

## Tax Incidence Analysis

Prepared by the Tax Research Division, Minnesota Department of Revenue

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### Governor's 2018 Tax Proposals Tax Bill (H.F.4385/S.F.3982) and MinnesotaCare Tax Extension

The Governor's 2018 Budget proposes the following tax law changes:

#### Governor's Tax Bill

- **Income Tax -- Personal**
  - Start tax calculations with Federal Adjusted Gross Income rather than Federal Taxable Income. Minnesota will maintain the standard deduction, itemized deductions, and personal and dependent exemptions from prior law. Those claiming the increased federal standard deduction will now be able to claim Minnesota's itemized deductions.
  - Increase Working Family Credit the rates and thresholds, increase the credit for those with three or more children, and other changes.
  - Create a new \$60 credit for each person on the return. The nonrefundable credit will phase out at higher incomes.
  - Maintain the itemized deduction for mortgage insurance premiums and the deduction for higher education tuition and fees.
- **Estate Tax:** Maintain the exclusion at \$2.4 million rather than allowing it to rise to \$3 million.
- **Sales Tax:** Limit the existing sales tax exemptions for data centers.
- **Cigarette and Tobacco Taxes:** Restore indexing of the cigarette tax rate for inflation and the prior-law tax rates on premium cigars.
- **Property Taxes:** Restore indexing of the state property tax levy for inflation.
- **Taxes on Business (Corporate and Non-corporate):**
  - Conform to most federal tax changes in the definition of the income. Fully conform to Section 179 expensing.
  - Five Minnesota-specific provisions that expand the corporate tax base.

#### MinnesotaCare Tax Extension Bill

- Repeal the sunset of the MinnesotaCare provider taxes, permanently maintaining the tax at its current 2% rate beyond December 31, 2019.

These tax law changes would modify the burden of state and local taxes compared to what it would be under current law. The budget's impact can be estimated using the database and underlying models developed for the *Minnesota Tax Incidence Study*. **Because the latest study projects income and taxes to calendar year 2019, this analysis generally estimates the impact of law changes in that calendar year.** That study's baseline projections of tax burdens to 2019 are reduced by \$280 million to account for the state and local tax cuts enacted in 2017. It is also adjusted to include the state impact of federal law changes that were included in the February forecast, which increased the resident tax burden by an estimated \$96 million.

The analysis is limited to **permanent** changes in tax law. **Law changes that are phased in over several years (such as the estate tax) or have a delayed effective date are modeled as if fully effective in 2019.** Because the MinnesotaCare provider taxes were in effect in calendar year 2019, they were included in the *Tax Incidence Study's* 2019 baseline tax burdens. To provide clarity, this analysis refers to “current 2019 law with MinnesotaCare provider taxes” and “current 2019 law without MinnesotaCare provider taxes.”

### ***Impact of Proposals on Minnesota State & Local Tax Burdens on Minnesota Residents***

**GOVERNOR’S TAX BILL:** The mix of tax cuts and tax increases in the Governor’s Tax Bill increases the net tax burden on Minnesota residents by **\$91.5 million**.

- **Income Tax Changes (nonbusiness):** Proposed changes in income tax provisions would reduce tax revenue by \$324.3 million, reducing the tax burden on Minnesota residents by **\$318.5 million**.

The new nonrefundable \$60 credit for each taxpayer and dependent reduces resident tax liability by **\$233.1 million**. The expansion of the Working Family Credit reduces resident tax by an additional **\$49.7 million**. Deductions for mortgage insurance and higher education tuition and fees reduce resident tax by **\$7.6** and **\$2.3 million** respectively.

The increase in the federal standard deduction reduces the number of taxpayers who will itemize deductions. Under current Minnesota law, those who claim the standard deduction on their federal return cannot itemize deductions on their Minnesota return. The automatic state tax impact of the federal law change was included in the February forecast (raising state revenue). The Governor’s bill will undo this tax increase, reducing Minnesota tax by **\$25.7 million**.

The impact of each of these provisions is modeled using the House Income Tax Simulation (HITS) Model for tax year 2019.

- **Income Tax Changes on Non-Corporate Businesses** (sole proprietors, S-corps, and partnerships): Conforming to most of the changes to the federal tax base will raise taxes on non-corporate business income by \$176.8 million, and **\$161.9 million** will be borne by Minnesota residents.
- **Corporate Tax Changes:** The burden of the estimated \$231.1 million increase in corporate tax is modeled using the corporate tax incidence model. After full adjustment, some of the burden would be borne in higher prices, some in lower wages, and some in lower returns to business owners. Tax burdens for Minnesota residents would rise by an estimated **\$166.4 million** (about 72% of added revenue). The remainder would be borne by nonresidents or the federal government (in lower federal corporate tax revenue). These estimates apply to the long-term burden, after businesses have fully adjusted to the change in tax burdens.

- **Property Tax Changes:** State property taxes on business property and seasonal recreational property will rise by \$21.9 million. The net impact on Minnesota residents is estimated to be **\$11.2 million**. In addition, homeowner property tax refunds will increase, reducing resident tax burdens by **\$1.1 million**.
- **Sales and Excise Tax Changes:** Sales taxes on business purchases will rise by \$37.9 million, increasing the tax burden on Minnesota residents by **\$35.5 million**. Cigarette and tobacco taxes will rise by \$9.6 million, with **\$9.3 million** falling on Minnesota residents.
- **Estate Tax Changes:** Taxes on estates will rise by \$27.1 million, increasing the tax burden on Minnesota estates by **\$25.6 million**.

### **GOVERNOR’S MINNESOTACARE TAX EXTENSION BILL:**

- The full-year impact of the 2% provider taxes in calendar year 2019 is forecast to be \$692.1 million, of which **\$634.5 million** is borne by Minnesota residents.
- Because this tax is still in effect in 2019, the impact of the increase can be shown only by removing the tax from 2019 tax burdens. Even though the repeal of the sunset extends an existing 2019 tax, the baseline 2019 tax is shown as “Current Law Tax without MinnesotaCare Tax.”

### ***Law Changes Not Included in this Analysis***

- **Temporary changes** to the Angel Investment Credit and conformity to several small federal changes.
- **Timing changes** to the Historic Preservation Credit and in Minnesota’s response to federal changes in bonus depreciation.
- **A small change** to the gross premiums tax (less than \$0.5 million).

### ***Results by Population Decile: Change in Minnesota State and Local Tax Burdens***

**Table 1** shows the effective tax rates in 2019 for each of three tax systems:

**A: Current Law without MnCare Tax.** The 2019 tax burdens published in the Tax Incidence Study are adjusted for (1) law changes enacted in 2017 (which reduced the total burden by \$184 million) and (2) the impact of the impending sunset of the MinnesotaCare provider taxes. These adjustments make the overall tax system less regressive, the Suits Index rising from what was shown in the Tax Incidence Study (at -0.0245) to -0.0154.

**B: Current Law with MnCare Tax.**

**C: Current Law with MnCare Tax and the Tax Bill.**

**Chart 1.**  
**Impact of Governor's Proposed Tax Changes in 2018 Budget Bills**

2019 Population Decile	Income Range	Percent of All Households	Human Services Bill Alone			Tax Bill Alone			Both Bills Together		
			Minnesota State and Local Tax Burden as Percent of Income								
			(A) Current Law without Mncare Tax	(B) Current Law with Mncare Tax	(B - A) Change	(B) Current Law with Mncare Tax	(C) Tax Bill Plus Current Law with Mncare Tax	(C - B) Change	(A) Current Law without Mncare Tax	(C) Tax Bill Plus Current Law with Mncare Tax	C-A Change
1	13,418 & under	10%	25.0%	25.8%	0.85%	25.8%	25.6%	-0.26%	25.0%	25.6%	0.59%
2	13,419 to 21,894	10%	11.9%	12.4%	0.57%	12.4%	12.2%	-0.21%	11.9%	12.2%	0.36%
3	21,895 to 31,391	10%	10.8%	11.3%	0.48%	11.3%	11.2%	-0.08%	10.8%	11.2%	0.40%
4	31,392 to 41,344	10%	10.7%	11.2%	0.43%	11.2%	11.0%	-0.16%	10.7%	11.0%	0.27%
5	41,345 to 55,093	10%	11.4%	11.7%	0.39%	11.7%	11.6%	-0.14%	11.4%	11.6%	0.25%
6	55,094 to 70,943	10%	11.7%	12.0%	0.34%	12.0%	12.0%	-0.07%	11.7%	12.0%	0.27%
7	70,944 to 92,150	10%	11.8%	12.2%	0.33%	12.2%	12.1%	-0.04%	11.8%	12.1%	0.29%
8	92,151 to 121,494	10%	11.7%	12.0%	0.32%	12.0%	12.0%	-0.02%	11.7%	12.0%	0.30%
9	121,495 to 174,624	10%	11.7%	11.9%	0.27%	11.9%	11.9%	0.00%	11.7%	11.9%	0.28%
10	174,625 & over	10%	11.1%	11.2%	0.11%	11.2%	11.4%	0.16%	11.1%	11.4%	0.27%
All Households		100%	11.5%	11.7%	0.25%	11.7%	11.8%	0.04%	11.5%	11.8%	0.28%

*Detail for the 10th Decile*

Lower Half	174,625 to 250,362	5%	11.2%	11.4%	0.21%	11.4%	11.4%	0.05%	11.2%	11.4%	0.26%
Next 4%	250,363 to 598,214	4%	10.9%	11.0%	0.12%	11.0%	11.2%	0.15%	10.9%	11.2%	0.27%
Top 1%	598,215 & over	1%	11.3%	11.3%	0.03%	11.3%	11.6%	0.25%	11.3%	11.6%	0.28%
Full Decile	174,625 & over	10%	11.1%	11.4%	0.11%	11.4%	11.6%	0.16%	11.1%	11.4%	0.27%

	Tax Incidence Study	(A)	(B)	(B - A)	(B)	(C)	(C - B)	(A)	(C)	(C - A)
Total Tax Burden (\$millions)	\$30,172	\$29,353	\$29,988	\$635	\$29,988	\$30,079	\$92	\$29,353	\$30,079	\$726
Suits Index	-0.0245	-0.0158	-0.0220	-0.3245	-0.0220	-0.0160	2.0377*	-0.0158	-0.0160	-0.0267

\*Generally Suits Indexes are between -1.0000 (most regressive) to +1.0000 (most progressive). However, the Suits Index for changes in tax can sometimes lie outside that range if taxes increase for high income households and decrease for low-income households (as in this case), or visa versa. The Suits Index of +2.0377 in this case reflects the increased tax burden in the 10th decile and decreased burden in the lower deciles. The tax change is highly progressive.

**The Governor's MinnesotaCare Tax Extension Bill** changes the tax burden from A to B. The tax burden rises by **\$635 million**, with increases in all deciles. The effective tax rates rise by more in the lower deciles and less in the higher deciles. All deciles except the top decile see the effective tax rates rising by more than the average for all households (0.25%). The Suits Index for the provider tax increase is -0.325 (quite regressive). It makes the tax system more regressive, raising the tax system Suits Index from -0.0158 to -0.0223.

**The Governor's Tax Bill** changes the burden from B to C. The bill increases the overall tax burden by **\$92 million**, raising the effective tax rate for all households combined by 0.04%. The changes by decile are much larger. The effective tax rate rises by 0.16% in the top decile. It falls for all other deciles, with reductions of 0.10% or more in 4 of the bottom 5 deciles. The bill is highly progressive, with a Suits Index of +2.0377.\* It raises the tax system Suits Index from -0.0223 to -0.0160.

**The Governor's bills combined** would result in a tax system that has an overall effective tax rate that is 0.04% higher than B (current 2019 law with the MinnesotaCare tax), but the resulting tax system would be just slightly more regressive than A (current 2019 law in the *absence* of the MinnesotaCare tax). The progressivity of the Tax Bill offsets almost all of the regressivity of the extended MinnesotaCare provider tax.

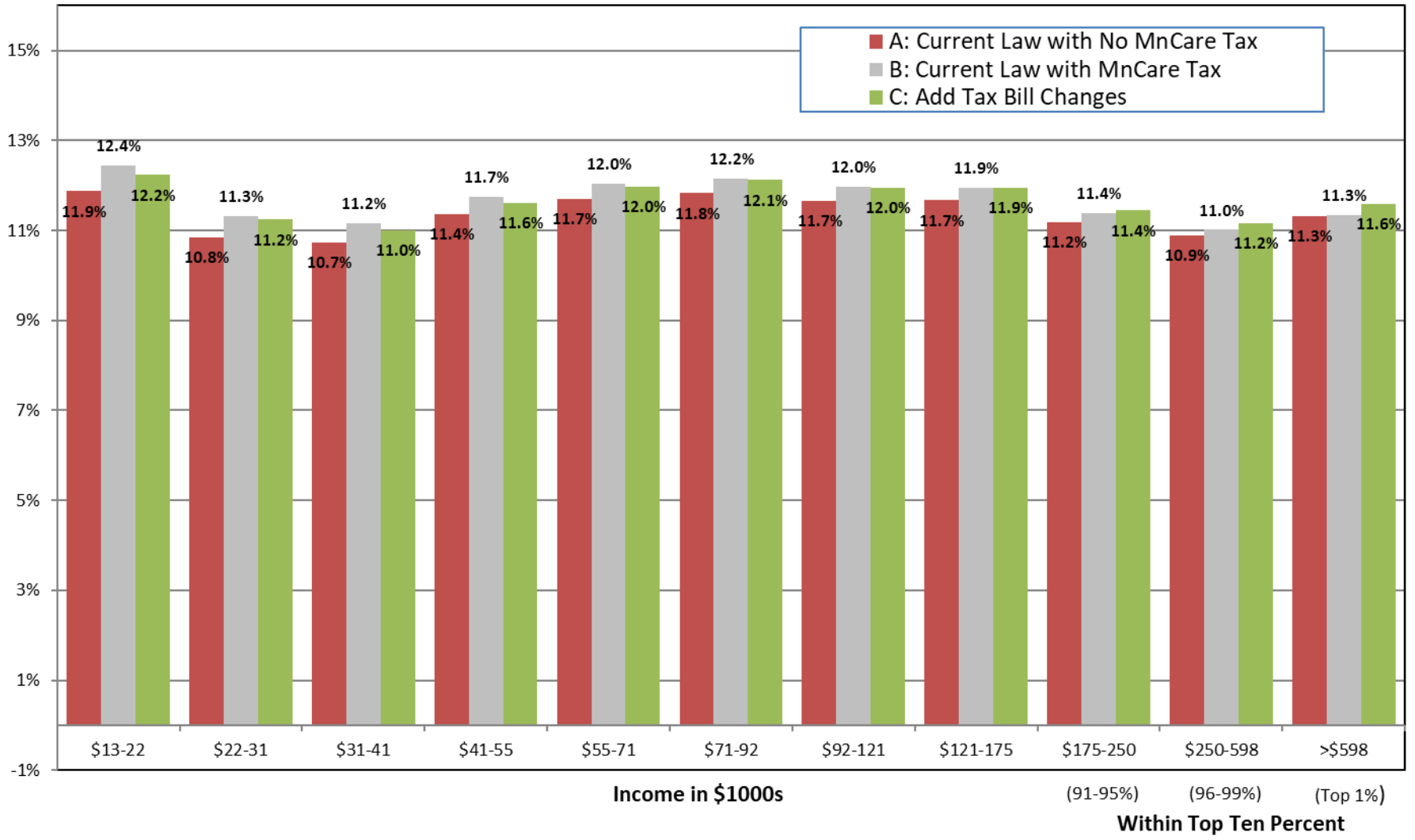
Compared to the 2019 law in effect at the time the *Tax Incidence Study* was completed, the overall effective tax rate would fall from 11.82% to 11.78% and the tax system Suits Index would rise from -0.0245 to -0.0158.

**Chart 1** shows the effective tax rates for deciles 2 through 10 under tax systems A, B, and C. The Governor's MinnesotaCare Tax Extension Bill is reflected by the difference between the heights of the first and second bars. The Governor's Tax Bill's impact is the difference between the second and third bar.

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\* See note at the bottom of Table 1.

**Chart 1.**  
**Tax Provisions in Governor's 2018 Budget Bills**  
**Effective Tax Rates in 2019 by Decile Compared to Current Law**



**Table 2** and **Chart 2** show the tax changes by tax type. **Table 3** provides more detail of the overall impact of proposals, in the same manner as shown on Table 3-1 in the *Tax Incidence Study for all current-law taxes*. (See page 44 of that report.)

**Table 2.**  
**Change in Minnesota State and Local Tax Burden by Tax Type**  
**Impact of Tax Proposals in Governor's 2018 Budget Bills**

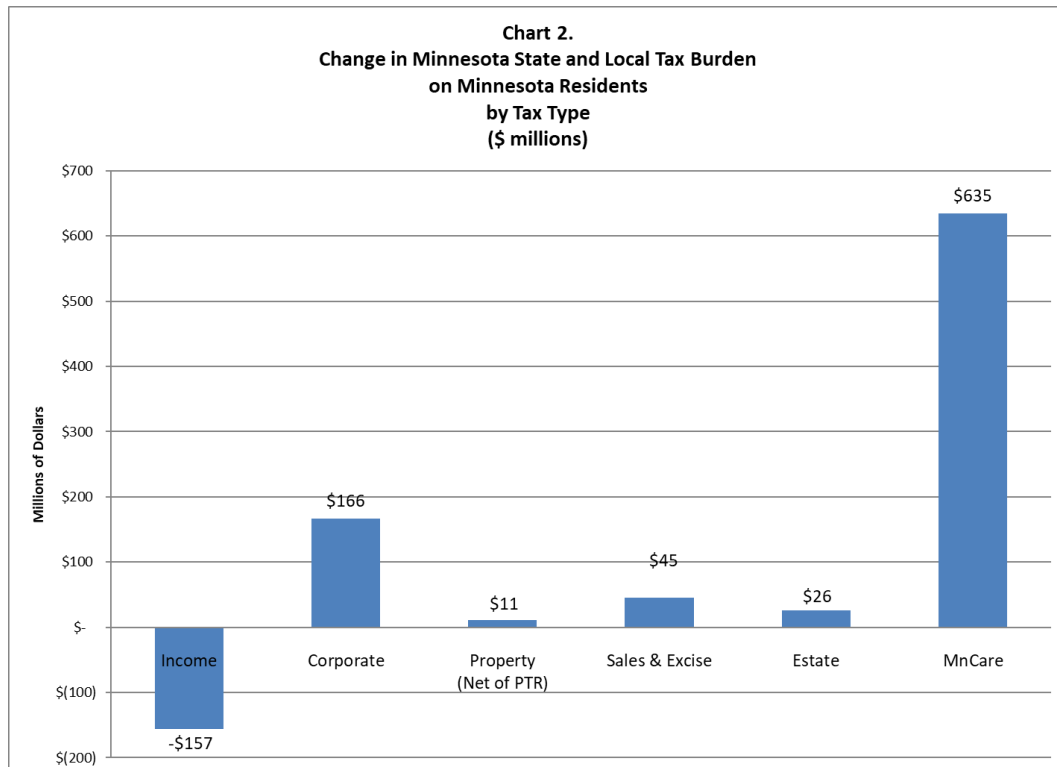
Estimated Calendar Year 2019 Impact, by Tax Type

Dollars in \$1000s

2019 Population Decile	Income Range	Percent of All Households	Percent of All Income	Change in Tax Burden							Percent of Total Change in Tax Burden
				Income Tax	Corporate Tax	Property Tax Net of PTR	Sales and Excise Taxes	Estate Tax	MnCare Provider Taxes	Total	
1	\$13,418 & under	10%	0.9%	(\$12,753)	\$4,414	\$263	\$2,104	\$261	\$18,884	\$13,172	1.8%
2	13,419 to 21,894	10%	1.9%	(19,216)	5,876	248	2,410	261	28,048	17,627	2.4%
3	21,895 to 31,391	10%	2.9%	(16,845)	7,400	274	2,684	261	35,604	29,377	4.0%
4	31,392 to 41,344	10%	4.0%	(28,430)	8,921	355	2,975	261	43,599	27,680	3.8%
5	41,345 to 55,093	10%	5.3%	(34,140)	10,726	639	3,303	527	52,425	33,480	4.6%
6	55,094 to 70,943	10%	6.8%	(30,508)	12,936	868	3,752	724	59,727	47,499	6.5%
7	70,944 to 92,150	10%	8.8%	(32,371)	16,296	1,159	4,429	1,383	75,148	66,044	9.1%
8	92,151 to 121,494	10%	11.5%	(35,769)	20,505	1,476	5,226	2,789	92,656	86,884	12.0%
9	121,495 to 174,624	10%	15.7%	(37,553)	27,286	1,945	6,500	3,780	108,929	110,887	15.3%
10	174,625 & over	10%	42.2%	91,051	51,991	4,008	11,456	15,389	119,486	293,381	40.4%
<b>ALL MINNESOTA HOUSEHOLDS</b>		<b>100%</b>	<b>100.0%</b>	<b>(\$156,534)</b>	<b>\$166,351</b>	<b>\$11,236</b>	<b>\$44,839</b>	<b>\$25,637</b>	<b>\$634,503</b>	<b>\$726,031</b>	<b>100.0%</b>

Detail for the 10th Decile

Lower Half	\$174,625 to 250,362	5%	11.1%	(\$13,906)	\$18,141	\$1,254	\$4,125	\$4,288	\$60,048	\$73,949	10.2%
Next 4%	250,363 to 598,214	4%	15.4%	25,184	21,157	1,531	4,655	6,806	48,016	107,350	14.8%
Top 1%	598,215 & over	1%	15.6%	79,773	12,694	1,224	2,676	4,296	11,421	112,083	15.4%
Full Decile	\$174,625 & over	10%	42.2%	\$91,051	\$51,991	\$4,008	\$11,456	\$15,389	\$119,486	293,381	40.4%



**Table 3. Impact of Tax Proposals in Governor's 2019 Budget Bills on State and Local Tax Collections and Tax Burdens (Calendar Year 2019)**

All dollars in millions

All dollar values rounded to nearest million dollars. All values that are truly zero are shown as blanks.

Tax Type	Change in Collections	As Imposed			After Shifting		Suits Index for Tax Change* (Full Sample)
		MN HH's	NR	Business	Minnesota	Exported	
<b>State Taxes</b>							
<b>Taxes on Income and Estates</b>							
Individual income tax	-148	-157	9		-157	9	1.420**
Corporate franchise tax	231			231	166	65	-0.167
Estate tax	27	26	1		26	1	0.197
<b>Total Income and Estate Taxes</b>	<b>111</b>	<b>-131</b>	<b>10</b>	<b>231</b>	<b>35</b>	<b>75</b>	<b>5.628**</b>
<b>Taxes on Consumption</b>							
Total sales tax							
General sales tax	38			38	36	2	-0.213
Sales tax on motor vehicles							
Motor fuels excise tax							
Alcoholic beverage excise taxes							
Cigarette and tobacco excise taxes	10	9	0		9	0	-0.490
Insurance premiums taxes							
Gambling taxes							
MinnesotaCare taxes	692	635	58		635	58	-0.325
Solid waste management taxes							
<b>Total Consumption Taxes</b>	<b>740</b>	<b>644</b>	<b>58</b>	<b>38</b>	<b>679</b>	<b>60</b>	<b>-0.321</b>
<b>Taxes on Property</b>							
State property tax							
Residential recreational property	1	1	0		1	0	-0.262
Commercial	14			14	7	7	-0.148
Industrial	4			4	2	2	-0.070
Utility	3			3	2	1	-0.188
Motor vehicle registration tax							
Mortgage and deed taxes							
<b>Total Property Taxes</b>	<b>22</b>	<b>1</b>	<b>0</b>	<b>21</b>	<b>12</b>	<b>10</b>	<b>-0.149</b>
<b>Property Tax Refunds</b>							
Homeowners	-1	-1			-1		0.870
Renters							
<b>Total Property Tax Refunds</b>	<b>-1</b>	<b>-1</b>			<b>-1</b>		<b>0.870</b>
<b>Total State Taxes</b>	<b>871</b>	<b>513</b>	<b>69</b>	<b>290</b>	<b>726</b>	<b>145</b>	<b>-0.027</b>
<b>Local Taxes</b>							
<b>Property Taxes</b>							
General Property Tax							
Homeowners (before PTR)							
Residential recreational property							
Commercial							
Industrial							
Farm (other than residence)							
Rental Housing							
Utility							
Mining Production Taxes (taconite)							
<b>Taxes on Consumption</b>							
Local Sales Taxes							
Local Gross Earnings Taxes							
<b>Total Local Taxes</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0.000</b>
<b>Total State and Local Taxes</b>	<b>871</b>	<b>513</b>	<b>69</b>	<b>290</b>	<b>726</b>	<b>145</b>	<b>-0.027</b>

Parts may not sum to totals due to rounding.

\* Suits indexes for a reduction in regressive taxes (such as the general sales tax) are shown as positive because the tax cut makes the system less regressive.

\*\*The net tax change in these cases is very progressive, with tax reductions in deciles 1 through 9 but sizable tax increases in decile 10. As a result, the calculated Suits Index exceeds 1.000.



## Appendix 1: Technical Notes

### A. Assumptions about Changes in Local Property Taxes

- Local government levies will change in response to changes in state aids and credits. Standard assumptions are used by the Property Tax Division to estimate the magnitude of those changes. (*Note: There were no changes in local government levies associated with the Governor's 2018 proposals.*)

### B. Estimating the Incidence of Changes in Business Taxes (“Incremental Incidence”)

- As explained on pages 70-71 of the 2017 *Tax Incidence Study*, the incidence of a change in the level of business taxes (“incremental incidence”) will differ from the incidence of existing business taxes (“average incidence”). Average incidence divides an existing business tax into three parts – the national average tax on all capital, the sector differential, and the Minnesota differential. In contrast, a change in the level of a business tax is all treated as a change in the Minnesota differential.
- If the level of Minnesota business taxes changes, this will generally change the amount of *federal tax* paid by the business – either the federal corporate income tax or the federal individual income tax (for flow-through businesses). For a corporation paying federal tax at the 21% rate, each additional \$1000 in Minnesota tax will reduce the federal tax burden by \$210. So \$210 of the \$1000 of Minnesota tax burden is borne by the federal government in foregone tax revenue. The burden of the remaining \$790 in tax may be shifted to consumers in higher prices or to workers in lower compensation – or it may reduce the after-tax income of the business owner. This analysis assumes federal tax rates of 21% for corporate tax and 17% for individual income tax.
- The extent to which the tax burden will be shifted to consumers or workers will depend on the nature of the market. Minnesota tax changes are most likely to result in price changes if the market is local and close competitors face the same change in tax. Businesses selling in national or international markets are much less likely to shift the added cost to consumers by raising prices (or reduce their price in response to a tax cut). *As in the incidence study, the incidence results assume the market has had time to fully adjust to any tax changes.*
- The incidence of the **business tax** changes in the bill (as modeled here) is as follows:
  - Corporate tax increases: 38% shifted to Minnesota consumers, 34% shifted to Minnesota workers, less than 1% borne by Minnesota owners, and 27% borne by nonresidents and the federal government.
  - Business property tax increases for nonresidential property: 32% of the benefits to Minnesota consumers, 14% to Minnesota workers, 6% to Minnesota owners, and 51% to nonresidents and the federal government.
  - Individual income tax increases on flow-through income: The burden is assumed to fall on the recipient of the income, as modeled using the House Income Tax Simulation (HITS) Model.