



To: Greg Davids
Chair, House Tax Committee

From: Mark Haveman
Executive Director, Minnesota Center for Fiscal Excellence

Re: MCFE Testimony on HF 848

Date: April 21, 2015

Dear Chair Davids:

Thank you for the opportunity to offer testimony on HF 848, the omnibus tax bill.

Over the past several years, progressivity has dominated tax policy discussion. For 89 years our organization has argued there are other important principles that should inform our tax system including competitiveness, administrative efficiency, transparency, stability, horizontal equity, and minimal economic distortion.

My testimony focuses on several provisions in the omnibus tax bill that advance or detract from these other, and no less important, concepts underlying good tax policy.

Regarding Article 1:

- The proposed modifications to domicile testing are an important and positive step toward providing greater clarity and predictability on this issue. As an organization with significant membership representation among tax accountants, attorneys and financial planners, it has been made abundantly clear to us that including the location of professional service providers as a residency factor is having a material and detrimental effect on the competitiveness of Minnesota's professional services sector.
- We do have concerns about the phased out exemption of Social Security income. We believe federal conformity already addresses the biggest potential concerns with taxing this income. There is no theory under which age alone should exempt a person from taxation, and the proposed exemption introduces potentially significant horizontal equity problems.

Regarding Article 2:

- We have major concerns about the reverse referenda provisions. This would create significant budgeting and planning problems for local governments and likely trigger creative financing methods that run contrary to principles of good government financial practice. More

fundamentally, a primary purpose of electing local officials is to match citizens' expectations of government with their willingness to pay for those expectations. While we appreciate the pressure put on legislators to assist in keeping property tax growth under control, we believe there is little to be gained, and potential for great damage, by embarking on this path.

Regarding Article 3:

- We believe the phase out of the State General Tax merits serious consideration. While the competitiveness implications for commercial and industrial property tax payers are real and important, we believe the primary motivation for this should be to allow local governments to have a revenue source that they can truly claim as their own. For this reason, the bipartisan 2012 Property Tax Reform Working Group also recommended a phase out of this tax. We would also add that when a revenue source holds as much public resentment as the property tax does, it becomes even more imperative for the state to remove its presence from the tax base.

Regarding Article 8:

- We have serious concerns about removing auto parts from the state sales tax base and dedicating the revenues to transportation funding. We believe any benefits are more than offset by considerable problems with respect to both tax administration and precedent. We have serious reservations about using the tax system as a de facto appropriations mechanism. More fundamentally, the precedent this provision creates is extremely troublesome. Its passage would likely lead to an avalanche of special interest attempts to dedicate other sales tax streams to their preferred causes. We believe this is a window that needs to stay closed.

Regarding Article 9:

- Our organization has long argued that providing general purpose aids to local governments is only a second best strategy to ensure all Minnesotans have access to essential services at affordable tax prices. We also believe that the provision of LGA tends to foster local cost structures that citizens cannot otherwise support or will be unwilling to support when inevitable recessions or competing budgetary pressures result in aid cuts. Nevertheless, it is essential that any aid that is provided accounts for both need as well as revenue raising capacity. There is overwhelming evidence that larger cities frequently have a more challenging and costly environment to deliver equivalent levels of local services. After decades of searching for the "perfect" formula, we believe the current formula developed with considerable expertise and on a bipartisan basis is likely as good a formula as we can have. We encourage you to let the formula do its work.

Regarding Article 10:

- We strongly support the proposed \$132.5 million transfer to the budget reserve account. It is crucial to recognize that our attempt to create a balanced "three legged stool" has resulted in a rocking chair tax system prone to greater volatility. According to MMB, the individual income tax has become more volatile over time, but depending more heavily on the incomes of the top 2% exacerbates this volatility trend. It is essential to follow the guidance of MMB and continue to make progress toward the budget reserve amount they recommend.

- We also recommend including federal taxes paid by Minnesota residents in the tax incidence study. Although we appreciate and recognize the policy value of a study that focuses exclusively only on Minnesota taxes, the study is now rarely used for anything other than as a data point in simple arguments over tax fairness. If that is going to be the study's sole purpose and use in tax policy development, it makes sense to us to include federal taxation to obtain a greater sense of the actual burdens felt by Minnesota households.

Thank you again for the opportunity to offer testimony