

Tax Incidence Analysis

Prepared by the Tax Research Division, Minnesota Department of Revenue
March 31, 2011

Senate Omnibus Tax Bill (SF 27 Ortman)

as passed by the Senate Tax Committee on March 25, 2011

The Bill Includes the Following Major Provisions:

- Cuts to local government aids and credits that will result in higher local property taxes, conversion of the market value homestead credit to a reduction in net tax capacity, and a phase-out – over 13 years – of the state property tax levy on business property and seasonal recreation property (“cabins”).
- A reduction in renter property tax refunds by reducing the proportion of rent that is assumed to be property tax from 19% to 15%.
- An increase in homeowner property tax refunds by reducing copays and raising refund maximums.
- A phased-in income tax subtraction for military retirement plan income, an expansion of the K-12 education credit to include private school tuition, an exclusion from the estate tax for qualified farm and business property up to \$4 million, and various exemptions from the sales tax base.
- Authorization for 5 cities to enact new local sales taxes or extend an existing tax.
- Authorization for any city to enact an additional 0.5% sales tax to bond for a wide variety of projects (subject to voter approval and with an aid offset in some cases).

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 and (2) reductions in local government aids and credits, which are assumed to result in increased local property tax levies.

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

Homestead property taxes:	+ \$102 million
Rental property taxes:	+ \$ 46 million
Residential recreational (cabins):	+ \$ 5 million
<u>Business property taxes:</u>	<u>- \$ 29 million</u>
Total	+ \$124 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, representing the third year of the phase-out period.¹

- **Property Tax Refunds:** The bill would reduce renter property tax refunds by \$54 million by reducing the assumed property tax share of rent from 19% to 15%. However, the bill expands homeowner property tax refunds by \$47 million by reducing co-pays and increasing maximum refunds. Homeowner refunds rise by an additional \$10 million due to the increase in homestead property taxes, for a net homeowner increase of \$57 million.
- **State Sales Tax:** State tax paid by individuals and businesses are reduced by about \$5 million (disregarding 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 5 cities (totaling about \$11 million per year).²
- **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 (phased-in 2011 to 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 one-tenth of that phase-out.
- The general authorization for city sales taxes (an additional 0.5% for broadly-defined bonding purposes) will likely result in additional local sales taxes. No such increases are included in this analysis.
- 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: \$2.4 million.)

¹ The impact of further reductions in the state levy is discussed further at the bottom of page 4.

² As noted below, the analysis does not include any additional local sales tax resulting from the bill's authorization of a 0.5% increase for any city. The revenue must be used for fairly broadly defined bonding purposes and must be approved by voters. See comment at the bottom of page 4.

Results by Population Decile: Minnesota Taxes

- The tax burden on Minnesota taxpayers would rise by \$117 million. Increases in homeowner and rental property taxes, reductions in the renter property tax refund, and additional local sales taxes would exceed the tax reductions in the bill (higher homeowner PTR, lower taxes on some business property, and selected reductions in income and sales taxes).
- Tax burdens would rise by an average of 0.06% of income. Tax increases as a percent of income are above average in the bottom 5 deciles and below average in the top 5 deciles, as shown in the table below. The smallest increases as a percent of income would occur in the 6th and 7th deciles and the top 5%.

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%	31.06%	0.60%
Second	\$ 11,299 to \$ 18,732	10%	12.10%	12.41%	0.30%
Third	\$ 18,733 to \$ 26,788	10%	11.02%	11.21%	0.19%
Fourth	\$ 26,789 to \$ 35,561	10%	11.55%	11.66%	0.10%
Fifth	\$ 35,562 to \$ 46,044	10%	12.06%	12.12%	0.06%
Sixth	\$ 46,045 to \$ 59,437	10%	12.10%	12.12%	0.02%
Seventh	\$ 59,438 to \$ 76,276	10%	12.07%	12.09%	0.03%
Eighth	\$ 76,277 to \$ 99,386	10%	12.30%	12.35%	0.05%
Ninth	\$ 99,387 to \$142,225	10%	11.89%	11.94%	0.05%
Tenth	\$ 142,226 & over	10%	10.36%	10.40%	0.04%
ALL		100%	11.47%	11.53%	0.06%
Top 5%	\$ 200,907 & over	5%	10.07%	10.11%	0.03%
Top 1%	\$ 472,626 & over	1%	9.68%	9.70%	0.02%

- The “population-decile” Suits index moves a bit further from zero, falling from -0.047 to -0.048. 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.)
- 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 19.6% (\$10 million) of the \$49 million increase in Minnesota home property taxes (net of PTR) and 13.9% (\$2 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 \$117 million, but it would increase the total burden of federal plus Minnesota state and local tax burdens by only \$105 million.
- When both federal and state taxes are considered, tax burdens would increase by an average of 0.05% of income. Increases would be larger in the bottom 5 deciles and smaller in the top 5 deciles. The smallest increases would be in the 6th, 7th, and 10th deciles.

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 ²
				Higher Itemized Deductions for Home Property Taxes	Lower Itemized Deductions for Minnesota Income Tax ¹	
First	\$ 11,298 & under	10%	0.60%	0.00%	0.00%	0.60%
Second	\$ 11,299 to \$ 18,732	10%	0.30%	0.00%	0.00%	0.30%
Third	\$ 18,733 to \$ 26,788	10%	0.19%	0.00%	0.00%	0.19%
Fourth	\$ 26,789 to \$ 35,561	10%	0.11%	0.00%	0.00%	0.11%
Fifth	\$ 35,562 to \$ 46,044	10%	0.06%	0.00%	0.00%	0.07%
Sixth	\$ 46,045 to \$ 59,437	10%	0.03%	0.00%	0.00%	0.03%
Seventh	\$ 59,438 to \$ 76,276	10%	0.03%	0.00%	0.00%	0.02%
Eighth	\$ 76,277 to \$ 99,386	10%	0.05%	-0.01%	0.00%	0.04%
Ninth	\$ 99,387 to \$142,225	10%	0.05%	-0.02%	0.00%	0.04%
Tenth	\$ 142,226 & over	10%	0.04%	-0.01%	0.00%	0.03%
ALL MINNESOTA HOUSEHOLDS		100%	0.06%	-0.01%	0.00%	0.05%
Top 5%	\$ 200,907 & over	5%	0.03%	-0.01%	0.00%	0.03%
Top 1%	\$ 472,626 & over	1%	0.02%	-0.01%	0.00%	0.02%

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

² Columns do not sum to new total due to rounding.

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

Note on Two Items 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 phaseout of the state levy in 2014 (with no other changes in the analysis), that would have reduced state revenue by \$705 million and would have raised the Suits index from the estimated -0.048 to -0.046.
- **Local sales taxes at 0.5%:** The bill gives all cities the option to levy an additional 0.5% local sales tax for a fairly broad range of bonding projects. It is likely that some cities will opt to levy such a tax. Because the sales tax is quite regressive, including additional local sales tax levies in this analysis would make the overall state and local tax system more regressive and make the the Suits index more negative (further from zero).

Table 1. Dollars of Tax Burden

Tax Incidence Analysis

Senate File 27 (Ortman) as it Passed the Tax Committee (March 25, 2011)

(Dollars in \$1000s)

2013 Population Decile	Income Range	Number of Housholds	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 ^{1,2}	Increase Home-owner PTR	Rental Property Tax	Reduction in Renter PTR ³	Other Business Property Taxes	Sales Taxes (State & Special Law Local) ⁴	Income Tax Law Changes ⁵	Total Net Change in Tax Burden	
First	\$ 11,298 & under	263,199	\$ 530,646	2,655	(2,680)	2,657	8,063	(47)	258	(503)	\$ 10,403	\$ 541,049
Second	\$ 11,299 to \$ 18,732	263,199	479,849	2,445	(3,627)	3,058	11,471	(573)	267	(1,030)	12,011	491,860
Third	\$ 18,733 to \$ 26,788	263,199	656,857	3,512	(6,326)	4,042	11,934	(366)	316	(1,621)	11,492	668,349
Fourth	\$ 26,789 to \$ 35,561	263,199	945,059	5,575	(9,940)	4,774	11,069	(666)	375	(2,396)	8,790	953,849
Fifth	\$ 35,562 to \$ 46,044	263,199	1,285,863	7,473	(11,546)	4,994	8,012	(876)	430	(1,894)	6,592	1,292,455
Sixth	\$ 46,045 to \$ 59,437	263,199	1,673,264	9,654	(11,583)	4,164	3,205	(626)	498	(1,504)	3,808	1,677,072
Seventh	\$ 59,438 to \$ 76,276	263,199	2,146,415	12,041	(7,593)	2,888	227	(1,029)	599	(1,936)	5,196	2,151,611
Eighth	\$ 76,277 to \$ 99,386	263,199	2,821,394	14,746	(3,082)	2,020	-	(190)	717	(2,330)	11,881	2,833,275
Ninth	\$ 99,387 to \$142,225	263,199	3,672,422	17,465	(225)	1,700	-	(817)	874	(2,247)	16,750	3,689,172
Tenth	\$ 142,226 & over	263,199	8,516,676	26,954	-	5,135	-	(1,486)	1,695	(1,839)	30,460	8,547,136
ALL MINNESOTA HOUSEHOLDS		2,631,989	\$ 22,728,445	102,519	(56,602)	35,432	53,981	(6,677)	6,029	(17,300)	117,383	\$ 22,845,828
Top 5%	\$ 200,907 & over	131,652	\$ 6,076,987	16,177	-	4,191	-	(1,063)	1,149	(765)	19,689	\$ 6,096,676
Top 1%	\$ 472,626 & over	26,332	\$ 2,992,407	4,699	-	2,870	-	(1,254)	523	(107)	6,731	\$ 2,999,138

¹ Impact is net of a \$5 million reduction in income taxes due to higher itemized deductions for home property taxes.

² Includes \$4 million in tax increases on residential seasonal recreation property (cabins).

³ Includes \$9.7 million increase in homeowner PTR resulting from higher homeowner property taxes.

⁴ Includes \$5.2 million *reduction* in state sales taxes and \$11.2 million *increase* in local sales taxes in Rochester, Fergus Falls, Hutchinson, Hermantown, and Lanesboro. (Assumes voter approval.)

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

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 March 31, 2011

Table 2. Tax Burden as Percent of Income

Tax Incidence Analysis

Senate File 27 (Ortman) as it Passed the Tax Committee (March 25, 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							Total Net Change in Tax	Proposed Law Tax as Percent of Income
				Homestead Property Tax ^{1,2}	Increase Home-owner PTR	Rental Property Tax	Reduction in Renter PTR ³	Other Business Property Taxes	Sales Taxes (State & Special Law Local) ⁴	Income Tax Law Changes ⁵		
First	\$ 11,298 & under	10%	30.46%	0.15%	-0.15%	0.15%	0.46%	0.00%	0.01%	-0.03%	0.60%	31.06%
Second	\$ 11,299 to \$ 18,732	10%	12.10%	0.06%	-0.09%	0.08%	0.29%	-0.01%	0.01%	-0.03%	0.30%	12.41%
Third	\$ 18,733 to \$ 26,788	10%	11.02%	0.06%	-0.11%	0.07%	0.20%	-0.01%	0.01%	-0.03%	0.19%	11.21%
Fourth	\$ 26,789 to \$ 35,561	10%	11.55%	0.07%	-0.12%	0.06%	0.14%	-0.01%	0.00%	-0.03%	0.11%	11.66%
Fifth	\$ 35,562 to \$ 46,044	10%	12.06%	0.07%	-0.11%	0.05%	0.08%	-0.01%	0.00%	-0.02%	0.06%	12.12%
Sixth	\$ 46,045 to \$ 59,437	10%	12.10%	0.07%	-0.08%	0.03%	0.02%	0.00%	0.00%	-0.01%	0.03%	12.13%
Seventh	\$ 59,438 to \$ 76,276	10%	12.07%	0.07%	-0.04%	0.02%	0.00%	-0.01%	0.00%	-0.01%	0.03%	12.10%
Eighth	\$ 76,277 to \$ 99,386	10%	12.30%	0.06%	-0.01%	0.01%	0.00%	0.00%	0.00%	-0.01%	0.05%	12.35%
Ninth	\$ 99,387 to \$142,225	10%	11.89%	0.06%	0.00%	0.01%	0.00%	0.00%	0.00%	-0.01%	0.05%	11.94%
Tenth	\$ 142,226 & over	10%	10.36%	0.03%	0.00%	0.01%	0.00%	0.00%	0.00%	0.00%	0.04%	10.40%
ALL MINNESOTA HOUSEHOLDS		100%	11.47%	0.05%	-0.03%	0.02%	0.03%	0.00%	0.00%	-0.01%	0.06%	11.53%
Top 5%	\$ 200,907 & over	5%	10.07%	0.03%	0.00%	0.01%	0.00%	0.00%	0.00%	0.00%	0.03%	10.11%
Top 1%	\$ 472,626 & over	1%	9.68%	0.02%	0.00%	0.01%	0.00%	0.00%	0.00%	0.00%	0.02%	9.70%

¹ Impact is net of a \$5 million reduction in income taxes due to higher itemized deductions for home property taxes.

² Includes \$4 million in tax increases on residential seasonal recreation property (cabins).

³ Includes \$9.7 million increase in homeowner PTR resulting from higher homeowner property taxes.

⁴ Includes \$5.2 million *reduction* in state sales taxes and \$11.2 million *increase* in local sales taxes in Rochester, Fergus Falls, Hutchinson, Hermantown, and Lanesboro. (Assumes voter approval.)

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

Senate Bill "Population-Decile" Suits Index:	-0.0480
Baseline "Population-Decile" Suits Index (from TIS):	-0.0467

Tax Research Division
 Minnesota Department of Revenue
 March 31, 2011

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

Tax Incidence Analysis *Including Change in Federal Tax*

House File 27 (Ortman) as it Passed the Tax Committee (March 25, 2011)

(Dollars in \$1000s)

2013 Population Decile	Income Range	Number of Households	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	\$ 10,403	-	-	10,403
Second	\$ 11,299 to \$ 18,732	263,199	12,011	-	-	12,011
Third	\$ 18,733 to \$ 26,788	263,199	11,492	-	-	11,492
Fourth	\$ 26,789 to \$ 35,561	263,199	8,790	326	174	9,116
Fifth	\$ 35,562 to \$ 46,044	263,199	6,592	493	220	7,086
Sixth	\$ 46,045 to \$ 59,437	263,199	3,808	324	241	4,132
Seventh	\$ 59,438 to \$ 76,276	263,199	5,196	(879)	362	4,316
Eighth	\$ 76,277 to \$ 99,386	263,199	11,881	(2,488)	467	9,393
Ninth	\$ 99,387 to \$142,225	263,199	16,750	(4,694)	574	12,056
Tenth	\$ 142,226 & over	263,199	30,460	(5,787)	371	24,673
ALL MINNESOTA HOUSEHOLDS		2,631,989	117,383	(12,705)	2,411	104,678
Top 5%	\$ 200,907 & over	131,652	19,689	(3,084)	137	16,606
Top 1%	\$ 472,626 & over	26,332	6,731	(1,549)	33	5,182

Tax Research Division
Minnesota Department of Revenue
March 31, 2011

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

Tax Incidence Analysis *Including Change in Federal Tax*

House File 27 (Ortman) as it Passed the Tax Committee (March 25, 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 ²
				Higher Itemized Deductions for Home Property Taxes	Lower Itemized Deductions for Minnesota Income Tax ¹	
First	\$ 11,298 & under	10%	0.60%	0.00%	0.00%	0.60%
Second	\$ 11,299 to \$ 18,732	10%	0.30%	0.00%	0.00%	0.30%
Third	\$ 18,733 to \$ 26,788	10%	0.19%	0.00%	0.00%	0.19%
Fourth	\$ 26,789 to \$ 35,561	10%	0.11%	0.00%	0.00%	0.11%
Fifth	\$ 35,562 to \$ 46,044	10%	0.06%	0.00%	0.00%	0.07%
Sixth	\$ 46,045 to \$ 59,437	10%	0.03%	0.00%	0.00%	0.03%
Seventh	\$ 59,438 to \$ 76,276	10%	0.03%	0.00%	0.00%	0.02%
Eighth	\$ 76,277 to \$ 99,386	10%	0.05%	-0.01%	0.00%	0.04%
Ninth	\$ 99,387 to \$142,225	10%	0.05%	-0.02%	0.00%	0.04%
Tenth	\$ 142,226 & over	10%	0.04%	-0.01%	0.00%	0.03%
ALL MINNESOTA HOUSEHOLDS		100%	0.06%	-0.01%	0.00%	0.05%
Top 5%	\$ 200,907 & over	5%	0.03%	-0.01%	0.00%	0.03%
Top 1%	\$ 472,626 & over	1%	0.02%	-0.01%	0.00%	0.02%

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

² 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.³
- 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, 19% borne by Minnesota owners, 23% borne by nonresidents.
 - Non-farm business property taxes: 29% shifted to consumers, 14% shifted to workers, 6% borne by Minnesota owners, 51% borne by nonresidents.
 - Farm business property taxes: 0% shifted to consumers, 3% shifted to workers, 77% borne by Minnesota owners, 20% borne by nonresidents.

³ For corporate tax, the analysis assumes a federal tax rate of 35%.