In This Issue:

- The Wayfair Decision – “Do They Have Just What They Need?”
- Minnesota’s Unfinished Business
- Reframing the Tax and Budget Debate
- Five Questions: The Candidates on Taxes
- Thanks Joel and Steve!

HIGHLIGHTS OF MCFE’S 92ND ANNUAL MEETING AND POLICY FORUM

The Wayfair Decision – “Do They Have Just What They Need?”

Our distinguished panel of national experts examined the Supreme Court’s Wayfair ruling, its implications, and what it means for large business, small business, marketplace providers, and state and local governments.

After decades of waiting less than patiently, Godot finally arrived in black robes. With the Supreme Court’s landmark 5-4 decision in Wayfair v. South Dakota, the physical presence standard for collecting sales taxes was struck down. This moment, long-anticipated by both governments and many businesses, has opened the front door to state taxation of remote sales and e-commerce.

The Wayfair company jingle is “You’ve got just what I need.” So did the Court’s Wayfair decision deliver what businesses and governments need with respect to policy, compliance and implementation matters surrounding the taxation of e-commerce? To find out, our annual meeting brought together individuals who have been on the frontline of this issue for many years. Moderated by former MCFE president Sue Haffield, our panelists included Doug Lindholm, President and Executive Director, Council on State Taxation; Harley Duncan, Managing Director, KPMG, Washington D.C.; Craig Johnson, Executive Director, Streamlined Sales Tax Governing Board, Inc.; and William Lasher, Senior Director, Indirect Taxes, eBay, Inc.

Minnesota’s Unfinished Business

Our annual meeting panel of Minnesota capitol veterans took a closer look at the tax issues and debates likely to generate headlines in the 2019 session.

The implications of Minnesota’s failure to enact a federal conformity bill in the 2018 legislative session – already being experienced by the Department of Revenue – will be more fully appreciated when the 2019 tax filing season commences, putting a major unresolved issue right back in the spotlight. Add in taxation of e-commerce, the scheduled elimination of the provider tax, state budget deliberations, and – perhaps above all – new players in the negotiations and all the ingredients exist for a tax policy year to remember.

Our panel of capitol veterans and state tax experts examined the policy issues and political dynamics that are likely to frame tax debates during the 2019 legislative session. Moderated by long-time capitol veteran and MCFE board member Rich Forschler, our panelists included Jenny Starr, Minnesota Department of Revenue; Joel Michael, Minnesota House Research; Ann Lenczewski, former chair, House Tax Committee; and Jim Girard, former legislator and commissioner, Minnesota Department of Revenue.

Wayfair and Minnesota

Because of the Supreme Court decision on Wayfair, two laws regarding e-commerce went into effect in Minnesota on October 1. The first is Minnesota’s economic nexus law for sales and use tax which dates back to 1989 and has been lying dormant for nearly 30 years. The second and much more recent addition is Minnesota’s “first in the nation” marketplace provider law passed in 2017. Building on the previous panel’s discussion, panelists began by looking at these issues from a Minnesota perspective.
everyone has expressed. Wayfair successfully leveled the playing field for large brick and mortar retailers who saw profit margins eroding because of the sales tax disparity. At the same time, burdens do exist with respect to remote sales tax collection even among larger businesses because “any sales tax person will tell you that technology is not the sole answer to the myriad burdens of collecting.”

But perhaps the biggest takeaway for big business, he noted, is the window of opportunity that now exists to address an underappreciated source of U.S. competitive disadvantage – the inefficiency and complexity of our system of consumption taxes. By any measure, the United States has the most complex and burdensome sub-national consumption tax system in the world. U.S. business labors under the complexities and burdens created because 46 states and countless localities impose disparate tax systems – unlike the more efficient consumption tax systems found in other countries. This, he argued “is not just a U.S. issue; it’s a global issue.” As more and more economies look to consumption taxes to raise revenue, it’s becoming more and more imperative to increase uniformity and efficiency and reduce compliance burdens. States might reap some extra revenues as a result of the decision itself, but the biggest economic benefits would come from redoubling efforts towards collaborating with other states on a uniform system.

In offering a small business perspective, Harley Duncan first observed that the perception of what constitutes “small” is in fact very small. He noted that South Dakota’s de minimus threshold of 200 transactions would represent only one-tenth of 1% of households in that relatively small state. As a result, the ruling effectively casts a very broad net and will bring in a lot of quite small companies doing modest business in the state. The biggest challenge for these small businesses, he argued, will be tracing and sourcing sales and rates to local jurisdictions. He continued, noting that his firm has estimated that a business that now has economic nexus everywhere will need to file, on average, 100 sales tax returns per month with various government entities. That’s both difficult and expensive and also raises issues of whether they will be able to scale up to submit many more returns without a serious investment in technology. He suggested those realities “could deserve some accommodation.”

Representing the states’ perspective, Craig Johnson declared the Wayfair decision not just a “huge, huge victory” for states but also a major validation for the Streamlined Sales Tax (SST) initiative. States want e-commerce businesses to succeed but also want a level playing field. He noted that collection authority, given the Court’s ruling, demands simplification, ease of administration, and access to all the information and tools necessary to comply. SST was created specifically to accomplish those objectives and in fact was recognized in the Court’s ruling for its efforts to prevent triggering undue burden. “It’s a big win for member states” he said, but he was unsure what it means for non-member states.

From a marketplace provider perspective, William Lasher argued the Wayfair decision itself had little direct impact. He noted the ruling was silent on the marketplace provider issue; rather, it’s been the growing numbers of state marketplace provider rules driving their actions. Nevertheless, as a self-described “sales tax guy at a place that doesn’t sell anything” Lasher emphasized the symbiotic relationship that exists between eBay as a provider and its sellers, which includes helping their sellers in navigating this new world. The curveball is that under these state marketplace provider laws, “our nexus not their nexus” is in play. He also noted the Wayfair decision did not have any effect on their talking points with respect to federal action, arguing there is a continuing need for federal action on simplification.

Unanswered Questions / Unresolved Issues

Around the country more than 30 states have come out with guidance on enforcement dates, and in Minnesota, enforcement of the state’s e-commerce and marketplace provider laws just began on October 1. As states prepare for the implementation and enforcement of these laws what are some of the practical (and perhaps unexpected) issues and challenges they are dealing with?

Craig Johnson argued states have generally done a very good job in being thoughtful and deliberate on implementing their e-commerce provisions. Most delayed implementation for several months following the Court’s decision recognizing it will take some time for businesses to prepare to comply and work through issues. States are not pursuing retroactive collections even though many had legislation on the books prior to the Wayfair ruling. He noted it’s important to recognize that tax administrators have to enforce the law on their books, and if it becomes evident that some businesses aren’t or can’t be ready to comply for whatever reason it’s incumbent on legislatures to do something different. The biggest challenge facing states, he continued, is getting the compliance information to the right people – particularly those selling into the state from around the country. Towards that end, SST is striving to be a “one stop shopping site” for this information.

Yet, Johnson continued, more work needs to be done. A notable implementation issue concerns the lack of uniformity with the basis for the threshold among states – e.g. gross sales vs. taxable sales vs. retail sales. There may be additional definitional and interpretive matters within that determination. Occasional sales add a wrinkle for which guidance is necessary. Finally, substantial nexus threshold determinations – especially deviations from the Supreme Court “blessed” 200 transactions/$100k sales threshold and the related potential for triggering undue burden – will be a critical decision for states in the post Wayfair world.

Doug Lindholm responded that there are a lot of potential challenges given the complexity of remote state sales tax collection. States may claim they now have complete collection authority but if they have incredibly complex systems, “they will be challenged.” If policymakers in a state focus on simplifying their own sales tax system independently, they are missing an important point. Instead, he argued, simplifying the entire subnational system of sales taxation through a uniform approach is the critical issue. It’s the disparity in systems across states
and localities that needs to be addressed to greenlight collection authority. With respect to the question of what sales should be included to meet the threshold, Lindholm argued forcefully for the establishment of one rule – perhaps developed by SST or NCSEL. He noted it would be much simpler for taxpayers to track just one definition, and it doesn’t really matter what that definition is as long as it’s consistent everywhere. An additional benefit: it would be much easier for a larger state to allow a scalable threshold dollar figure for determining when a taxpayer must collect in its jurisdiction.

As a “big fan” of SST he concluded there is now an important window of opportunity to push states toward uniformity to offset the potential for successful litigation regarding undue burden. “State courts do not have an appreciation of the complexity of this issue,” he said. In response to a question about where the first challenges might come from, Lindholm replied it will likely be the result from states acting parochially on these issues and failing to act in a coordinated manner instead of pursuing a true national simplification effort.

Role for Congress?

In dissenting, four justices believed Congress should solve the problem, and four bills that would address this issue have been introduced at the federal level. Is there a further role for Congress and what’s the prognosis for these bills? Harley Duncan described the bills saying they have all been around “forever” and reflect one of two approaches. The first approach seeks to establish or codify some set of national standards which would need to be met to exercise collection authority over remote sellers. The other approach seeks to turn back the clock, set a very high bar for collections, and generally make remote sales taxation much more difficult. Duncan expressed considerable skepticism that anything will pass. For years, even with the support and influence of major retailers, business organizations, and states, nothing was passed. Now that these organizations have finally “won” in court, it’s difficult to envision them now asking Congress to act and constrain states. Combined with the fact that it’s much easier to kill something in Congress than pass it, there appears to be no dynamic for passage of any legislation. One thing that could change the situation, he added, is if states move in such diverse paths that stronger cumulative and undue burden cases can be made. However, the message being conveyed to legislators is that states are handling this judiciously, thoughtfully, and carefully.

Lindholm agreed saying, “the political dynamic has completely flipped.” Opponents of e-commerce taxation are now arguing for legislation to save small businesses. But with brick and mortar retailers and states lined up against it, it’s very difficult to see congressional action getting real traction. However, this still begs the question of how can we get one set of rules to truly simplify the system. Lindholm said he would much rather see states come together voluntarily than force the issue through federal legislation because you never know what you would get from Congress and the interests at work behind it. Craig Johnson agreed, saying SST is keeping a careful eye out for potential “rogue” states recognizing the danger they could pose to two decades of work.

The Marketplace Provider Twist

Minnesota was the first of 11 states to enact a marketplace provider law, which adds an interesting twist in which individual sellers would have the nexus but marketplace providers would collect the tax. What are the practical challenges of implementing these laws?

William Lasher highlighted several challenges marketplace provider laws present that have special relevance for a platform like eBay that is exclusively a marketplace with no retailing activity:

- Some products are not UPC code based (anything and everything gets sold) and therefore not mapped to some tax code which creates challenges in determining their taxability.
- Occasional sellers are common on their platform, and while many states have exemptions for occasional sellers eBay (and other marketplace providers) have no way of knowing what a seller does off the platform.
- “Proving the negative” – the need to establish proof that a seller is not registered because they fall under threshold limitations.
- States defining marketplace provider roles differently. Some states simply added marketplace providers to the definition of “retailer” which brings the issues of discounts, coupons, and bad debts into play. Are these issues now the marketplace provider’s or the seller’s? Who is responsible for tax remittance and who is responsible for adjustments to the tax after the fact?

He reiterated state notice and reporting rules in some state marketplace laws are more concerning and impactful than the Wayfair fallout. Under notice and reporting rules, platforms would be responsible for sending buyers a list of things bought. The list would also be sent to the tax authority and buyers would have to sort it out. “Not a great buying experience,” remarked Lasher.

With respect to liability of errors on audits, if platforms rely on sellers’ representations, then the marketplace provider can’t be responsible for any errors since it has never seen the item being sold. Harley Duncan noted that many smaller sellers have expressed concern about platform tax remittance, questioning how available the documentation that platforms have remitted tax on their behalf would be if the state audits them. The same concern applies to platforms if they rely on some subset of sellers to remit their own tax and are “next in line” for producing the required tax revenues. Lindholm noted when there is some inherent uncertainty between what the seller is selling and what the tax person is supposed to be remitting — a common occurrence on marketplace platforms – there is a tendency to over collect to limit the consequences of an error. However, there is a plaintiffs’ bar looking for class action opportunities like this. 1% of incorrect transactions on $10 billion of sales will present an irresistible opportunity for them.

Craig Johnson commented that in the contracts SST has with Certified Service Providers (CSP), the CSP is liable to the state for taxes in all cases where they process a seller’s transactions. However, he noted that in service contracts between the CSP and the seller, the CSP may push some of that liability back onto the seller, so a careful review of the contract is in order. With respect to audits, SST has found the biggest issues occur in mapping in which a seller puts its sales into product categories and the state certifies those categories. However, states
don’t currently know what each seller has put into those categories. SST is currently working with CSPs to fine tune this process. Ultimately the goal is to eliminate needs for states to audit sellers that have CSPs.

Still More Questions

What about inbound (foreign origin) sales? Harley Duncan said he knows of nothing in treaties, federal law or Wayfair that says that sales taxes would not apply. The two issues that arise are whether any undue burden argument might exist for foreign sellers and – more significantly – enforcement. Lindholm echoed the enforcement concerns, especially with regards to non-tangible products, and maintained the issue has yet to be addressed in an effective way.

Does Wayfair have longer term impacts for state income and property tax regimes? Lindholm thought Wayfair will affect income tax compliance, because it removes the only Supreme Court reference to physical presence regarding nexus generally. With many taxpayers still not filing in jurisdictions where they only have some sort of economic presence and the Supreme Court’s silence on an income tax nexus standard, Lindholm opined that states are bound to be more aggressive in this area.

Last but not least, what is the Streamlined Sales Tax initiative’s future? Lindholm said thanks to the Court’s majority opinion, new life has been breathed into Streamlined and states which have been reluctant to join may now see a reason to join to avoid future litigation. Duncan disagreed, believing Streamlined will continue to be what it is – highly limited in its ability to pull in more states because from all current appearances, you don’t need to be in Streamlined to have collection authority. He argued there is still a valuable role for SST in registration systems, CSPs, audit systems and definitions, but that will not be enough to incent other states to sign up. Johnson was optimistic about SST’s future, noting marketing and communication efforts to non-member states are in high gear. However, any moves to join SST will have to be driven by the business community and remote sellers in non-member states. Lasher argued the fact that SST is an 18-year project still only featuring 50% adoption answers the question. He said it needs to be expanded and improved and the way to do that is through federal legislation driving action.

In the end, we note that – like Waiting for Godot – the outcome of the Wayfair case is challenging to interpret straightforwardly. Has the landscape of e-commerce been settled? Or not? Based on the perspectives of our panelists, sales taxation of e-commerce may now be the law of the land but the uncertainties continue as we now wait to see what the repercussions might be.

Minnesota’s Unfinished Business

(Continued from P.1)

Jenny Starr began by providing an informational overview of the status of Revenue’s administrative, compliance, and enforcement initiatives regarding e-commerce. She summarized the details of the two newly-effective laws noting Minnesota’s small seller threshold is different from South Dakota’s (either 100 or more retail sales shipped into Minnesota or 10 or more retail sales shipped into Minnesota totaling at least $100,000 during a period of 12 consecutive months). With respect to the marketplace provider law, she noted Minnesota has not adopted a notice and reporting requirement.

Revenue, unsurprisingly, has been exceptionally busy in preparing for the implementation of these laws and has created a wide variety of tools and resources to educate businesses and enable them to comply. This has included webinars for remote sellers with no historical relationship with the state, webinars for in-state firms, and frequently asked questions and answers on the Department’s website, which are continually expanded as issues come up. Revenue’s website is getting “a lot of action” to access tools such as Minnesota rates and boundaries tables spreadsheet. The agency is currently beta testing a map application for a sales tax rate look up tool which it plans to release in November.

Starr concluded by noting Minnesota is well positioned for this moment having been a member of SST from the beginning and because the legislature has worked to keep the state in compliance for over 13 years. That latter task, she added, is no small feat and is a credit to the hard work of tax committee members and Revenue employees. As a result, Minnesota is one of only 11 states that the Tax Foundation has identified as “green to go” in implementing Wayfair.

Given all this, are there still some issues surrounding Wayfair that may need attention and that the legislature may want or need to address in 2019? Ann Lenczewski said she definitely thinks issues will come up as taxpayers work through these new realities. She expected interest in an amnesty program, especially for marketplace providers who want to comply but are having a difficult time doing it. Small business threshold rules are likely to get some additional scrutiny because she believed the Legislature hasn’t really heard yet from the small business community. It’s important to understand, she continued, that legislators probably haven’t fully digested the implications of Minnesota’s marketplace provider law for two reasons. First, it was co-authored by both tax chairs but was not a big feature of the tax bill discussion in 2017. Moreover, it had a “someday in the future” implementation dynamic that also reduced legislative attention and scrutiny. She believed these provisions will get more attention as people come forward with their experiences.

Jim Girard agreed there likely will be a call for some type of reexamination, although we don’t know exactly what the concerns will be yet. One area he has heard perhaps needing some additional attention and clarity revolves around local option sales tax matters. He reiterated that preparing for this moment has been a bipartisan effort in Minnesota for over 20 years.

Joel Michael noted that Minnesota’s marketplace provider law was passed in a totally different “pre-Wayfair” context. He suggested there needs to be a conversation about how to make it work well in this new environment. As the law stands now, there is the potential for multiple entities to be deemed sellers who would each have collection obligations, so it’s important to clarify this in a way that works best for everybody – sellers, the Department of Revenue, and marketplace providers. Although Revenue is aware
of and working to resolve matters like this, it may be necessary to tweak the statutory language for transparency and clarity purposes.

“If At First You Don’t Succeed…”

Federal conformity retreated from the public consciousness following the 2018 tax bill veto, but will be back on the stage in the 2019 session. Especially with elections looming, predicting what will happen regarding this issue is at best risky and at worst a waste of time. But the administrative, policy and political dynamics underlying the debate are worth considering.

Jenny Starr began with an informational update on Revenue’s preparations for the 2019 tax filing season. She provided an overview of the process and timeline the Department uses to update its filing system – from synthesizing law changes immediately following session’s conclusion through tax form and instruction updates, processing system testing, and software vendor certification all the way to the opening of the filing season. Normally the Department updates 80 forms (and 100 more in the special taxes division), but this year required the special development of a number of new schedules and worksheets. To the enormous credit of the dedicated Department staff, all deadlines were successfully met. In addition, the Department has invested in a wide variety of educational resources to deal with conformity-related issues. This includes publishing a list of over 50 “frequently asked questions” and participating in numerous educational sessions, listening sessions, and continuing legal education programs. The result – “we will have the filing system in January, it will work, and it’s going to be successful.”

How are taxpayers going to react to the 2019 filing season? Jim Girard said “it depends on who you are.” In his view, filers who use software will probably not experience a particularly noticeable difference. Taxpayers who use an accountant are likely to notice bigger bills as two different tax systems have to be reconciled. Those who do their own taxes are in for a rude awakening and their frustration and confusion will likely be compounded by the likelihood that tax preparers’ time will be in short supply as the additional complexity will limit their ability to take on new clients. He noted it is abundantly clear that it’s too late to address 2018 returns. Any conformity effort will be prospective for tax year 2019.

Ann Lenczewski predicted lots of frustration and confusion for the business community and an “expensive hassle,” noting existing disconnects in Minnesota business returns are only going to get worse. On the individual side, the Department’s recent ruling allowing inconsistent election of deductions will likely help many Minnesotans who otherwise would be looking at a state income tax increase. However, she speculated that many suburban, upper middle-class Minnesotans are positioned to experience big tax increases because of SALT deduction caps. As a result, the bipartisan group of legislators representing these taxpayers are most likely to get the discussion moving.

Joel Michael called the prospects of an early conformity bill “miniscule” for several reasons. Early conformity bills in the past have focused on federal extenders, but this is a very different situation. Moreover, the “ship for tax year 18 has sailed”, yielding no advantage for an early bill. And perhaps most significantly, lawmakers are protective of every bit of leverage that can be used during end of session negotiations.

Are there one or two conformity issues that absolutely must be addressed? From an administrative perspective, Jenny Starr flagged the massive complexity in depreciation and Section 179 expensing. Joel Michael and Ann Lenczewski concurred, saying business provisions with multi tax year effects need to be at the top of the priority list – like cost recovery/bonus depreciation, like kind exchanges, and net operating losses. Those things are “a nightmare if we are not in alignment. Jim Girard agreed but added that the whole foreign earnings issue is not going away and the legislature will have to address it somehow.

Will the dynamics behind last year’s ill-fated conformity effort – specifically the reluctance to reexamine various tax preferences eliminated in the TCJA – likely be repeated this coming year? Jim Girard remarked that he believed a lot of opportunities were missed last year to simplify filing and address some needed administrative clean-up issues while “blaming it on the feds.” However, he continued, anytime you simplify the system some shifting of burden is guaranteed to take place and the Legislature has a long history of requiring that any burden shifts be paid for. He suspects that’s unlikely to change in 2019.

Joel Michael expressed hope that this prediction is wrong and that the 2019 legislature “will look at federal changes with a more discerning eye” this time around when deciding how to tackle conformity. He noted the governor always sets the tone of the debate and suspected the political aura surrounding the TCJA’s passage likely had a major impact on Governor Dayton’s proposal to reflexively preserve all the preferences and deductions being eliminated at the federal level in the state’s tax code. The irony, he noted, is that a progressive Democrat would be expected to support some of the TCJA’s changes, like limiting the mortgage-interest deduction and the property tax deduction. Noting his personal policy bias is toward promoting greater simplicity and

From The Director:
Thanks Joel and Steve!

Mark Haveman

When first learning about the impending retirements of Joel Michael and Steve Hinze from House Research, I can pretty much guarantee everyone’s instinctive reaction was something along the lines of “Now what are we going to do?” You knew the day was coming sometime but you really didn’t want to think about it.

That day is upon us and together Joel and Steve represent 84 years (42 years each!) of dedicated service not just to the Minnesota House of Representatives but to everyone who participates in the legislative process – citizens, lobbyists, and certainly organizations like the MCFE. Their insights, understanding, work products, and advice have been invaluable to our work over the years for which we cannot thank them enough.

On behalf of all our members and readers, we say thank you, we will miss you, and may your retirement years be happy, healthy, fulfilling — and filled with weekends in May with absolutely nothing to do.

— M.H.
ease of administration, he said three things animate debates – politics, personality, and policy. The personalities will change, the intensity of the politics have faded a bit over time, and so he hopes this creates an opportunity for the conformity policies to be more carefully and thoughtfully vetted in 2019.

Other Matters?

With respect to tax administration, Jenny Starr said the Department’s technical bill may include some cleanup efforts with respect to the state’s economic nexus and marketplace provider laws. On an internal note, she commented that the additional work triggered by non-conformity created significant opportunity costs for the Department in other administrative matters. For example, the Department was committed to speeding up the publication of Revenue Notices but attorney staff had to be diverted to other work. Similarly, both individual and corporate audits have slowed because auditors were moved to teams working on forms and instructions.

In the legislature, Ann Lenczewski flagged the provider tax, which is scheduled to phase out completely after 2019, as being a guaranteed topic of discussion. Dedication of auto repair taxes and rural homeowner property tax relief are two other areas she anticipated will get attention. One process issue she suggested keeping an eye on is the creation of the new Legislative Budget Office, which will now be engaged in the same type of fiscal note creation as Minnesota Management and Budget raising the prospects of “dueling numbers” on which to construct policy.

Jim Girard said the likelihood of retaining some type of divided government is high and what happens with the provider tax – worth about $700 million in revenue – will have a major impact on all other tax debates in the 2019 session. At the same time, from what he has observed, there has been curiously little discussion of the nuts and bolts of tax policy in campaign races. People may start talking about tax issues once they start filing, but right now issues like health care and education are dominating local debates.

Joel Michael agreed that the campaigns have offered little insight into what might be coming from them regarding tax issues. He did note that a budget surplus in November is practically guaranteed and a tax cut will be on the agenda. With respect to the provider tax, he reflected on the fact that like most states Minnesota’s tax system doesn’t grow as fast as the economy grows for many reasons, most of which have to do with our tax bases. However, the provider tax is one tax that has been growing and its elimination will change the responsiveness of our overall tax system. He continued, noting that the health care sector generally escapes a lot of taxation that other business sectors do not. Most hospitals are non-profit and therefore exempt from property taxes and business entity taxes. Health care services taxed under the provider tax are exempt from the higher rate sales tax. Employer paid health care benefits are not subject to income tax. When one buys health insurance under a plan other than an indemnity insurer you pay half the rate of the insurance premium tax, and if you are covered by an employer’s self-insured plan there’s no tax at all. (We also note all prescription and over-the-counter drugs, medical devices and their replacement parts, and prescription eyeglasses / contact lenses are exempt from the sales tax – ed.) As a result, a large and growing sector of the state’s economy is paying a relatively low percentage of state and local taxes – while at the same time much of our spending is driven by health care costs. That puts us in what he described as a “budget vice” which is an underlying subtext to the debate nobody is likely paying attention to.

Having sold our crystal ball on eBay a few years back, we have few predictions of our own to add to our panelists’. What clearly runs through their comments, though, are some important realities about the intersection of politics and policy. Deadlines force choices. Constituent complaints are an effective way to grab legislators’ attention. And the changing nature of the tax landscape will force everyone to think long and hard about how to best position Minnesota for continued success.

Reframing the Tax and Budget Debate

Annual meeting luncheon speaker and author of Dead Men Ruling, Dr. Eugene Steuerle, argues that presenting an opportunity cost perspective on government budgets is not just a way to make budget debates more productive, it’s also essential to allow citizens to regain control over their fiscal destiny.

From being one of principal architects of the 1986 tax reform while at the U.S. Treasury, to his presidency of the National Tax Association, to his leadership and service on countless boards and policy advisory committees it is difficult to identify an area of tax and fiscal policy where our annual meeting luncheon speaker, Dr. Eugene Steuerle, has not left his fingerprints. In his luncheon address highlighting the fiscal challenges future spending commitments have created for all governments, the Richard B. Fisher Chair at the Urban Institute, Institute Fellow, and Co-founder of Urban Brooking Tax Policy Center argued the way we frame and present these issues can make a difference.

Steuerle began by noting we’ve gone so far down the road in establishing agendas for the future that voters have no flexibility unless they renege on promises made to them. It’s not a function of austerity; we are richer than we ever have been. But austerity is being confused with inflexibility and lost opportunity. The consequences are real and stark including growing deficits, lack of flexibility during economic downturns, and lack of physical and social investment in children. No less important, it becomes exceptionally difficult for legislators to innovate. At the same time fiscal democracy has been eroded – citizens can no longer vote on what to do with their tax dollars.

This condition is relatively new; for most of our nation’s history, spending was highly discretionary and government reported surpluses well into future. While most everyone is aware of the federal debt, most legislators and citizens do not appreciate how much flexibility to allocate resources based on current priorities and needs has been taken away from them.

The nature and sources of the problem are well-recognized – Medicare, Medicaid, Social Security, tax subsidies, pension subsidies, and interest on the debt. By 2035, he noted, it is estimated that one-third of the adult population will be retired for one-third of their adult lives. A typical couple with an average wage of about $50,000 retiring in 2015 is being promised about $1 million in Medicare and Social Security benefits. For millennials retiring 35 years later, the number is about $2 million in senior-related promises – leading to cuts in education supports and other areas of government needed to increase productivity, growth, and mobility to pay for these obligations. The result is a budget for a declining economy.
How do we start to turn this ship? Steuerle argued it begins with presenting budgets in a way that better communicates the story that is unfolding by documenting the changes in revenues and spending over time on a real, rather than a nominal, basis. He demonstrated the applicability of this approach by applying the methodology to the most recent federal budget debate, which showed that 150% of the increase in revenues was functionally committed before Congress did anything. Such an approach, he argued, makes clear “what is getting squeezed today.” He noted such an analysis is a bit more complicated at the state level because states do not have a classification of “mandatory spending” like the CBO does at the federal level. However, the Urban Institute is currently developing a taxonomy to facilitate this type of analysis at the state level. In summary, it’s a way to bring to bring budgetary trade-offs to light while holding legislators accountable for the total changes that are taking place, not just changes that are being proposed.

With an expected sizable state budget surplus forthcoming, these issues might seem less applicable to us. But buried in the numbers in the forecast from the last biennial budget session, the 28% health and human services piece of the general fund budget was projected to consume nearly 60% of all the new revenue available to the state. In addition, while we know what we do contribute to pension plans, a recalculated budget analysis based on what we are supposed to pay for these commitments would likely tell an interesting story. An “opportunity cost” perspective on the state budget is no less relevant for Minnesota. It piques our own interest and we look forward to working with these ideas in anticipation of the 2019 legislative session.

Five Questions: The Candidates on Taxes

We posed five questions to the gubernatorial candidates on some tax matters outside of the usual “how much” debate that tends to dominate the discussion. With thanks to each candidate for providing their thoughts and perspectives, here are their unedited responses.

“Minnesota’s Department of Revenue has a history of being well-run, and within the limits of any government institution, being policy-driven rather than politically-driven. My biggest concern is that our tax policies have become political tools of an ideologically driven administration.

Ideally tax policy should be about collecting sufficient revenue to fund the budget, with the minimum economic distortion possible. When the government picks winners and losers through the tax code, incomes and economic growth are driven down, harming everyone. It will never be possible to drive politics out of tax policy, but to the greatest extent possible government shouldn’t be impeding economic growth.”

“Tax conformity should be seen as a technical issue, not an opportunity for political machinations. This approach doesn’t rule out discussions of the policy implications of tax code changes, which can take place in the larger context of budget negotiations. But tax conformity provides a necessary foundation for providing as predictable a tax code as possible.”

“After some challenging times for the state budget following the recession, the state now enjoys budget stability and a sizable rainy day fund. I will work to protect the stability of the state budget and making sure any changes to tax policy are sustainable. Minnesota is known for our good government, but our state could do a better job of giving folks a better idea how their taxes are being used. You shouldn’t need a PhD in mathematics to understand budgets and we can better prepare local government, schools, business, and families plan for their futures.”

“Support a standalone conformity process. We need to get this right and ensure that political games do not prevent us from addressing this. We need a tax system that upholds our values and policy goals. Through a standalone process we can focus on administration and simplification.”

ONE: Considering the current state of Minnesota tax policy, what do you believe Minnesota does well and what are your biggest concerns?

TWO: Last year, federal tax conformity became wrapped up in a larger supplemental budget debate. In 2019, lawmakers will face the same choice as last year – pursue a standalone, revenue-neutral conformity plan focusing on tax administration and simplification needs or make conformity proposals (and any revenue implications) part of a bigger biennial budget and tax distribution debate. Which approach do you prefer and why?
“Running any large organization requires a rare combination of skills: managerial, political, and of course experience in tax policy. To these I would add another requirement: real world experience in the consequences of tax policy. Without prejudging the outcome of a rigorous candidate search, I am inclined to prefer people with business experience. Tax policy is not a purely academic enterprise; policies create trade-offs in the real world. We need a Revenue Commissioner who views things not just from the perspective of government, but also the private sector.”

“Property tax reform is one of the most complicated and politically fraught areas of tax policy. Major revisions take place once a generation, as the result of extensive negotiation and compromise. Given the current governor’s hostility to business, it’s a good thing that major property tax reform hasn’t happened recently. I strongly endorse the goal of a simpler and more transparent property tax system that enhances competitiveness and intend to restart the conversation on property tax reform.”

“Over the years, we have seen that state government pull back on its investments in schools, roads, and local communities. Specifically, we have seen LGA funding go down near $30.5 million since fiscal year 2003. That shifted the burden from the state government to local government and counties to cut local services or raise local levies and taxes.

My Community Prosperity Plan will restore Local Government Aid. And my plan proposes Community Prosperity Grants, which allows communities to unleash economic prosperity by providing public goods and services, from funding local child-care programs, to boosting local infrastructure, to training local high skilled workers, to developing local amenities such as parks or trails.”

It’s hard to pick just one, so I won’t. Instead I will rank them in terms of need for remediation. Minnesota’s tax code has no problem at all with revenue adequacy—in fact, I believe the state collects too much in taxes. Similarly, I believe that our current tax code’s preference for equity undermines neutrality and competitiveness, while adding to the complexity of the system.

“Minnesota has historically been competitive because of our world-class workforce, our history of innovation supported by college/schools that outrank most other states, and because we’ve tried to make sure that folks have the tools they need to get ahead. But we can do more, because too many folks are being left behind. In my administration, I will focus on equity and fairness in creating a budget with structural balance.”

**THREE:** History shows different governors emphasize different qualities in selecting Revenue commissioners. Some prioritize content expertise, some executive management experience and skills, some political and advocacy experience. What would you look for and prioritize in choosing a Revenue commissioner?

“I would look for someone with a broad vision, who is able to see how a tax break or burden impacts different people, communities, and businesses across the state. We can make smart investments in our future, and ensure that everyone is contributing in a fair and equitable way, and are receiving the services they need. Expertise and leadership are key.”

**FOUR:** Minnesota has a justified reputation for having the most complicated property tax system in the nation. Recommendations like those from the bipartisan 2012 Property Tax Working Group to make Minnesota’s property tax, “more transparent, understandable, simple, efficient, predictable, accountable, and competitive” have gone nowhere. What would be your focus for improving the state’s property tax system specifically and the state/local finance relationship generally?

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**FIVE:** Which principle of sound tax policy – equity/fairness, neutrality, revenue adequacy, ease of compliance and administration, simplicity/transparency, or competitiveness – currently requires the most remedial attention in the Minnesota tax system? Why?

“Minnesota has historically been competitive because of our world-class workforce, our history of innovation supported by college/schools that outrank most other states, and because we’ve tried to make sure that folks have the tools they need to get ahead. But we can do more, because too many folks are being left behind. In my administration, I will focus on equity and fairness in creating a budget with structural balance.”