] Post TCJA, there are even more reasons why preserving itemization deserves reconsideration and a reexamination of other exclusions and subtractions deserves attention:

- *While the hassle of itemizing remains unchanged, the cost/benefit relationship of itemizing is greatly reduced.* For those who itemize at the state level only, the value of tax savings from itemizing is only a fraction of that realized on federal returns, but the time and recordkeeping demands are the same.
- *Incorporating old federal itemizing rules into state law won't actually provide the tax increase protection people think it will.* This is because, according to legislative staff, the AGI changes under TCJA provisions can cause recalculation of the myriad of phase-outs or various deductions such as the amount of allowable itemized deductions, taxable Social Security benefits. and so forth.
- *Phase-outs of itemized deductions and exemption allowances undermines transparency.* These features in both the House and Governor's proposal effectively create hidden tax rate increases.
- *Other mechanisms exist to address policy purposes while also improving simplicity and fairness of the system.* Much of the taxpayer harm from lost deductions can be offset by repurposing those dollars into beefing up the state standard deduction. Likewise, incentives like charitable contributions can be supported without tying the benefit provided to the level of income earned perhaps through flat percentage credits like those offered by Utah and Wisconsin.

It's also worth noting the cognitive dissonance with other policy objectives and espoused principles that can result. For example, reflexively preserving old federal tax law in the state tax code preserves many itemized deductions that disproportionately benefit higher income households. It's difficult to understand how the governor and progressive advocates can argue in the state's conformity response to fully protect a state subsidy (deductibility) for local property taxes paid on very expensive homes and at the same time express concern about the wealthy not paying their fair share.

For years simplicity, administrative efficiency, reliability, and stability in revenue systems have taken a distant back seat to fairness issues and levels of taxation in Minnesota tax policy debates. What's interesting is that the common ground between Governor Dayton and the House – notably the changes to business depreciation/accounting rules, converting the starting point for income taxation to adjusted gross income, and making features that expire federally permanent in the state – are rooted in those politically useless yet essential principles. If policymakers really do want to take full advantage of the "unique opportunity" federal reform presented, they need to make sure those ideas are front and center in any compromise agreement. ■

The State of the Minnesota Property Tax

New data and reports offer perspective on Minnesota property tax trends and competitiveness.

Local property taxation is accustomed to being in the media spotlight and receiving the lion's share of citizens' attention to tax matters. As lawmakers struggle with responding to federal tax reform, the property tax has taken a bit of a back seat this year. We take a moment to look at several reports released since the beginning of the year that provide a helpful snapshot on the affordability and competitiveness of property taxes in Minnesota along with how the tax is trending.

Homeowner Affordability: Voss Payable 2016

With the usual lack of fanfare accompanying its release and the equally customary media indifference, the Minnesota Department of Revenue's latest "Residential Homestead Property Tax Burden Report" (a.k.a. "Voss Report") continues to be a largely overlooked but indispensable tax policy resource. The Voss Report matches individual homeowners' property tax burdens with their household income to determine how big a claim on income homeowner property taxes really are. To protect taxpayers' privacy, the report summarizes results at the regional level. The report for taxes payable 2016 is now available (data cleaning demands a one-year lag time in results).

As a tax policy topic easily influenced by

[1] Note that two of these twelve states – Utah and Wisconsin – offer tax credits that are tied to itemized deduction elements.

anecdote, emotion, and case examples that are readily projected onto the population at large, the Voss Report is a powerful fact-based reference point and often serves as a needed antidote to property tax rhetoric. It drills down from aggregate tax collections, which can mask a multitude of issues and relationships, to capture what the individual property taxpayer's world actually looks like.

What does the landscape of homeowner property tax affordability look like? Three findings jump out:

Property tax effort relative to income among homeowners in Greater Minnesota is less than their metro-area counterparts. Statewide, net median burdens after property tax refunds ("effective tax rate", or "ETR") as a share of homeowners' income edged up from 2.3% in 2015 to 2.4% in 2016. On a regional basis, the ETR in Greater Minnesota grew from 2.0% to 2.1%; with metro-area homeowner taxes remaining unchanged at 2.6% since 2015. On an absolute basis, the median net homestead tax in Greater Minnesota was $1,284, representing a $68 increase over 2015 while the $2,417 median metro homeowner tax increased $124 over the previous year.

Affordability changes appear remarkably uniform across the state. Looking more closely at each of the 20 state regions comprising the report, there is remarkable uniformity in the changes in homestead burden as a share of homestead income. In 12 regions, the effective tax rate increased 0.1%, in 7 regions it remained the same and in one region (Northwest/Headwaters) the effective tax rate declined by 0.1%.

Even with the recent uptick, property taxes still consume less homeowner income than ten years ago. As the accompanying table shows, with the exception of the Arrowhead, taxes relative to income have fallen in every region of the state since 2007 (the first year of the Voss report). For all the ongoing concern about inadequate state support for local governments, property taxes are still routinely eating up around 10%-20% less of median homeowner incomes compared to a decade ago.

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The biggest takeaway from Voss 2018 is the continued extraordinary success of the state's income tested property tax refund ("circuit-breaker") program. As the findings show, it remains a simple, effective and powerful influence in keeping property taxes affordable regardless of where taxpayers live.

As informative as these findings are, results over large geographic regions can still mask important trends occurring at the local level. One wish we have to make the report more useful is that Revenue would provide county level and perhaps city level median and quartile results, which would provide useful benchmarking information for truth in taxation hearings and offer some new perspective on the impact of general purpose aid distribution.

Comparative Burdens and Competitive Position: 2018 50 State Property Tax Comparison Study

More information on property tax competitiveness and affordability comes from the 2018 edition (for 2017 taxes payable) of our *50-State Property Tax Comparison Study* – a joint effort with the Lincoln Institute of Land Policy – which has just been published and is available via our home page. For the uninitiated, the report examines property taxes on homestead, commercial, industrial and apartment properties with specific values located in the largest city in each state (i.e. "urban cities"), in a comparable rural city in each state, and in the largest 50 cities in the country. States and localities often treat different

Change in Net Median Homeowner Property Taxes' Share of Income, by Region, 2007-2016

Region	Median Net Homeowner Property Tax As Share of Household Income		Percentage Point Change 2007-2016
	Payable 2007	Payable 2016	
Arrowhead	1.8%	1.9%	0.1
Central	2.8%	2.3%	(0.5)
East Central	2.9%	2.4%	(0.5)
Minnesota Valley	2.2%	1.8%	(0.4)
North Central	2.1%	1.9%	(0.2)
Northwest/Headwaters	2.1%	1.8%	(0.3)
South Central	2.2%	2.0%	(0.2)
Southeast	2.4%	2.2%	(0.2)
Southwest	1.7%	1.5%	(0.2)
West Central	2.0%	2.0%	0
Greater Minnesota	**2.3%**	**2.1%**	**(0.2)**
Anoka	2.9%	2.4%	(0.5)
Carver/Scott	3.3%	2.7%	(0.6)
Dakota	3.0%	2.5%	(0.5)
Minneapolis	3.6%	2.9%	(0.7)
North Hennepin	3.4%	2.7%	(0.7)
Saint Paul	3.1%	2.6%	(0.5)
Southeast Hennepin	3.3%	2.8%	(0.5)
Southwest Hennepin	3.3%	2.8%	(0.5)
Suburban Ramsey	3.2%	2.7%	(0.5)
Washington	2.9%	2.6%	(0.3)
Seven-County Metro	**3.2%**	**2.6%**	**(0.6)**
Statewide	**2.8%**	**2.4%**	**(0.4)**

2007 and 2016 *Voss Report*, MN Department of Revenue
Note: Median net property taxes equal taxes minus any property tax refund.
Note: 2007 figures rounded to tenths of a percent to match the data presented in the 2016 report

Selected 50 State Property Tax Comparison Study Results, Payable 2017

Property Type	Market Value of Real Property	Ranking (Change From 2016)		Effective Tax Rate		Tax Burden Above/(Below) National Average	
		Urban	Rural	Urban	Rural	Urban	Rural
Home	Median (ETR)*	23 (-1)	22 (-1)	1.35%	1.25%	(9.6%)	(6.6%)
Commercial	$1,000,000	8 (+1)	2 (--)	2.85%	3.31%	+38.8%	+89.1%
Industrial (50% real)#	$1,000,000	17 (+1)	6 (+1)	1.79%	1.99%	+19.5%	+56.4%
Industrial (40% real)^	$1,000,000	23 (+2)	11 (+1)	1.43%	1.59%	+5.1%	+35.2%
Apartment	$600,000	22 (—)	26 (-5)	1.69%	1.66%	(8.1%)	+2.3%

* Median value for Minneapolis was $235,200, per Census Bureau's *American Community Survey*
* Median value for Glencoe was $124,100, per Census Bureau's *American Community Survey*
# Where 50% of the total $2 million parcel value is land and buildings (real property)
^ Where 40% of the total $2.5 million parcel value is land and buildings (real property)

types of property differently: with variations in tax rates, exemptions, or assessment ratios, for example. Our study controls for these and other effects to compare effective tax rates – taxes relative to property values – to provide the most meaningful comparison of property taxes between these cities.

The predominant theme of the Voss Report – the continued relative affordability of homeowner property taxes in Minnesota– is also reflected in the latest "50 state" findings. The 1.35% effective tax rate on the median-valued Minneapolis home is once again below the average for all urban cities – for the 11th time in the last 14 years. These results should not be surprising given the combined effects of Minnesota's property tax classification scheme, the homestead value exclusion, and the state's relatively strong education finance responsibilities compared to other states. It's important to recognize that Minnesota's income tested property tax refund program is not included in these results. Given our relative generosity compared to refund programs existing in other states, our homeowner property tax rankings would likely be even lower.

Comparatively high burdens on commercial – and to a lesser extent, industrial – property continue to be the case. Commercial property tax burdens have been higher for years across Minnesota – both in our urban rankings, where Minneapolis' eighth-place ranking for a $1 million-valued commercial property represents the seventh top ten finish in a row – and in our rural rankings, where Glencoe's $1 million commercial property ranks second for the sixth consecutive year. (To understand why choosing different Minnesota cities for national comparison purposes would not make a meaningful difference in these results, see "Why City Choices Don't Impact Minnesota Rankings" (accompanying sidebar, page 6).

The state's rankings for industrial properties fare somewhat better, because these types of properties with their higher levels of personal property (mainly machinery and equipment, inventories, and fixtures/office furniture) benefit much more from Minnesota's blanket exemption of personal property than commercial properties do. However, as more states enact exemptions for personal property, Minnesota's competitive status with respect to business property taxation is increasingly a function of levy amounts rather than structural features.

Looking at the findings through the lens of regional competitiveness conveys a perspective that is slightly less disadvantageous because upper Midwest states are collectively home to some of the highest commercial property tax burdens in the nation. Our rural rankings remain persistently high; however, the new $100,000 exclusion from the state general tax combined with the reduction in the levy will likely make a noticeable impact in next year's rural rankings for the $150,000 commercial and industrial parcels – which are more prevalent in rural Minnesota than $1 million or $25 million parcels.

Property Taxes on $1 Million Commercial Parcel, Payable 2017, Upper Midwest States

Urban Cities			
Locations	Total Tax	Rank (of 53)	Tax vs Regional Average
Minneapolis, MN	**$34,208**	**8**	**2%**
Chicago, IL	45,405	4	35%
Aurora, IL	41,180	6	22%
Des Moines, IA	35,968	7	7%
Detroit, MI	50,914	1	51%
Fargo, ND	11,500	49	(66%)
Sioux Falls, SD	17,428	35	(48%)
Milwaukee, WI	33,014	13	(2%)
Upper Midwest Avg.	**$33,702**	—	—

Rural Cities			
Locations	Total Tax	Rank (of 50)	Tax vs Regional Average
Glencoe, MN	$39,720	2	47%
Galena, IL	24,560	21	(9%)
Hampton, IA	29,702	8	10%
Manistique, MI	35,174	4	30%
Devils Lake, ND	12,794	39	(53%)
Vermillion, SD	19,322	28	(29%)
Rice Lake, WI	28,218	9	4%
Upper Midwest Avg.	**$27,070**	—	—

Note: Since the city of Chicago's property tax system is structurally different from the rest of the state, the 50 state study includes two urban rankings for Illinois.

Why City Choices Don't Significantly Impact Minnesota's 50-State Property Tax Study Rankings

Our use of Minneapolis and Glencoe to represent "urban" and rural" categories in the study often raises the question: would choosing different Minnesota cities for national comparison purposes would make a meaningful difference in the state's rankings? If local levies were the only force driving the relative size of tax bills and resulting rankings that would be the case. But they're not.

Property tax systems' structural features have major influences on tax rankings. Such features include both technical issues like classification schemes and assessment practices and broader topics related to the fiscal system, such as the existence of any state levies, the relationship between state and local governments, and access (or lack thereof) to revenues outside of the property tax to support local government. Importantly, these structural influences are not city-dependent but impact the property tax bills of every similar type of property across a state.

The purpose of the 50 State Study has always been to understand how state property tax system design affects property tax burdens. Our property tax study captures these influences, and the rankings reflect those influences.

To illustrate the considerable influence of state structural features, consider our rural commercial rankings. Our selection process for rural cities narrows the field considerably to improve comparability. Generally, we use cities that fall in one of two categories in the U.S. Department of Agriculture's rural-urban continuum, which classifies cities based on size and geographic location. All of our rural cities are county seats with populations between 2,500 and 10,000 to ensure as much as possible a set of cities that provide similar public services (especially in the public safety and public works areas) and to eliminate regional centers. Whenever possible, the cities are located in counties located outside of metropolitan areas, with the exceptions being where such counties do not exist – largely in northeastern states (think "rural Rhode Island").

Using this typology, 25 Minnesota cities could qualify for inclusion as a "rural" representative of our property tax comparison study. In conjunction with our payable 2016 report, we calculated the taxes for the $1 million commercial property for each of these 25 cities. Our report incorporates assessment error using sales ratio data from the Minnesota Department of Revenue, however, that data did not exist for commercial properties in several of these cities given the small number of sales that occurred. When we – conservatively – substituted the median sales ratio for the cities we did have data for, then in 16 of these 25 cities the $1 million commercial property would have ranked in the top 5 nationally. In 22 of the 25 cities the property would have ranked in the top seven. If, instead, we assumed a sales ratio of 100% (the standard procedure for our report), then 21 of the 25 rural cities would have been in the top 5. Such findings indicate that all cities share in the influence of the structural design of the Minnesota property tax system and that influence has the predominant effect on state rankings.

Whether the resulting burden shifting onto higher value properties appreciably exacerbates the tax burden differential for these owners remains to be seen.

Looking Forward: The 2018 Levy Story

Perusing the Department of Revenue's certified levies for 2018 brings us to the present and throws light on a couple of interesting developments. For starters, property tax levies grew appreciably faster in larger cities and counties than in their smaller counterparts. This is reflected in the notable difference between mean and median levy changes. Although the average property tax increase for cities was 6.2%, the median change was just about half that, or 3.2%. Likewise, the average property tax change for counties was 4.1%, but the median change was only 3.6%. Digging more deeply, property taxes in cities with more than 5,000 people grew by 5.5% (excluding the anomalous 24% growth in St. Paul's levy as a result of the shift away from Right of Way financing) – which is roughly 40% higher than the 4.0% growth in cities under 5,000. The moral of the story here is that large increases in the levies for 2018 are typically not being found in small town, rural Minnesota.

Another striking finding involves school property taxes. Although the levy increase on a statewide basis was rather robust 6.6%, this average masks an incredible diversity of school property tax levy changes across Minnesota. As the accompanying graph shows, at the extremes 33 districts saw their levies drop by 10% or more (including several in the 30% to 50% range!) while 30 districts had levy increases of at least 21%, including 7 districts where the levy increase exceeded 40%. Moreover, for all the hue and cry about property tax levels, it's interesting to note that $82 million of the $179 million in higher school taxes were market value levies – and therefore likely to be voter approved.

The Response – House Property Tax Division Report

With legislative bandwidth and available resources largely dedicated to protecting taxpayers from any TCJA-related effects at the state level and providing an additional dollop of tax relief on top of that, it shouldn't be surprising that property tax and local government finance is more or less a budgetary afterthought this year. The House's Property Tax Division report features $11.5 million in net cost savings and revenue gains for the current biennium out of $3.65 billion in forecasted spending. Most of that stems from a couple of items: the repeal of the political contribution fund and what has become a fairly predictable poke at the city of Minneapolis, this time in the repeal of its library aid.

Many of the House's property tax policy elements are of the familiar, mundane nature including TIF and local sales tax provisions and a couple of highly targeted exemptions/abatements with only very modest, if any, redistributional consequences. However, the division report does include welcome first steps in moving forward on the recommendations of the excellent 2012 Property Tax Working Group report. The House property tax provisions propose to consolidate all residential property into a single property tax classification, which would eliminate 7 statutory classes of property.

From The Director: Constitutional Dedication vs. Competition

Mark Haveman

A transportation finance hearing offers a lesson on how government is supposed to work.

"Competition" is often regarded as a rather uncomfortable word when used in the context of government. If its mention doesn't immediately conjure up the idea of privatization and all the political tension and objections that accompanies it, the word at least feels out of place with the abstract nouns usually associated with government such as equity, fairness, and justice.

But competition is the *de facto* foundation of the state general fund, where limited tax dollars must be allocated on the basis of merit and need. 99.5% of the time, general fund competition is largely hidden from view. Instead, as the "veto everything" movement demonstrated last session, diverse spending interests can normally be counted on to bond together to oppose tax relief and retain more tax dollars to support various causes.

Every once in a while, however, the glue holding spending interests together cracks. Such was the case in a recent Senate Transportation and Finance Policy Committee hearing on SF 3837, which proposes a constitutional amendment to allocate sales tax revenues from motor vehicle repair and replacement parts exclusively to fund roads. (Lawmakers actually have already dedicated the sales tax revenues from motor vehicle replacement parts to road and bridge construction in statute. SF 3837 would take that one step further by hanging a constitutional "do not disturb" sign next to the revenue streams.)

As with any bill in which a few hundred million of general fund revenue hangs in the balance, the committee hearing did not lack for testifiers. Business, public sector union, and local government representatives with a direct stake in transportation infrastructure spending expressed enthusiastic support for the bill. But other business, public union, and local government representatives strongly opposed it arguing school funding, senior care, environmental protection, local government aid – among many other things – are no less important. None of this was particularly surprising but it was strange (and admittedly a little entertaining) to see some public unions on the opposite side of other public unions, and some local government representatives opposing other local government representatives.

Indeed, comments from a couple committee members seemed to indicate that the fractures among historical allies were more disturbing to them than the substance of the bill itself.

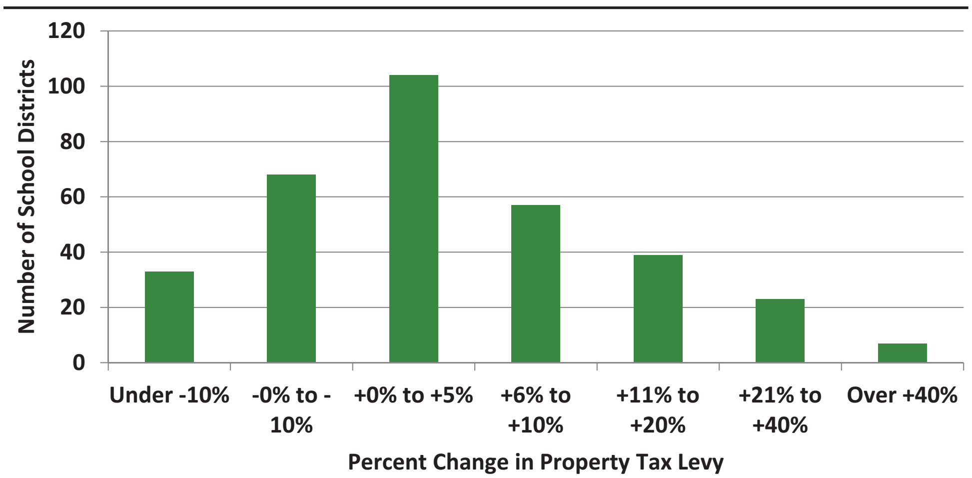
There are many reasons why dedicated funding is problematic public policy and dedication through the constitution even more so. The under recognized, unappreciated, but perhaps most important one is this: competition for limited resources is the only thing that can be reliably counted on in government to drive the pursuit of greater efficiency, productivity, and innovation in the delivery of public goods and services.

It's especially true in the context of the increasingly challenging budget dynamics the next few decades seem certain to deliver. It's also why the 1995 Brandl/Weber *Agenda for Reform* argued, "In the future competition must be viewed not as a problem but as one of our most powerful tools." "Competition" may not sound much like equity, fairness, or justice. But it will be much more difficult to deliver on those ideals if we let the innovation that competition breeds slip through our fingers.

— M.H.

According to House Research, the redistributional consequences of this administrative clean-up are negligible. In some cases (mainly blind/and disabled homestead ownership) where burdens might rise from classification consolidation, the bill adjusts refund mechanisms accordingly to offset any increases. The bill also modifies several property tax deadline and due date modifications also per the recommendations of the Working Group report. Whether these changes move through the process will be an interesting test case of the appetite the state has for embarking on beneficial property tax administrative reforms.

Change in School District Levies, Payable 2017 to Payable 2018



And looming in the background is Governor Dayton's stated interest in reinstating the inflator on the state general levy. Whether this is negotiation fodder or a "go to the mat" element of the Governor's proposal remains to be seen. Either way it adds another dimension of potential intrigue and suggests that even though federal conformity is consuming most of the oxygen, when all is said and done Minnesota's property tax system will still have its moment in the sun.

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