

MINNESOTA • REVENUE

PROPERTY TAXES City LGA Formula Modified Optional Local Sales Tax

May 6, 2003

	Yes	No
Separate Official Fiscal Note Requested		
Fiscal Impact		
DOR Administrative Costs/Savings		

Department of Revenue
Analysis of S.F. 1533 (Skoe)

	Revenue Gain or (Loss)			
	<u>F.Y. 2004</u>	<u>F.Y. 2005</u>	<u>F.Y. 2006</u>	<u>F.Y. 2007</u>
	(000's)			
LGA Appropriation	\$0	\$10,016	\$10,262	\$10,515
Homeowner Refunds	\$0	\$260	\$267	\$273
Local Sales Tax	\$0	\$0	\$0	\$0
Transition Aid	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
General Fund	\$0	\$10,276	\$10,529	\$10,788

Effective beginning with aids payable in 2004.

EXPLANATION OF THE BILL

The proposal makes a number of changes to definitions and formulas used in determining local government aid to cities. Revenue base is redefined to equal the sum of 1) the amount levied for taxes payable in the previous year, 2) the originally certified local government aid in the previous year, and 3) the taconite aids received in the previous year. The city revenue need formula is changed to calculate need based on city groupings rather than population for small and large cities. A city group is the cluster group the city is assigned to by the League of Minnesota Cities report "Clustering Minnesota Cities," October 2002. Group revenue base per capita for a city is equal to 1) the sum of the revenue base for all cities assigned to its city group, divided by 2) the sum of the population for all cities assigned to its city group.

For all central group cities, city revenue need per capita is equal to the group revenue base per capita. For aids payable in 2005 and future years, its city revenue need is equal to 1) city revenue need in the previous year multiplied by 2) one plus the percentage increase in the implicit price deflator for government consumption expenditures and gross investment for state and local government. The city revenue need per capita for a city not in the central cities group equals the group revenue base per capita plus one-half of the amount that the city's revenue base per capita exceeds its group revenue base per capita. The city revenue need per capita for a city may not exceed 150% of its group revenue base per capita.

EXPLANATION OF THE BILL (continued)

The proposal establishes higher education exempt aid which is calculated for a city as the number of students attending institutions of higher education in the city multiplied by its exempt property indicator and by a compensation percentage. The exempt property indicator for a city is determined by its percentage of higher education exempt property. The compensation percent must be the same for all cities and must be calculated to distribute \$10 million annually.

The proposal establishes regional overburden aid for cities which is calculated as its overburden factor multiplied by the overburden compensation percent. The overburden factor for a city is equal to the population of all the cities and towns within a geographic center that is within 50 miles of the geographic center of the city. If a city or town located in that area is closer to a different city with a population greater than or equal to that of the first city, its population is not included in determining the overburden factor. Only cities that are a county seat and are located outside the seven-county metropolitan area may have an overburden factor greater than zero. The overburden compensation percent must be the same for all cities and must be calculated to distribute \$10 million annually.

The proposal provides an attached machinery aid for cities in 2004 and subsequent years. Any city which received at least \$70 per capita in attached machinery aid in calendar year 1983 shall receive an amount equal to the amount of attached machinery aid it received in calendar year 1983.

The proposal redefines aid distribution for a city in 2004 and thereafter as the sum of 1) its formula aid, 2) its higher education exempt aid, 3) its regional overburden aid, and 4) its attached machinery aid. The annual percentage increase for cities uses the current law method.

If a city receives less aid than the previous year and the reduction is greater than 3% of its city net tax capacity, it qualifies to receive transition aid. The amount of transition aid shall be equal to the difference between 1) the amount of aid it received under the proposed city aid distribution in the previous year, and 2) the amount of aid it is certified to receive under the proposed city aid distribution in the current year, plus an amount equal to 3% of its city net tax capacity.

A city which qualifies for transition aid may choose to forego the aid and instead, by ordinance, impose a sales and use tax of 0.5% within the city. The sales and use tax would be state administered and subject to the provisions of Minnesota Statutes. The proceeds of the tax may be used for any general city purpose.

The proposal changes the appropriation for aids payable in 2004 from \$607.6 million to \$597.6 million. Annual increases in the appropriation are calculated using the current law method.

The proposal also repeals the city aid base, certain local government aid variables, and the \$450,000 aid paid to the city of Coon Rapids.

REVENUE ANALYSIS DETAIL

Property Tax

- The proposed changes to the city aid formula would cause a change in distribution among cities.
- The change in the annual appropriation for aids is decreased by about \$10 million for aids payable in 2004. The impact in subsequent years is \$10 million plus inflation.
- As a result of the reduced appropriation, homeowner property tax refunds would be reduced accordingly. The total shift equaled about \$10 million, and 2.6% of this total shift results in the expected decrease in property tax refunds.

Sales Tax

- It is not known how many cities would choose to receive transitional aid and how many would choose to enact an optional local sales tax. Enactment of an optional local sales tax would have no impact on the general fund or any other state fund.

Number of Taxpayers Affected: Unknown.

Source: Minnesota Department of Revenue
Tax Research Division
<http://www.taxes.state.mn.us/polic.html#analyses>