

## Tax Incidence Analysis

Prepared by the Tax Research Division, Minnesota Department of Revenue

June 8, 2011

### Conference Omnibus Tax Bill (HF 42 Davids)

As passed by the House and Senate May 2011

#### ***The Bill Includes the Following Major Provisions:***

- Cuts local government aids and credits, which will result in higher local property taxes, converts the market value homestead credit to a reduction in net tax capacity, and phases out – over 13 years – the state property tax levy on business property and seasonal recreation property (“cabins”).
- Reduces renter property tax refunds by (1) lowering the proportion of rent that is assumed to be property tax from 19% to 15% and (2) cutting maximum income eligibility levels.
- Increases homeowner property tax refunds by reducing co-pays and raising refund maximums.
- Creates an income tax subtraction for 55% of military retirement plan income (effective 2013), expands the K-12 education credit to include private school tuition (effective 2013), excludes qualified farm and business property up to \$4 million from the estate tax, and creates a variety of new exemptions from the sales tax base.
- Expands the corporate R & D credit and speeds up 100% sales apportionment.
- Authorizes 9 cities to enact new local sales taxes or extend an existing one.

These tax law changes would modify the burden of state and local taxes compared to what it would be under current law. The bill’s impact can be estimated using the database and underlying models developed for the *Minnesota Tax Incidence Study*. **Because that study projects income and taxes to calendar year 2013, this analysis generally estimates the impact of law changes in that year.**

#### ***Law Changes Included in the Analysis***

- **Property Taxes:** Changes in property taxes, by type of property, were estimated by the Property Tax Research section of the Property Tax Division. Changes were modeled in 2013, but assume the changes that would be effective in 2014. The estimated change in property tax burdens includes the impact of (1) a reduction in the state property tax levy on business property and cabins (down \$60 million) and (2) reductions in local government aids and credits, which are assumed to result in increased local property tax levies (up \$342 million).

The changes in property taxes (before PTR, and including both the state levy and local property taxes) are estimated to be:

Homestead property taxes:	+ \$154 million
Rental property taxes:	+ \$ 61 million
Residential recreational (cabins):	+ \$ 6 million
<u>Business property taxes:</u>	<u>+ \$ 61 million</u>
Total	+ \$282 million

The burden of the incremental increases in rental and other business property taxes was modeled using the business property tax model. Some of the burden is borne in higher prices, some in lower wages, and some in lower returns to business owners. The estimates show the long-term burden, after businesses have fully adjusted to the change in tax burdens.

Because the state property tax is phased out over 13 years, the full impact would be much larger than what is shown here for 2014 law, which represents the third year of the phase-out period.<sup>1</sup>

- **Property Tax Refunds:** The bill would reduce renter property tax refunds by \$100 million by lowering the assumed property tax share of rent from 19% to 15% and changing the thresholds and co-pays. The current maximum household income threshold of \$53,540 would be reduced to \$40,000 for senior and disabled renters and \$25,000 for all other renters. However, the bill expands homeowner property tax refunds by \$32 million by reducing co-pays and increasing maximum refunds. Homeowner refunds rise by an additional \$13 million due to the increase in homestead property taxes, for a net homeowner increase of \$45 million.
- **State Sales Tax:** State tax paid by individuals and businesses is reduced by about \$1 million (disregarding \$6 million in exemptions for local governments). This tax relief is assumed to be proportional to the existing consumer sales tax burden.
- **Local Sales Taxes:** In addition, the bill authorizes new, increased, or extended special-law local sales taxes in 9 cities (totaling about \$17 million of tax in 2013).
- **Income Tax:** The bill expands the K-12 credit to include school tuition, and it provides an income tax subtraction for 55% of military retirement income. Both are effective starting in tax year 2013. Total impact for tax year 2013: \$17.3 million.
- **Corporate tax:** The bill increases the R & D credit rate for eligible expenditures over \$2 million from 2.5% to 4.7% (effective 2014). Revenue impact: \$25.2 million (if effective in 2013).

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

- The full phase-out of the statewide property tax levy on business and seasonal recreation property (cabins) is not effective until 2024. This analysis only includes about 7.5% of impact of total repeal.
- The increase in the estate tax exemption for farmers and small business owners is not included due to lack of information about the income of those who would benefit. (Total impact in 2013: \$4.1 million.)
- Federal income tax conformity is not included. Incidence is modeled for 2013 and federal update provisions are limited almost entirely to tax years 2011 and 2012.
- The speed-up of 100% sales apportionment for corporate tax (from 2014 to 2011) is omitted because the impact is temporary.
- The \$5.7 million in sales tax exemptions for local governments (mostly for public safety radio) are excluded, though these exemptions might be assumed to reduce local property taxes.

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<sup>1</sup> The impact of further reductions in the state levy is discussed further on page 5.

### Results by Population Decile: Minnesota Taxes

- The tax burden on Minnesota taxpayers would rise by \$275 million. Increases in homeowner and business property taxes, reductions in the renter property tax refund, and additional local sales taxes would exceed the tax reductions in the bill (increased homeowner PTR and selected reductions in income, corporate, and sales taxes).
- Tax burdens would rise by an average of 0.14% of income. Tax increases as a percent of income fall steadily with income, as shown in the table below. The smallest increases as a percent of income would occur in the 10<sup>th</sup> decile (+0.07%, compared to +0.18% for the bottom 9 deciles combined), with even smaller increases for the top 5% (+0.06%) and top 1% (+0.04%).

2013 Population Decile	Income Range	Percent of All Households	Tax Burden as Percent of Income		
			Current Law	Proposed Law	Change
First	\$ 11,298 & under	10%	30.46%	31.55%	<b>1.09%</b>
Second	\$ 11,299 to \$ 18,732	10%	12.10%	12.64%	<b>0.54%</b>
Third	\$ 18,733 to \$ 26,788	10%	11.02%	11.47%	<b>0.45%</b>
Fourth	\$ 26,789 to \$ 35,561	10%	11.55%	11.94%	<b>0.39%</b>
Fifth	\$ 35,562 to \$ 46,044	10%	12.06%	12.32%	<b>0.26%</b>
Sixth	\$ 46,045 to \$ 59,437	10%	12.10%	12.23%	<b>0.13%</b>
Seventh	\$ 59,438 to \$ 76,276	10%	12.07%	12.17%	<b>0.10%</b>
Eighth	\$ 76,277 to \$ 99,386	10%	12.30%	12.40%	<b>0.11%</b>
Ninth	\$ 99,387 to \$142,225	10%	11.89%	11.99%	<b>0.10%</b>
Tenth	\$ 142,226 & over	10%	10.36%	10.43%	<b>0.07%</b>
ALL		100%	11.47%	11.61%	<b>0.14%</b>
Top 5%	\$ 200,907 & over	5%	10.07%	10.13%	<b>0.06%</b>
Top 1%	\$ 472,626 & over	1%	9.68%	9.72%	<b>0.04%</b>

- The “population-decile” Suits index moves further from zero, falling from -0.047 to -0.051. This represents an increase in the regressivity of the overall tax system, as would be expected given the pattern of changes by decile. (Note: Full-sample Suits index is not available.)
- The Suits index for the “total net change in tax burdens” is -0.374. That is more regressive than any existing tax other than tobacco and gambling.

More details are provided on **Tables 1 and 2** below.

## Results by Population Decile: Change in Minnesota and Federal Tax Burdens

Because homeowner property taxes and state income taxes can be claimed as itemized deductions on federal income tax returns, a change in these taxes will change federal tax liability. The change in federal tax will offset part of the change in Minnesota income taxes and homeowner property taxes.

There is no federal offset for those who do not itemized deductions, nor is there any offset for a taxpayer who is subject to the federal alternative minimum tax (because property and state income taxes are not deductible). For those who itemize (and are not subject to the federal AMT), the portion of the change in Minnesota tax that is offset by the change in federal liability is generally equal to the federal tax rate on the last dollar of the taxpayer's income. The offset is 15% for a taxpayer in the 15% tax bracket and 35% for a taxpayer in the 35% tax bracket.

- The change in federal tax liability offsets 20.4% (\$23 million) of the \$114 million *increase* in Minnesota home property taxes (net of PTR) and 13.9% (\$2.4 million) of the \$17.3 million *reduction* in Minnesota income taxes.
- Although the bill would increase the burden of Minnesota state and local taxes by \$275 million, it would increase the total burden of federal plus Minnesota state and local tax burdens by \$21 million less, a net increase of \$254 million.
- When both federal and state taxes are considered, tax burdens would increase by an average of 0.13% of income. The federal tax offset has the largest impact at higher income levels, so the increase in effective tax rates falls a bit more rapidly as income rises.

2013 Population Decile	Income Range	Percent of All Housholds	Net Change in Minnesota Tax Burden as Percent of Income	Net Change in Federal Tax as Percent of Income Due to:		Net Change in Minnesota and Federal Tax Burden as Percent of Income <sup>2</sup>
				Higher Itemized Deductions for Home Property Taxes	Lower Itemized Deductions for Minnesota Income Tax <sup>1</sup>	
First	\$ 11,298 & under	10%	<b>1.09%</b>	0.00%	0.00%	<b>1.09%</b>
Second	\$ 11,299 to \$ 18,732	10%	<b>0.54%</b>	0.00%	0.00%	<b>0.54%</b>
Third	\$ 18,733 to \$ 26,788	10%	<b>0.45%</b>	0.00%	0.00%	<b>0.45%</b>
Fourth	\$ 26,789 to \$ 35,561	10%	<b>0.39%</b>	0.00%	0.00%	<b>0.39%</b>
Fifth	\$ 35,562 to \$ 46,044	10%	<b>0.26%</b>	0.00%	0.00%	<b>0.26%</b>
Sixth	\$ 46,045 to \$ 59,437	10%	<b>0.13%</b>	-0.01%	0.00%	<b>0.13%</b>
Seventh	\$ 59,438 to \$ 76,276	10%	<b>0.10%</b>	-0.01%	0.00%	<b>0.09%</b>
Eighth	\$ 76,277 to \$ 99,386	10%	<b>0.11%</b>	-0.02%	0.00%	<b>0.09%</b>
Ninth	\$ 99,387 to \$142,225	10%	<b>0.10%</b>	-0.02%	0.00%	<b>0.08%</b>
Tenth	\$142,226 & over	10%	<b>0.07%</b>	-0.01%	0.00%	<b>0.06%</b>
ALL MINNESOTA HOUSEHOLDS		100%	<b>0.14%</b>	-0.01%	0.00%	<b>0.13%</b>
Top 5%	\$200,907 & over	5%	<b>0.06%</b>	-0.01%	0.00%	<b>0.05%</b>
Top 1%	\$472,626 & over	1%	<b>0.04%</b>	-0.01%	0.00%	<b>0.04%</b>

<sup>1</sup> Change is positive in all but the bottom three deciles, but rounds to 0.00% for all deciles.

<sup>2</sup> Columns do not sum to new total due to rounding.

More details are shown in **Tables 3 and 4** below.

### ***Note on an Item Excluded from the Analysis***

- **Phase-out of state property tax:** Because the state property tax levy on business property and cabins is more regressive than the overall state and local tax burden, its phase-out – if considered alone – would make the overall tax structure less regressive. If the analysis here had assumed a full phase-out of the state levy in 2014 (with no other changes in the analysis), state revenue would have fallen by an additional \$738 million. Because about half of the savings would go to nonresidents, the phase-out would reduce Minnesota tax burdens by \$382 million rather than by \$738 million. So rather than rising by \$275 million as shown in Total tax burdens would have fallen by \$107 million compared to current law, and the Suits index would have moved down to -0.049 – still more regressive than current law, but less regressive than what is shown elsewhere in this analysis (-0.051).

**Table 1. Dollars of Tax Burden**

Tax Incidence Analysis  
Omnibus Tax Bill (May 2011)

(Dollars in \$1000s)

2013 Population Decile	Income Range	Number of Households	Current Law Total State and Local Tax Burden	Change in Minnesota State & Local Tax Burden									Proposed Law Total State and Local Tax Burden
				Homestead Property Tax <sup>1,2</sup>	Increase Home-owner PTR <sup>3</sup>	Rental Property Tax	Reduction in Renter PTR	Other Business Property Taxes	Sales Taxes (State & Special Law Local) <sup>4</sup>	Income Tax Law Changes <sup>5</sup>	Corporate Tax Changes	Total Net Change in Tax Burden	
First	\$ 11,298 & under	263,199	\$ 530,646	3,977	(1,628)	3,476	11,601	1,668	647	(503)	(258)	<b>\$ 18,979</b>	\$ 549,625
Second	\$ 11,299 to \$ 18,732	263,199	479,849	3,658	(3,210)	3,983	16,560	1,000	724	(1,030)	(359)	<b>21,326</b>	501,175
Third	\$ 18,733 to \$ 26,788	263,199	656,857	5,259	(5,878)	5,262	21,926	1,630	852	(1,621)	(519)	<b>26,912</b>	683,769
Fourth	\$ 26,789 to \$ 35,561	263,199	945,059	8,149	(7,201)	6,219	24,957	1,824	999	(2,396)	(723)	<b>31,827</b>	976,886
Fifth	\$ 35,562 to \$ 46,044	263,199	1,285,863	10,810	(8,084)	6,504	17,679	2,059	1,141	(1,894)	(907)	<b>27,309</b>	1,313,172
Sixth	\$ 46,045 to \$ 59,437	263,199	1,673,264	14,135	(9,948)	5,425	6,849	2,892	1,323	(1,504)	(1,146)	<b>18,028</b>	1,691,292
Seventh	\$ 59,438 to \$ 76,276	263,199	2,146,415	17,736	(5,767)	3,767	472	3,271	1,587	(1,936)	(1,444)	<b>17,685</b>	2,164,100
Eighth	\$ 76,277 to \$ 99,386	263,199	2,821,394	22,000	(3,035)	2,637	-	5,206	1,908	(2,330)	(1,933)	<b>24,453</b>	2,845,847
Ninth	\$ 99,387 to \$142,225	263,199	3,672,422	26,118	(262)	2,223	-	6,038	2,319	(2,247)	(2,652)	<b>31,536</b>	3,703,958
Tenth	\$ 142,226 & over	263,199	8,516,676	40,435	-	6,752	-	12,782	4,418	(1,839)	(5,416)	<b>57,132</b>	8,573,808
<b>ALL MINNESOTA HOUSEHOLDS</b>		<b>2,631,989</b>	<b>\$ 22,728,445</b>	<b>152,278</b>	<b>(45,014)</b>	<b>46,248</b>	<b>100,043</b>	<b>38,370</b>	<b>15,918</b>	<b>(17,300)</b>	<b>(15,357)</b>	<b>275,186</b>	<b>\$ 23,003,631</b>
Top 5%	\$ 200,907 & over	131,652	\$ 6,076,987	24,284	-	5,513	-	8,710	2,979	(765)	(3,590)	<b>37,131</b>	\$ 6,114,118
Top 1%	\$ 472,626 & over	26,332	\$ 2,992,407	7,058	-	3,778	-	3,115	1,347	(107)	(1,446)	<b>13,745</b>	\$ 3,006,152

<sup>1</sup> Impact is net of a \$5.6 million reduction in income taxes due to higher itemized deductions for home property taxes.

<sup>2</sup> Includes \$4.8 million in tax increases on residential seasonal recreation property (cabins).

<sup>3</sup> Includes \$13.2 million increase in homeowner PTR resulting from higher homeowner property taxes.

<sup>4</sup> Includes \$1.1 million *reduction* in state sales taxes on individuals and \$17 million *increase* in local sales taxes in Rochester, Fergus Falls, Marshall, Hutchinson, Hermantown, Cloquet, Medford, and Lanesboro. (Assumes voter approval.)

<sup>5</sup> Includes expansion of K-12 education credit and subtraction for 55% of military retirement income.

**Table 2. Tax Burden as Percent of Income**

Tax Incidence Analysis  
Omnibus Tax Bill (May 2011)

2013 Population Decile	Income Range	Percent of All Housholds	Current Law Tax as Percent of Income	Change in Minnesota State & Local Taxes as Percent of Income									Proposed Law Tax as Percent of Income
				Homestead Property Tax <sup>1,2</sup>	Increase Home-owner PTR	Rental Property Tax	Reduction in Renter PTR <sup>3</sup>	Other Business Property Taxes	Sales Taxes (State & Special Law Local) <sup>4</sup>	Income Tax Law Changes <sup>5</sup>	Corporate Tax Changes	Total Net Change in Tax	
First	\$ 11,298 & under	10%	30.46%	0.23%	-0.09%	0.20%	0.67%	0.10%	0.04%	-0.03%	-0.01%	<b>1.09%</b>	31.55%
Second	\$ 11,299 to \$ 18,732	10%	12.10%	0.09%	-0.08%	0.10%	0.42%	0.03%	0.02%	-0.03%	-0.01%	<b>0.54%</b>	12.64%
Third	\$ 18,733 to \$ 26,788	10%	11.02%	0.09%	-0.10%	0.09%	0.37%	0.03%	0.01%	-0.03%	-0.01%	<b>0.45%</b>	11.47%
Fourth	\$ 26,789 to \$ 35,561	10%	11.55%	0.10%	-0.09%	0.08%	0.31%	0.02%	0.01%	-0.03%	-0.01%	<b>0.39%</b>	11.94%
Fifth	\$ 35,562 to \$ 46,044	10%	12.06%	0.10%	-0.08%	0.06%	0.17%	0.02%	0.01%	-0.02%	-0.01%	<b>0.26%</b>	12.32%
Sixth	\$ 46,045 to \$ 59,437	10%	12.10%	0.10%	-0.07%	0.04%	0.05%	0.02%	0.01%	-0.01%	-0.01%	<b>0.13%</b>	12.23%
Seventh	\$ 59,438 to \$ 76,276	10%	12.07%	0.10%	-0.03%	0.02%	0.00%	0.02%	0.01%	-0.01%	-0.01%	<b>0.10%</b>	12.17%
Eighth	\$ 76,277 to \$ 99,386	10%	12.30%	0.10%	-0.01%	0.01%	0.00%	0.02%	0.01%	-0.01%	-0.01%	<b>0.11%</b>	12.40%
Ninth	\$ 99,387 to \$142,225	10%	11.89%	0.08%	0.00%	0.01%	0.00%	0.02%	0.01%	-0.01%	-0.01%	<b>0.10%</b>	11.99%
Tenth	\$ 142,226 & over	10%	10.36%	0.05%	0.00%	0.01%	0.00%	0.02%	0.01%	0.00%	-0.01%	<b>0.07%</b>	10.43%
<b>ALL MINNESOTA HOUSEHOLDS</b>		<b>100%</b>	<b>11.47%</b>	<b>0.08%</b>	<b>-0.02%</b>	<b>0.02%</b>	<b>0.05%</b>	<b>0.02%</b>	<b>0.01%</b>	<b>-0.01%</b>	<b>-0.01%</b>	<b>0.14%</b>	<b>11.61%</b>
Top 5%	\$ 200,907 & over	5%	10.07%	0.04%	0.00%	0.01%	0.00%	0.01%	0.00%	0.00%	-0.01%	<b>0.06%</b>	10.13%
Top 1%	\$ 472,626 & over	1%	9.68%	0.02%	0.00%	0.01%	0.00%	0.01%	0.00%	0.00%	0.00%	<b>0.04%</b>	9.72%

<sup>1</sup> Impact is net of a \$5.6 million reduction in income taxes due to higher itemized deductions for home property taxes.

<sup>2</sup> Includes \$4.8 million in tax increases on residential seasonal recreation property (cabins).

<sup>3</sup> Includes \$13.2 million increase in homeowner PTR resulting from higher homeowner property taxes.

<sup>4</sup> Includes \$1.1 million *reduction* in state sales taxes on individuals and \$17 million *increase* in local sales taxes in Rochester, Fergus Falls, Marshall, Hutchinson, Hermantown, Cloquet, Medford, and Lanesboro. (Assumes voter approval.)

<sup>5</sup> Includes expansion of K-12 education credit and subtraction for 55% of military retirement income.

<b>"Population-Decile" Suits Index with Omnibus Bill:</b>	<b>-0.051</b>
Baseline "Population-Decile" Suits Index (from TIS):	-0.047
<i>"Population-Decile" Suits Index for Change in Tax:</i>	<i>-0.374</i>

Tax Research Division  
Minnesota Department of Revenue  
June 8, 2011

**Table 3. Change in Dollars of Tax Burden: Minnesota and Federal Taxes**

Tax Incidence Analysis *Including Change in Federal Tax*  
 Omnibus Tax Bill (May 2011)

(Dollars in \$1000s)

2013 Population Decile	Income Range	Number of Housholds	Net Change in Minnesota Tax Burden	Net Change in Federal Tax Due to:		Net Change in Minnesota and Federal Tax Burden
				Higher Itemized Deductions for Home Property Taxes	Lower Itemized Deductions for Minnesota Income Tax	
First	\$ 11,298 & under	263,199	\$ 18,979	-	-	18,979
Second	\$ 11,299 to \$ 18,732	263,199	21,326	-	-	21,326
Third	\$ 18,733 to \$ 26,788	263,199	26,912	-	-	26,912
Fourth	\$ 26,789 to \$ 35,561	263,199	31,827	(71)	174	31,931
Fifth	\$ 35,562 to \$ 46,044	263,199	27,309	(330)	220	27,199
Sixth	\$ 46,045 to \$ 59,437	263,199	18,028	(703)	241	17,565
Seventh	\$ 59,438 to \$ 76,276	263,199	17,685	(2,367)	362	15,680
Eighth	\$ 76,277 to \$ 99,386	263,199	24,453	(4,046)	467	20,875
Ninth	\$ 99,387 to \$142,225	263,199	31,536	(7,040)	574	25,070
Tenth	\$ 142,226 & over	263,199	57,132	(8,681)	371	48,822
ALL MINNESOTA HOUSEHOLDS		2,631,989	275,186	(23,238)	2,411	254,359
Top 5%	\$ 200,907 & over	131,652	37,131	(4,629)	137	32,639
Top 1%	\$ 472,626 & over	26,332	13,745	(2,327)	33	11,451

Tax Research Division  
 Minnesota Department of Revenue  
 June 8, 2011

**Table 4. Change in Minnesota and Federal Tax Burden as Percent of Income**

Tax Incidence Analysis *Including Change in Federal Tax*  
 Omnibus Tax Bill (May 2011)

2013 Population Decile	Income Range	Percent of All Households	Net Change in Minnesota Tax Burden as Percent of Income	Net Change in Federal Tax as Percent of Income Due to:		Net Change in Minnesota and Federal Tax Burden as Percent of Income <sup>2</sup>
				Higher Itemized Deductions for Home Property Taxes	Lower Itemized Deductions for Minnesota Income Tax <sup>1</sup>	
First	\$ 11,298 & under	10%	<b>1.09%</b>	0.00%	0.00%	<b>1.09%</b>
Second	\$ 11,299 to \$ 18,732	10%	<b>0.54%</b>	0.00%	0.00%	<b>0.54%</b>
Third	\$ 18,733 to \$ 26,788	10%	<b>0.45%</b>	0.00%	0.00%	<b>0.45%</b>
Fourth	\$ 26,789 to \$ 35,561	10%	<b>0.39%</b>	0.00%	0.00%	<b>0.39%</b>
Fifth	\$ 35,562 to \$ 46,044	10%	<b>0.26%</b>	0.00%	0.00%	<b>0.26%</b>
Sixth	\$ 46,045 to \$ 59,437	10%	<b>0.13%</b>	-0.01%	0.00%	<b>0.13%</b>
Seventh	\$ 59,438 to \$ 76,276	10%	<b>0.10%</b>	-0.01%	0.00%	<b>0.09%</b>
Eighth	\$ 76,277 to \$ 99,386	10%	<b>0.11%</b>	-0.02%	0.00%	<b>0.09%</b>
Ninth	\$ 99,387 to \$142,225	10%	<b>0.10%</b>	-0.02%	0.00%	<b>0.08%</b>
Tenth	\$ 142,226 & over	10%	<b>0.07%</b>	-0.01%	0.00%	<b>0.06%</b>
ALL MINNESOTA HOUSEHOLDS		100%	<b>0.14%</b>	-0.01%	0.00%	<b>0.13%</b>
Top 5%	\$ 200,907 & over	5%	<b>0.06%</b>	-0.01%	0.00%	<b>0.05%</b>
Top 1%	\$ 472,626 & over	1%	<b>0.04%</b>	-0.01%	0.00%	<b>0.04%</b>

<sup>1</sup> Change is positive in all but the bottom three deciles, but rounds to 0.00% for all deciles.

<sup>2</sup> Columns do not sum to new total due to rounding.

## Technical Addendum

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

- When general purpose aids to local governments are reduced, a portion of those aid cuts will result in property tax increases. Recent levy reports from local governments indicate that overall levy back reported by cities and counties was 56% in 2010. Levy back declined to 42% in 2011 when deeper aid cuts were imposed.
- For 2012 and future years we assume that non-school local governments will levy back 50% of aid cuts up to a 10% increase in their property tax levy. Any cut beyond that level will be levied back at a 30% rate. In other words, those jurisdictions facing deeper aid cuts that will require a greater percent increase in their levy will be expected to have a lower levy-back rate.

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

- As explained on pages 61-62 of the Tax Incidence Study, the incidence of a change in the level of business taxes (“incremental incidence”) will differ from the average 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 35% rate, each additional \$1000 in Minnesota tax will reduce the federal tax burden by \$350. So \$350 of the \$1000 of Minnesota tax burden is borne by the federal government in foregone tax revenue. The burden of the remaining \$650 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 an average federal tax rate for business property owners of 30% for corporate tax and 20% for individual income tax.<sup>2</sup>
- 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 see 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 time to fully adjust to any tax changes.*
- The incidence of the business tax changes in the bill (as modeled here) is as follows:
  - Rental property tax increases: 58% shifted to renters, 20% borne by Minnesota owners, 23% borne by nonresidents.
  - Non-farm business property taxes: 31% shifted to consumers, 13% shifted to Minnesota workers, 7% borne by Minnesota owners, 49% borne by nonresidents.
  - Farm business property taxes: 0% shifted to consumers, 3% shifted to workers, 77% borne by Minnesota owners, 20% borne by nonresidents.
  - Corporate R & D credit: 8% of benefits to consumers, 52% to Minnesota workers, and 39% to nonresidents

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<sup>2</sup> For corporate tax, the analysis assumes a federal tax rate of 35%.