



GOVERNOR DAYTON'S

Tax Reform

FOR A BETTER MINNESOTA

*September 5, 2012 – Metropolitan Council Committee of the Whole
Presented by Revenue Commissioner Myron Frans*

Governor Dayton's Priorities

Getting Minnesota Working Again

Governor's Priority #1



**Create jobs and
improve
Minnesota's
competitiveness**

Governor's Priority #2



**Improve how state
government works
to deliver the best
services at the best
price**

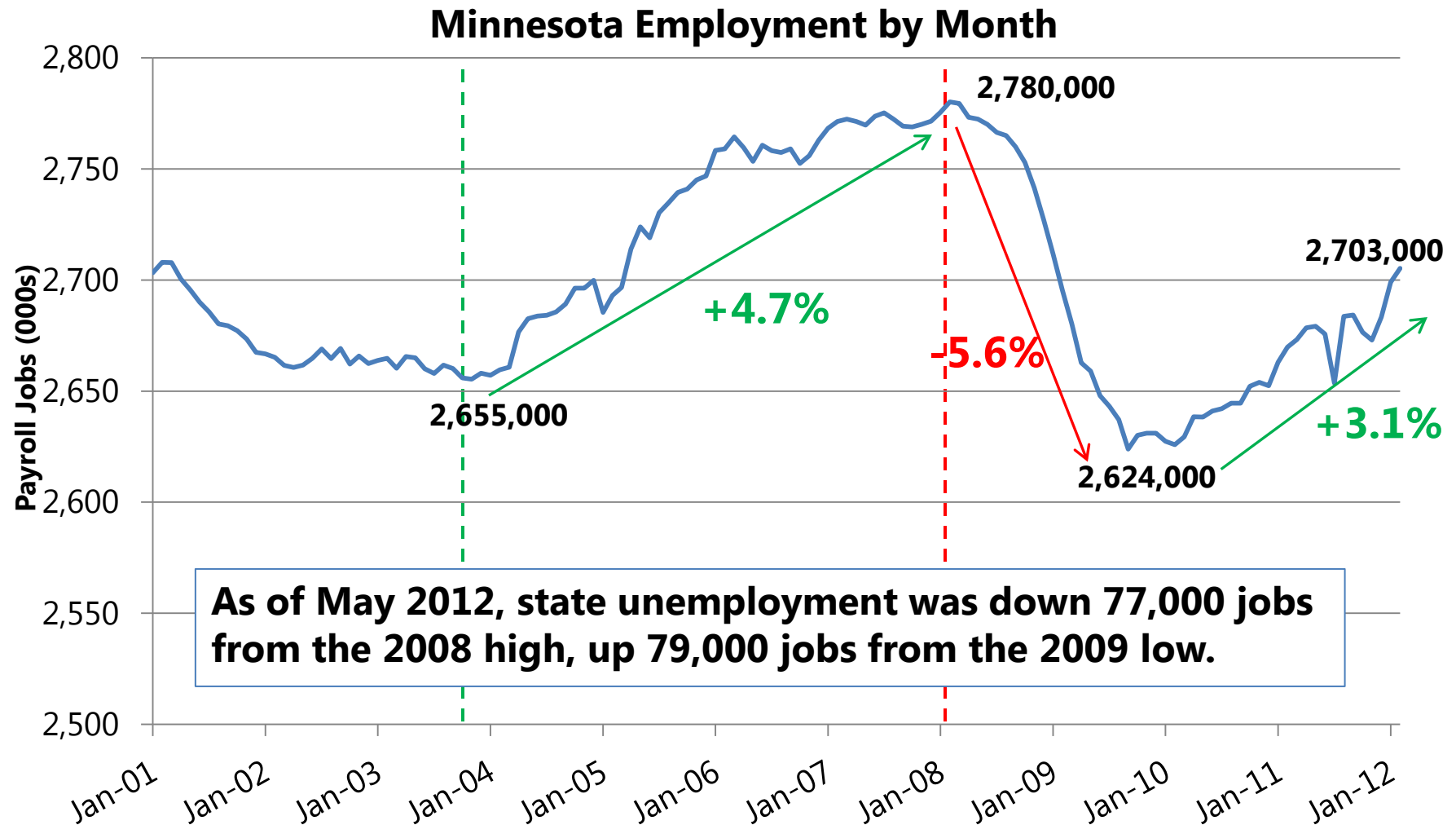
Governor's Priority #3



**Make Minnesota's
tax system more
fair**

TAX REFORM

The number of jobs matter

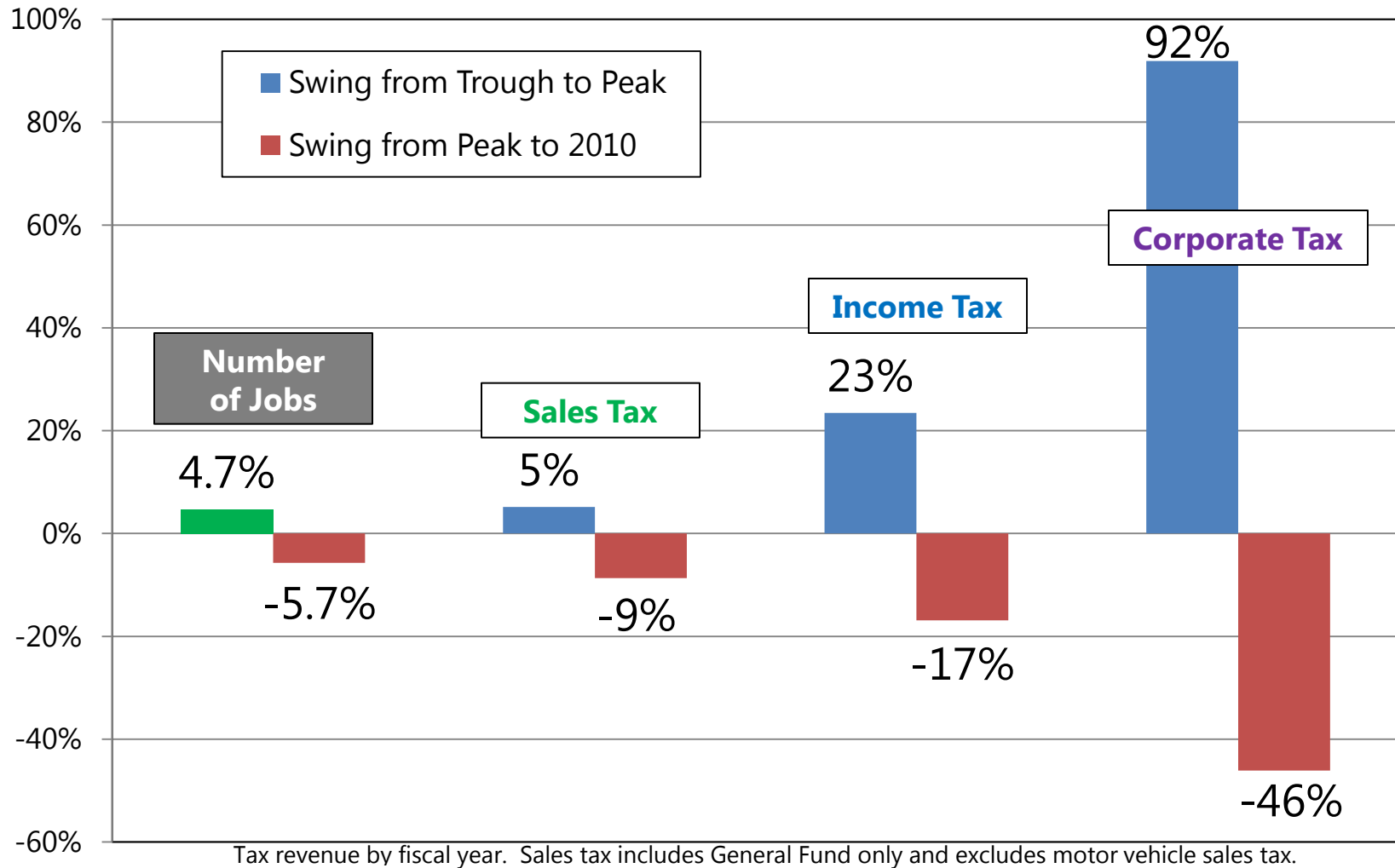


Source: CES Employment, U.S. Bureau of Labor Statistics



Jobs matter to the state budget

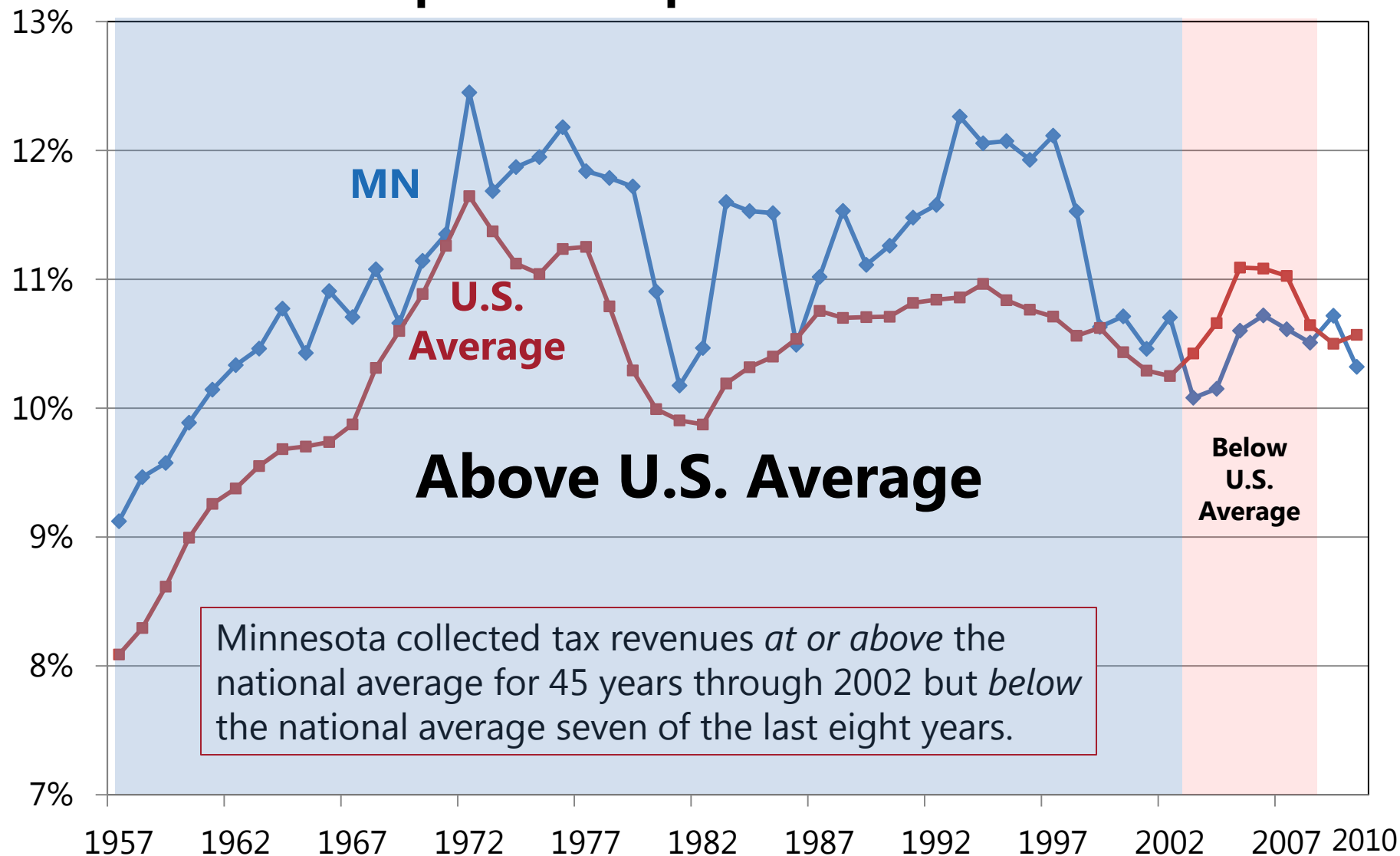
Changing number of jobs drives big swings in state revenue



Taxes tell part of the story...



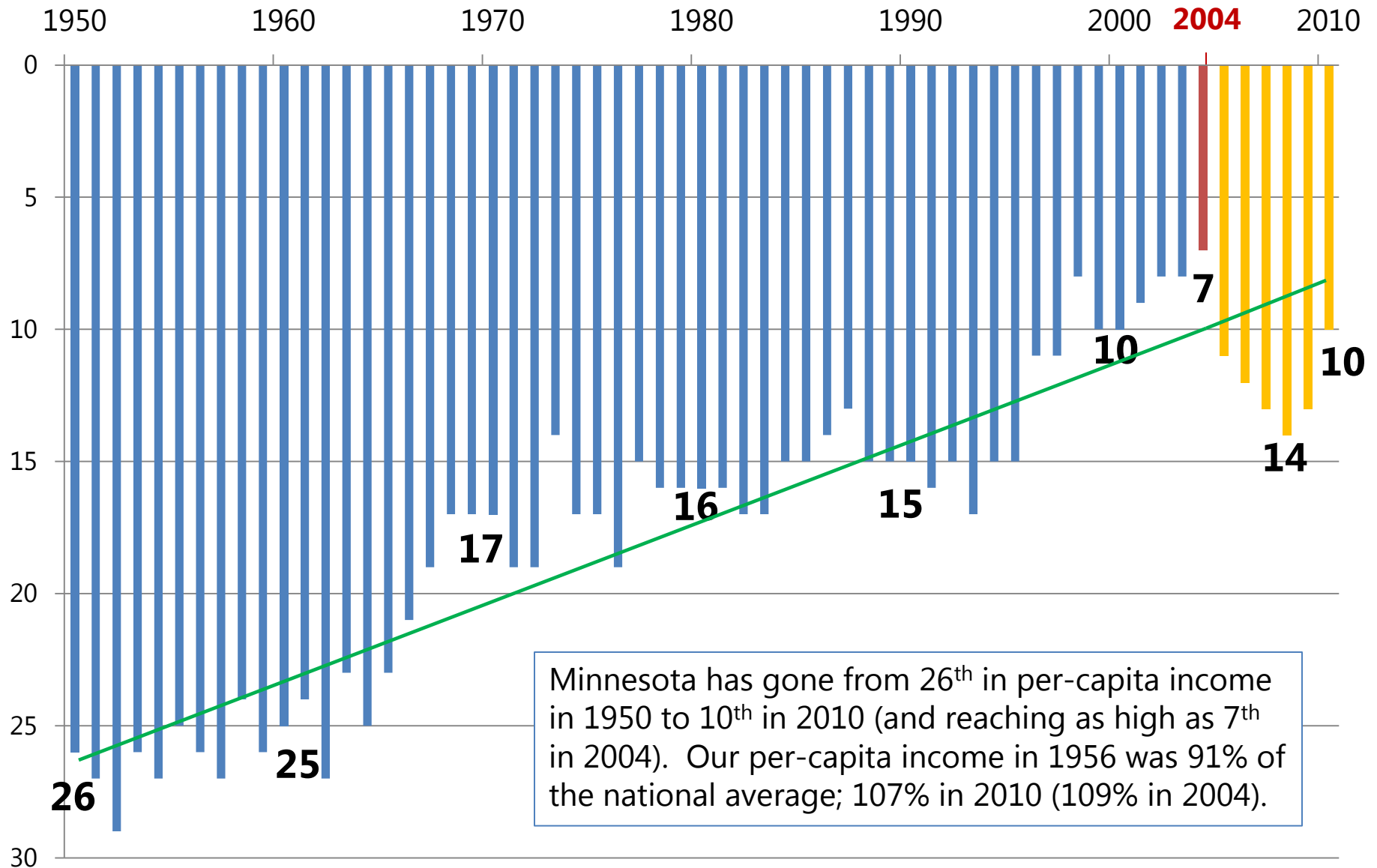
State and local tax revenue as a percent of personal income



**...But taxes don't tell the
whole story**



Minnesota per-capita income rank among 50 states

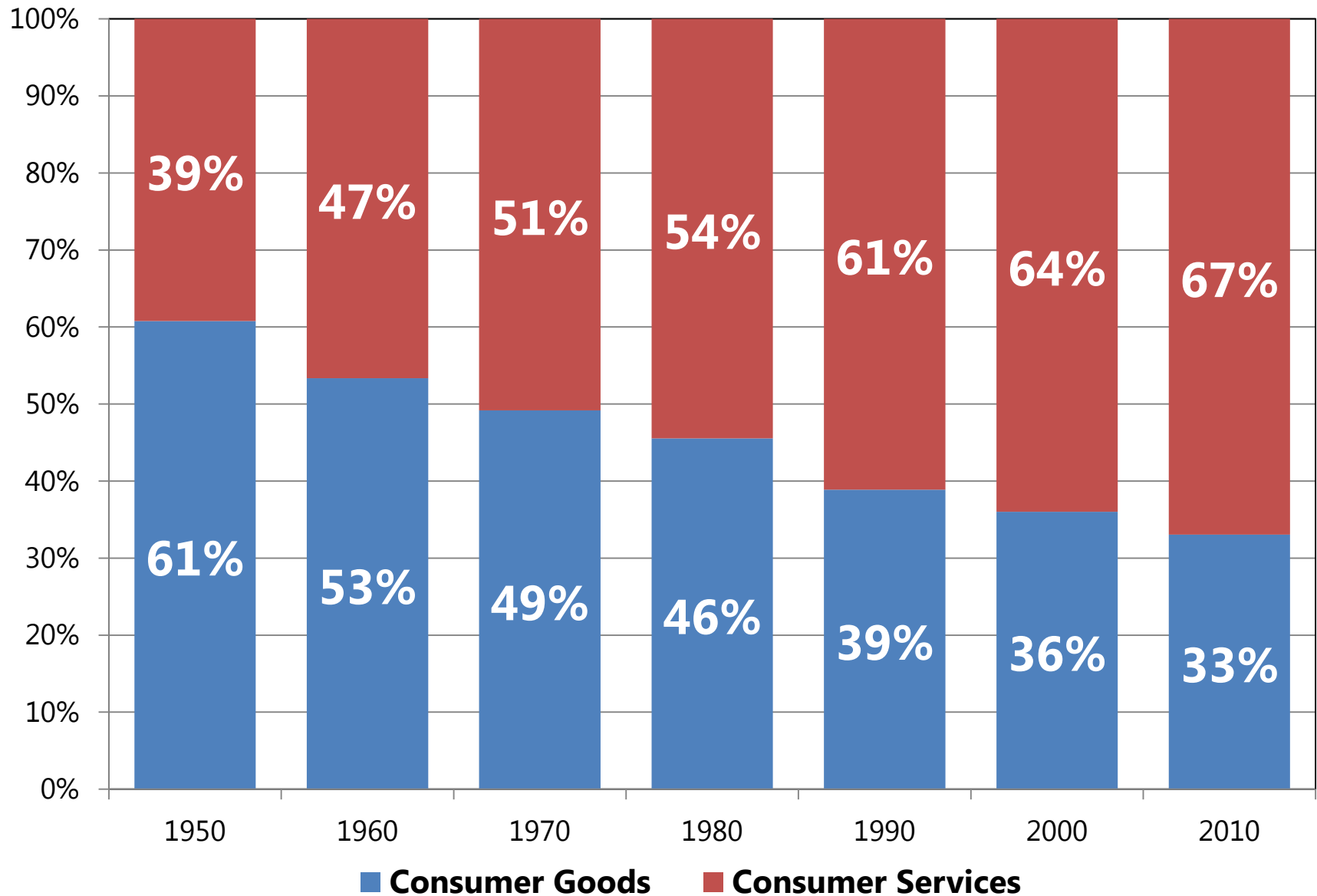


Take a closer look...

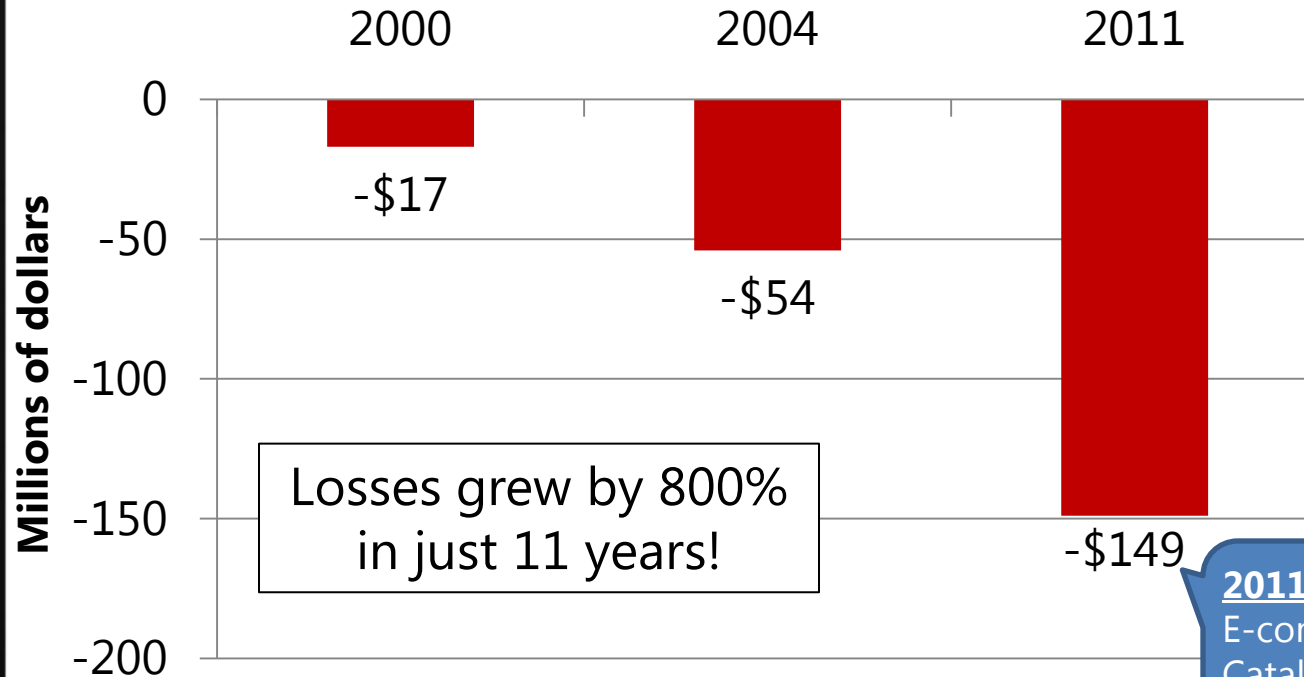




Consumers are spending more as a share of their income on services, less on goods



Estimated annual lost tax revenue from consumer e-commerce sales



2011 total loss = \$400 m

E-commerce \$149 m

Catalogs \$ 55 m

Remote seller \$190 m

Is our current tax system competitive?



...Yes?

Ernst and Young says Minnesota is among the top ten states with the lowest effective tax rates on new investment.¹

- Single sales apportionment factor
- Personal property exemption
- Capital equipment exemption
- R&D tax credit

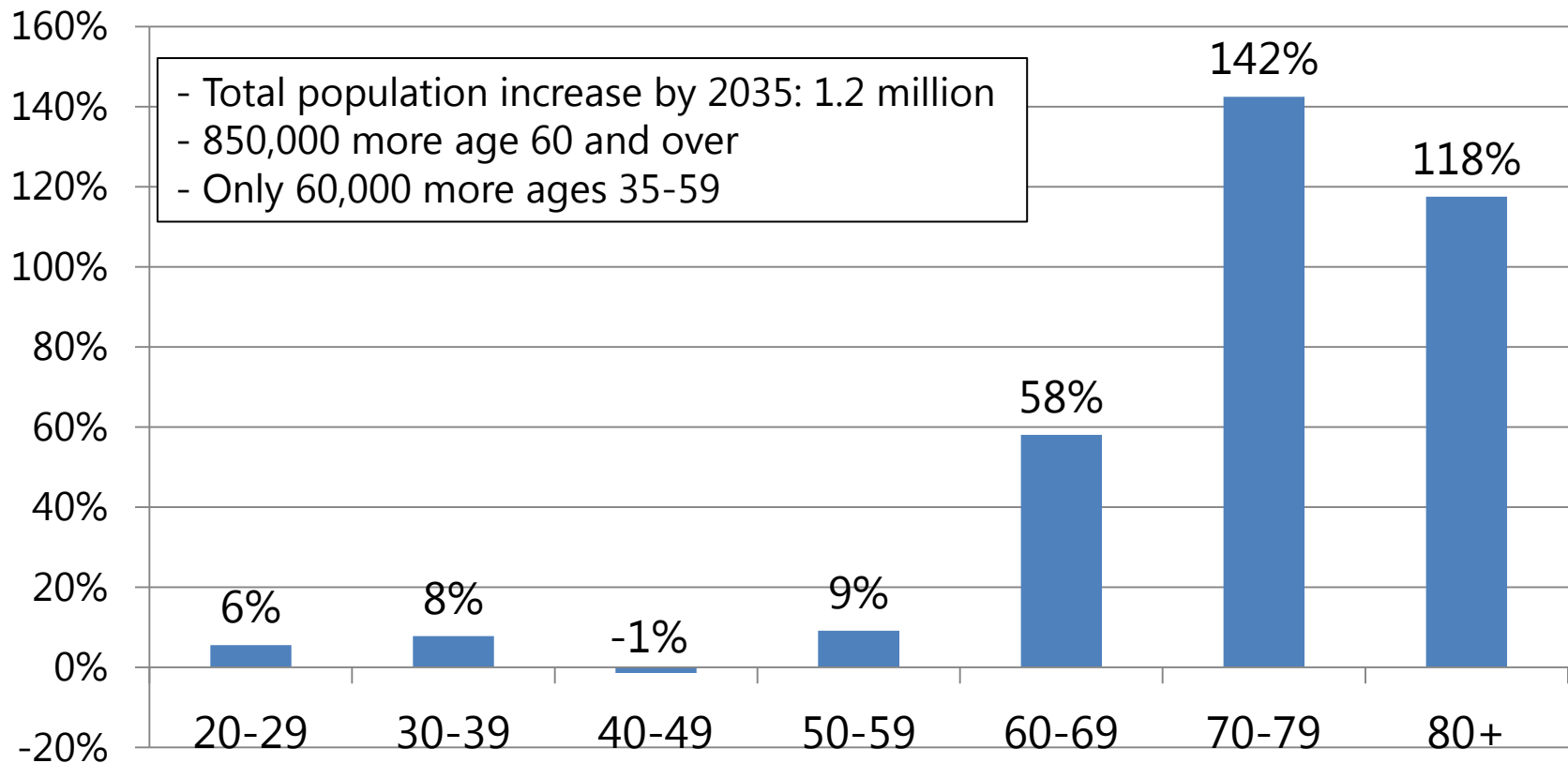


...No?

The Small Business and Entrepreneurship Council says Minnesota is among the 10 worst tax systems largely due to high statutory rates (not effective rates).²

Demographic change is coming

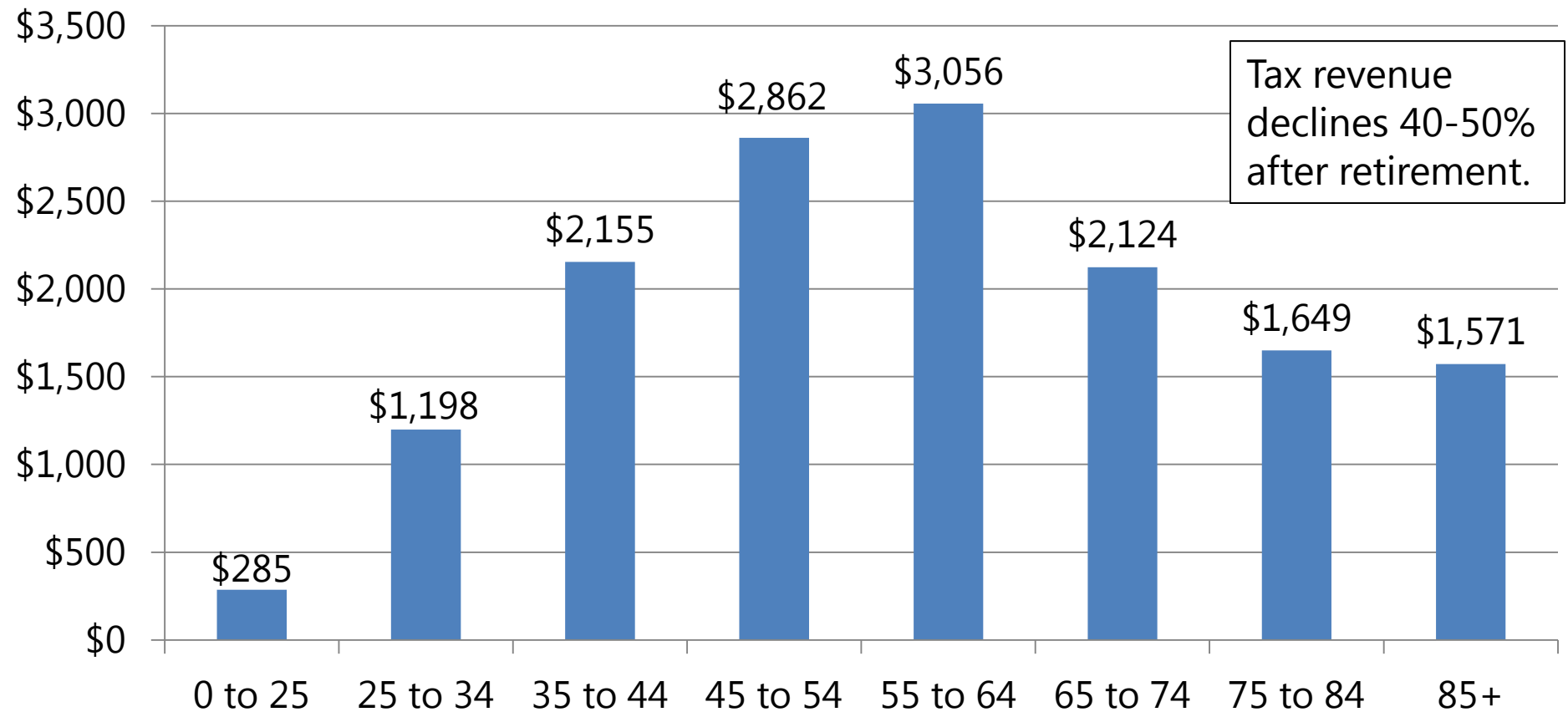
Percent change in age groups, 2007 - 2035





Demographics impact income tax revenue

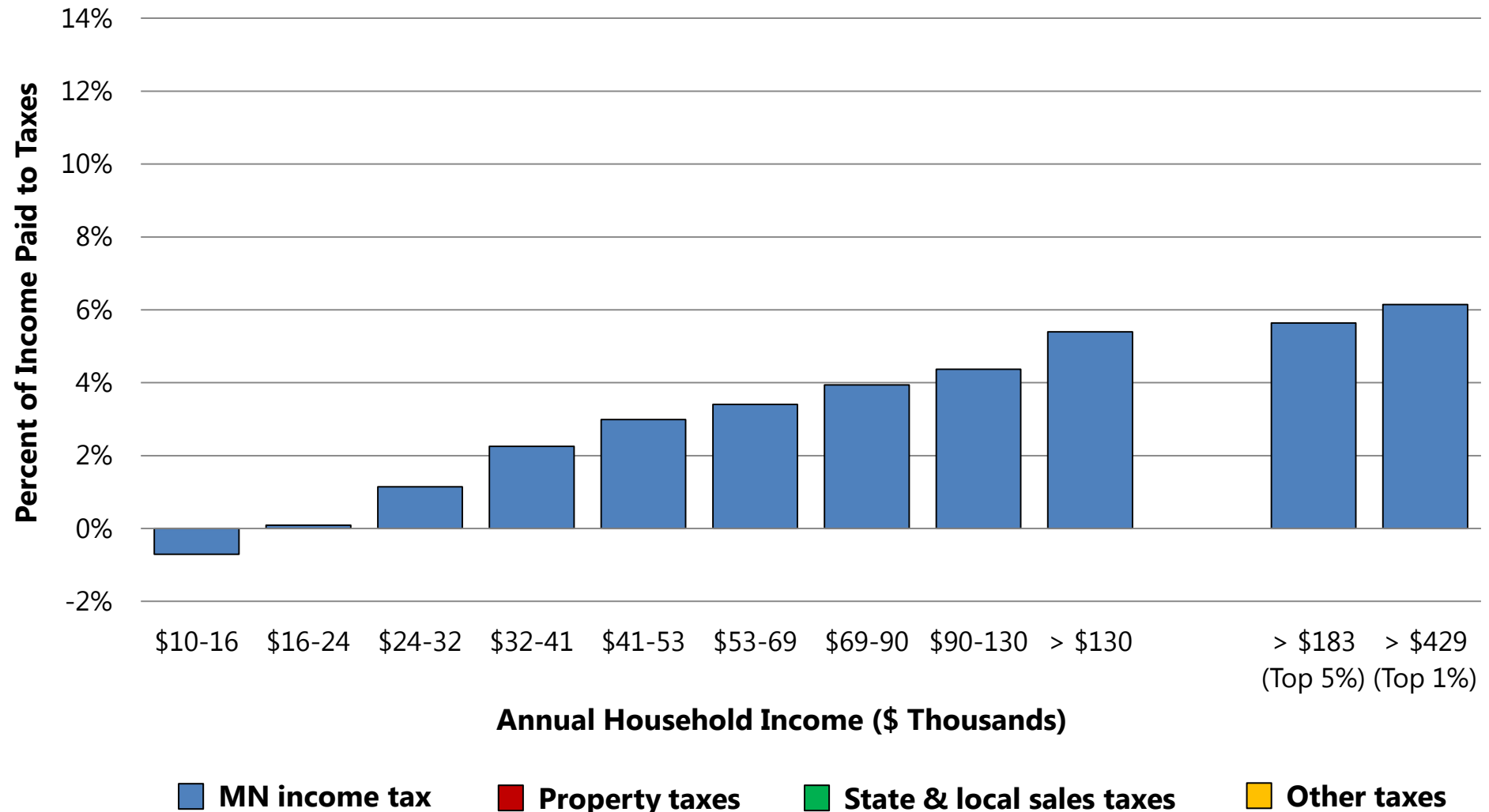
2007 average income taxes paid per MN taxpayer by age



Who pays?

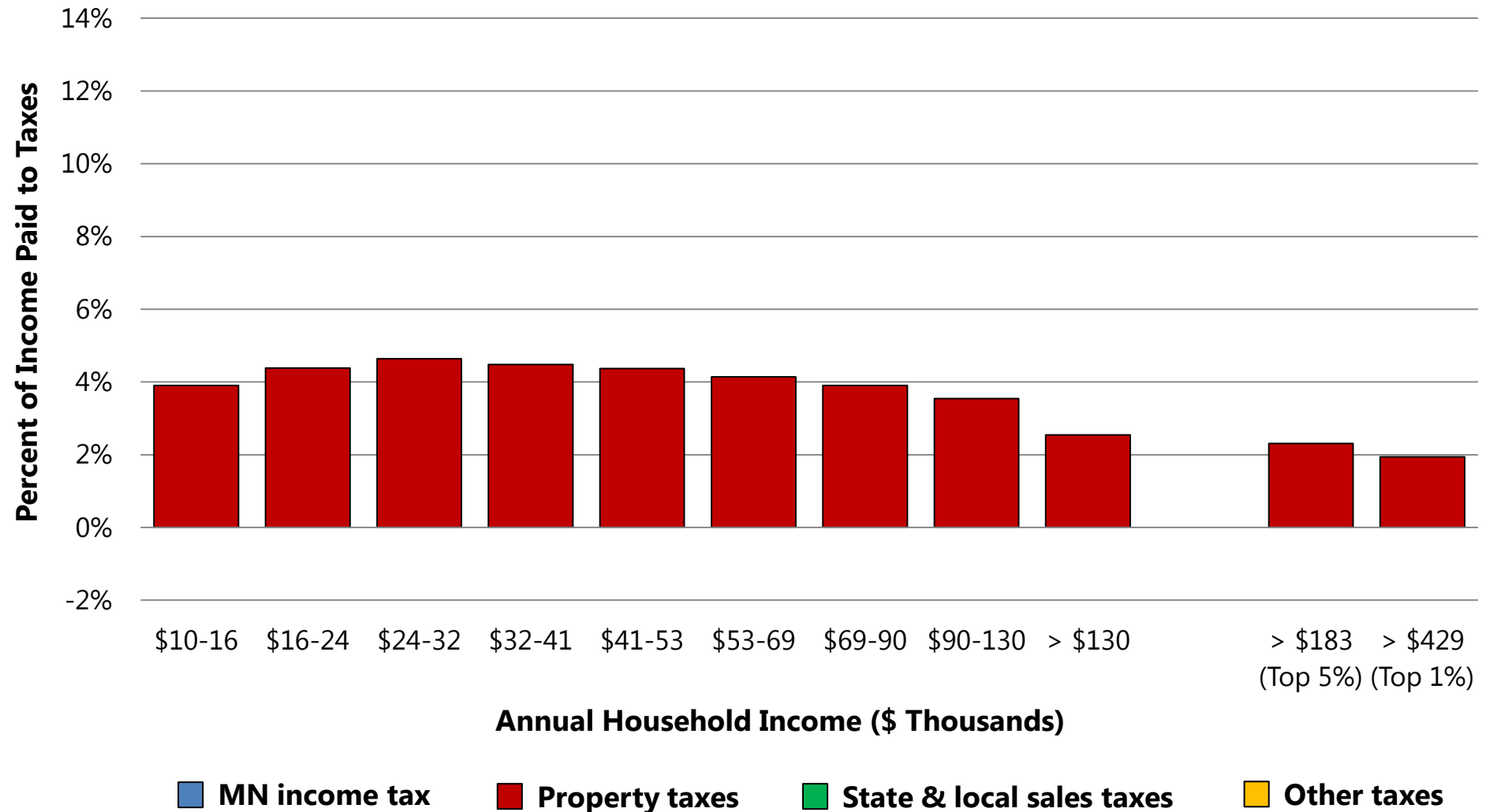
Our S&L effective tax rate includes regressive taxes and the progressive income tax

Cumulative state & local tax burden by population decile (2008)



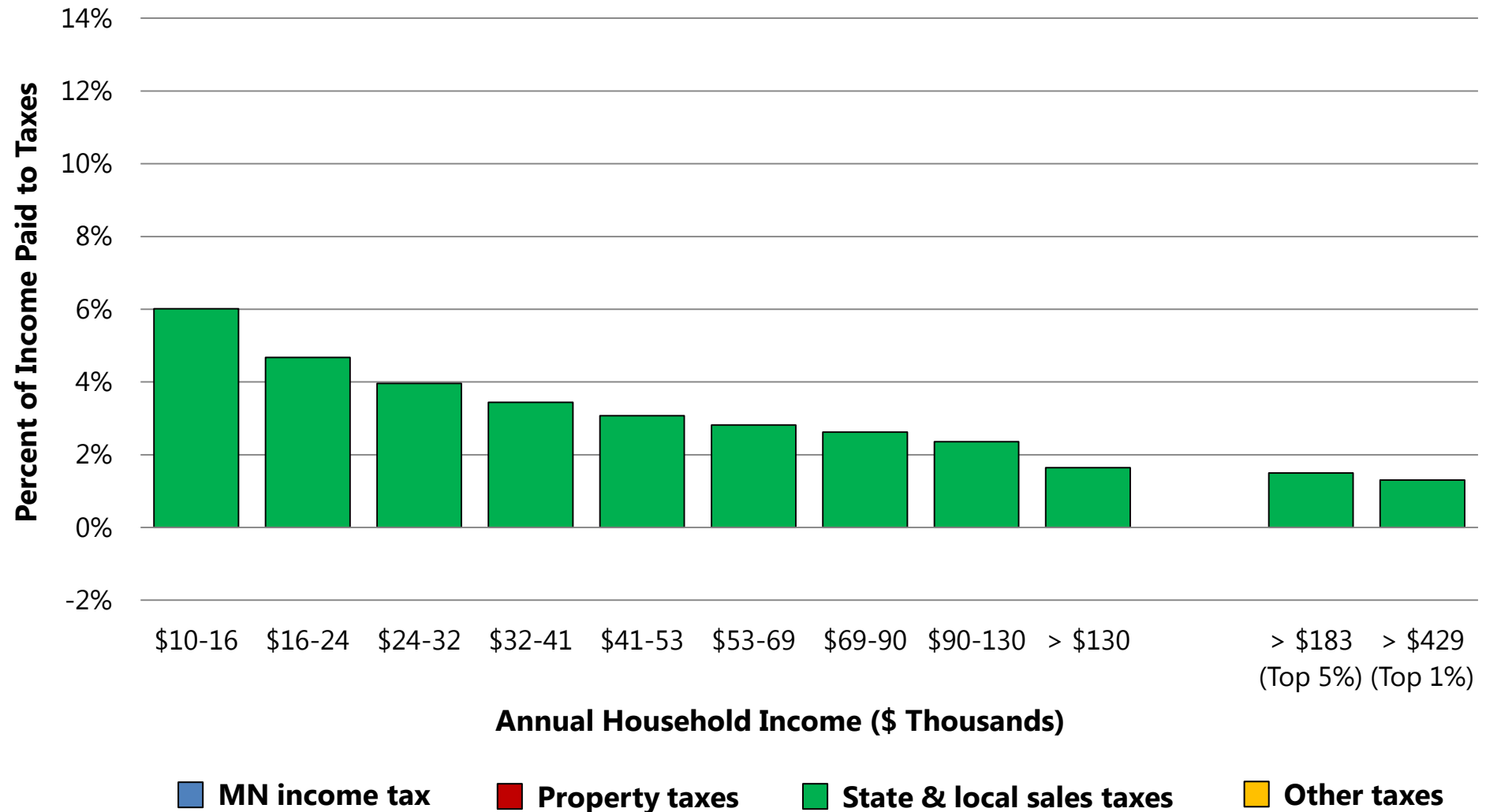
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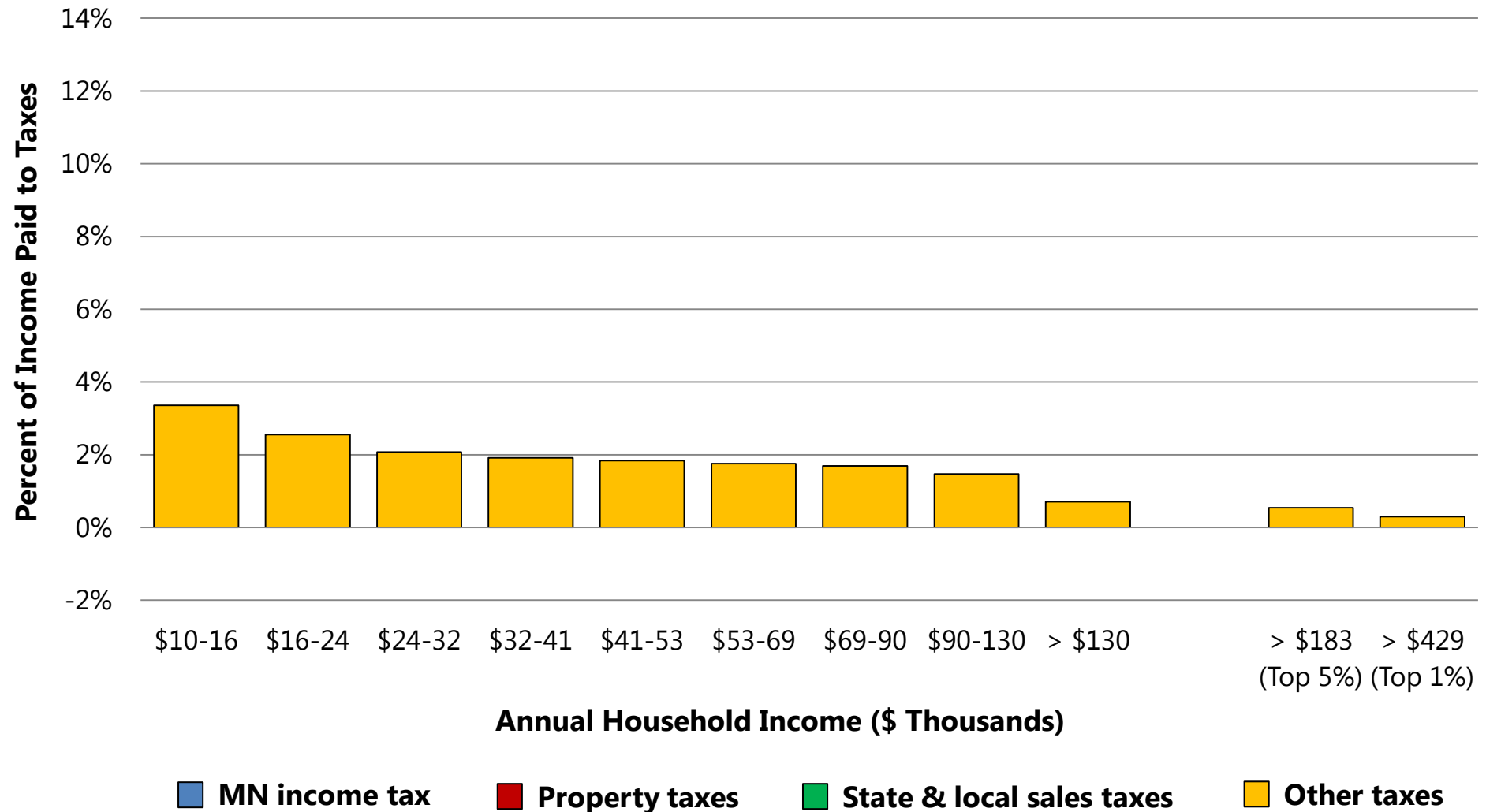
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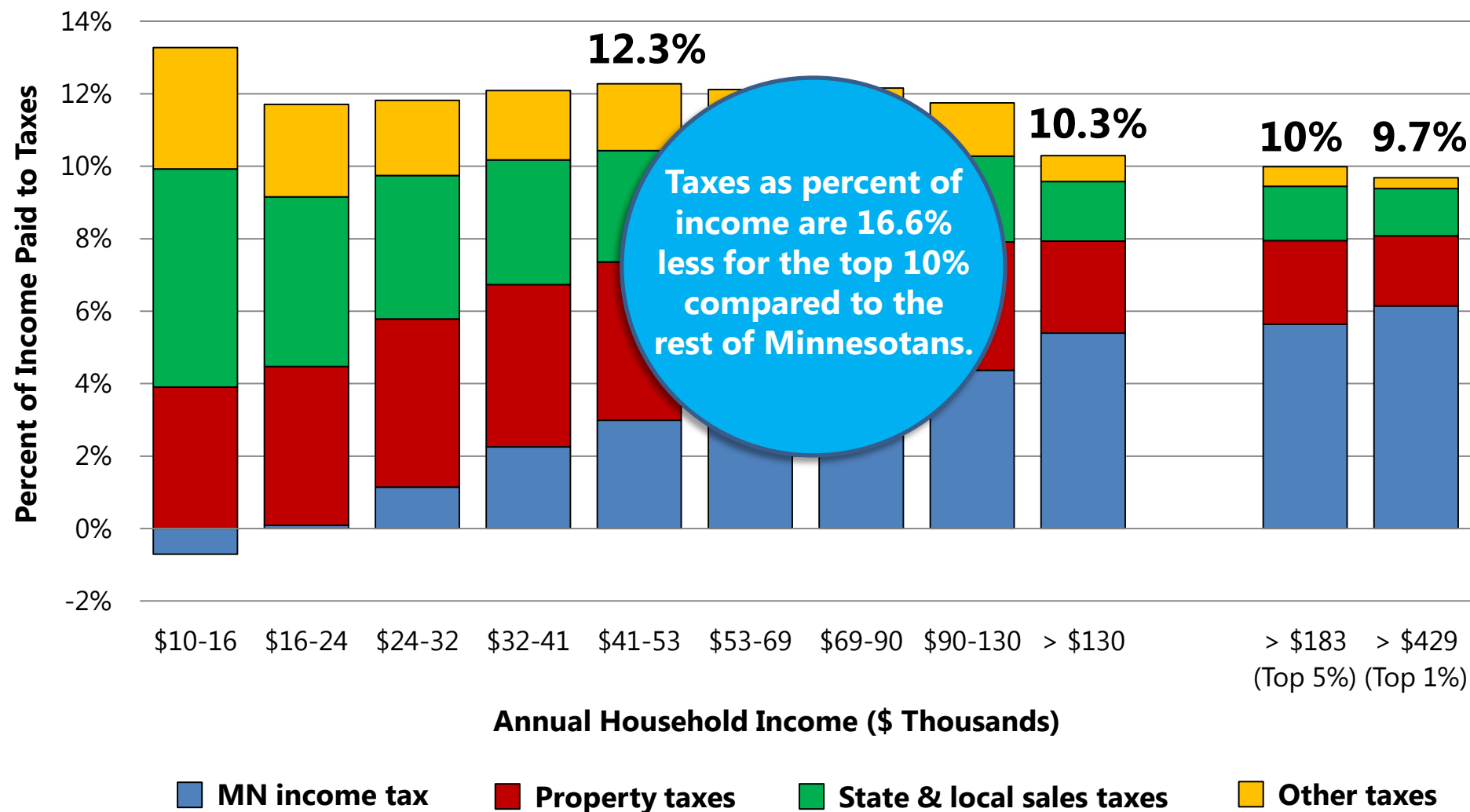
Cumulative state & local tax burden by population decile (2008)





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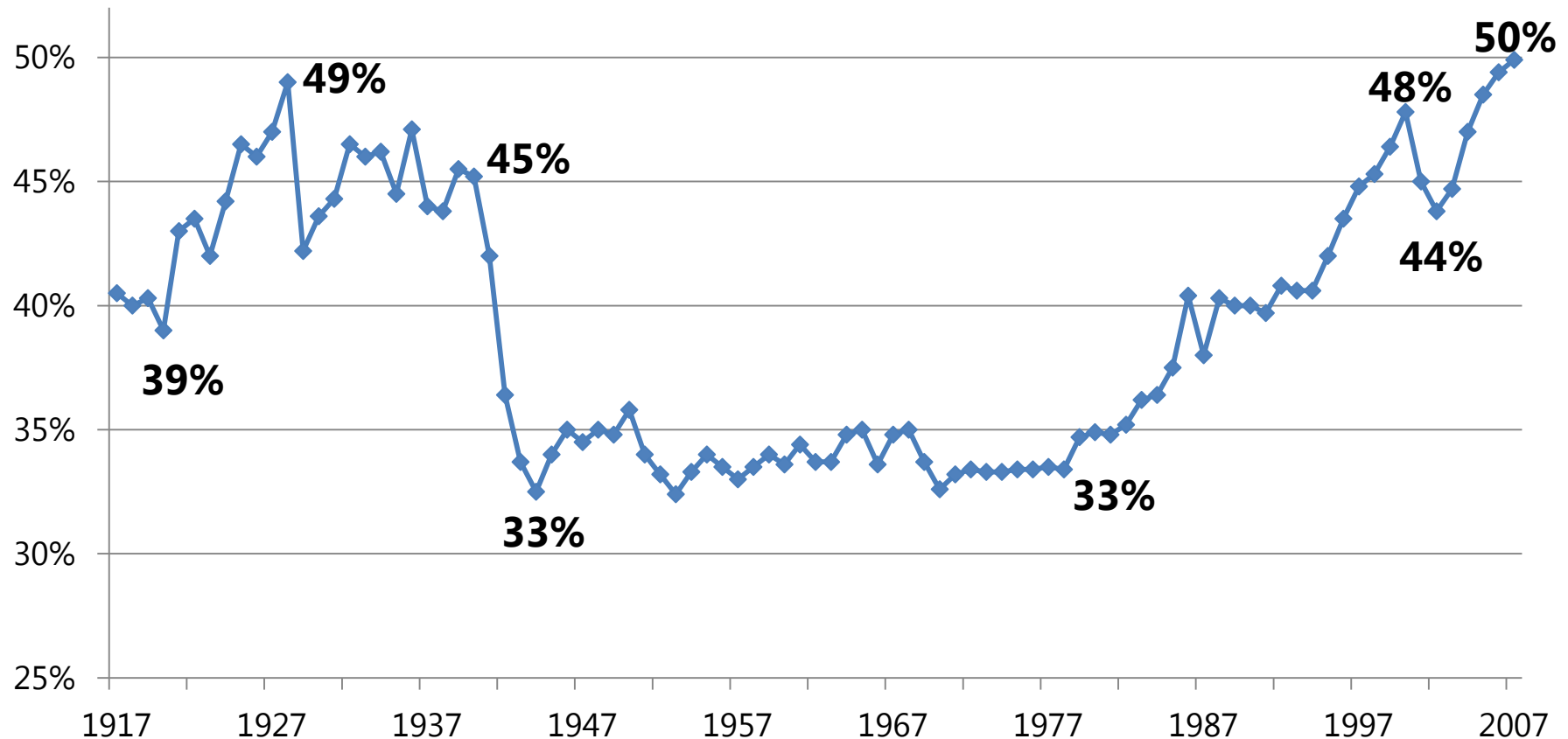
Cumulative state & local tax burden by population decile (2008)



**While income is increasingly
concentrated at the top...**

Growing income disparity

Top 10% now has 50% share of income (U.S.)

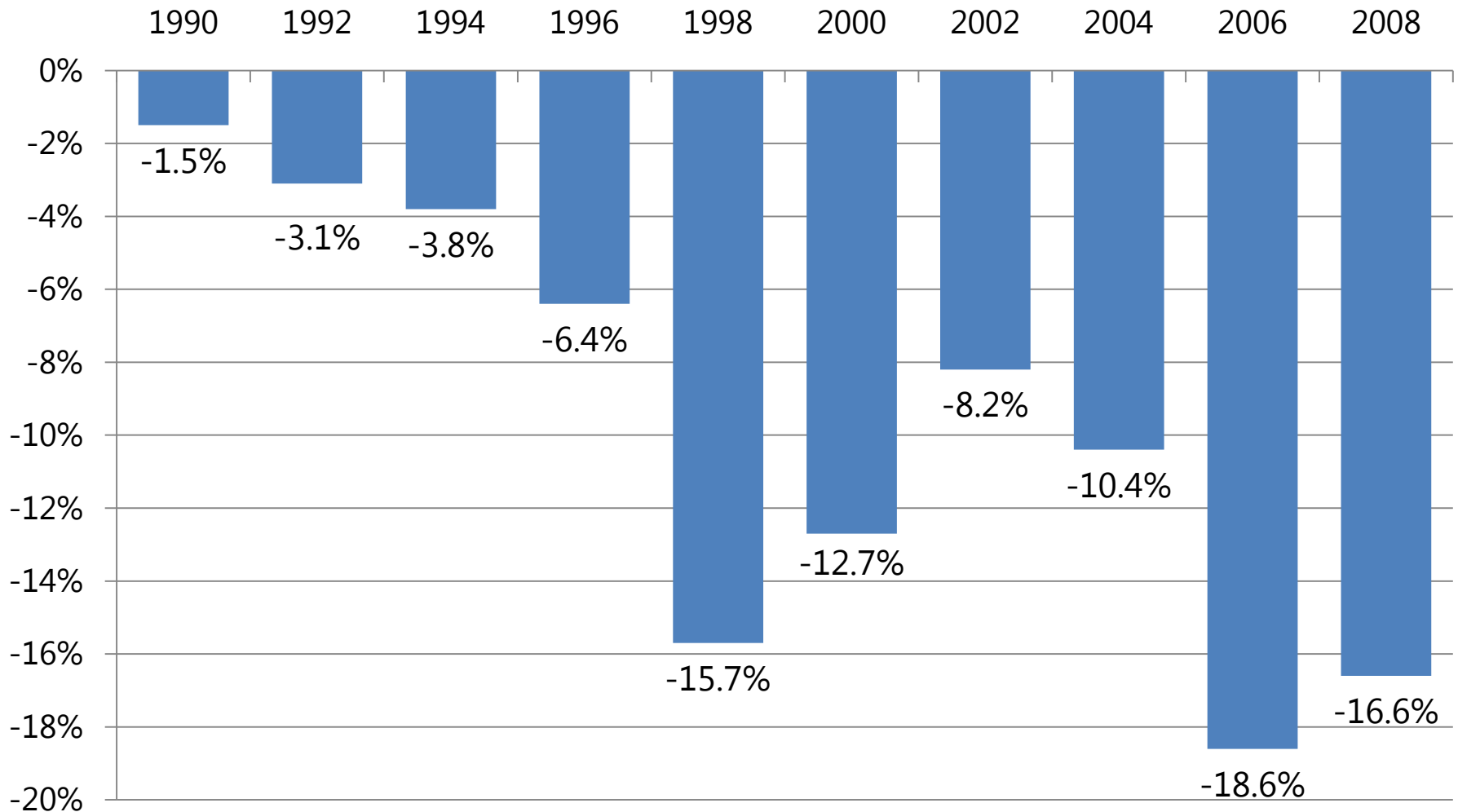


In 2007, top decile includes all U.S. families with annual income above \$109,600.

Sources: *Piketty & Saez (2003), series updated to 2007, Journal of Economic Literature, Vol. XLIX (Mar -11)*

**The tax burden is being
shifted to those with the
least ability to pay**

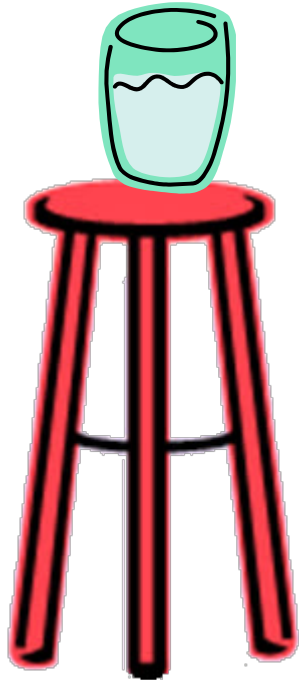
As a percent of income, the top 10 percent pay less than the rest of Minnesotans (and increasingly so!)



**Over time, the mix of taxes
in Minnesota has become
unbalanced**

The three legged stool

"Balanced"

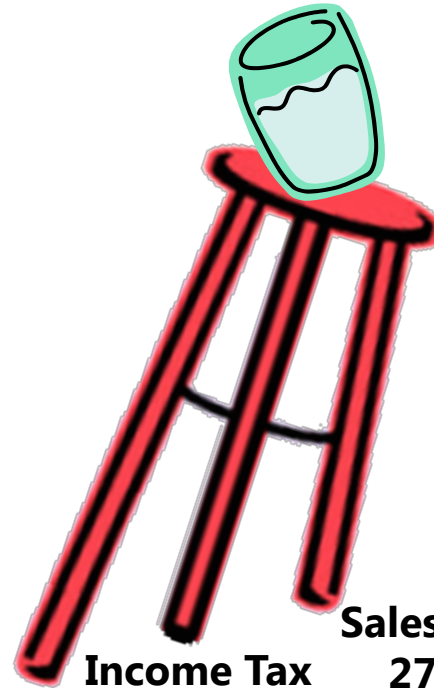


**Property Tax
33%**

**Income Tax
33%**

**Sales Tax
33%**

2010



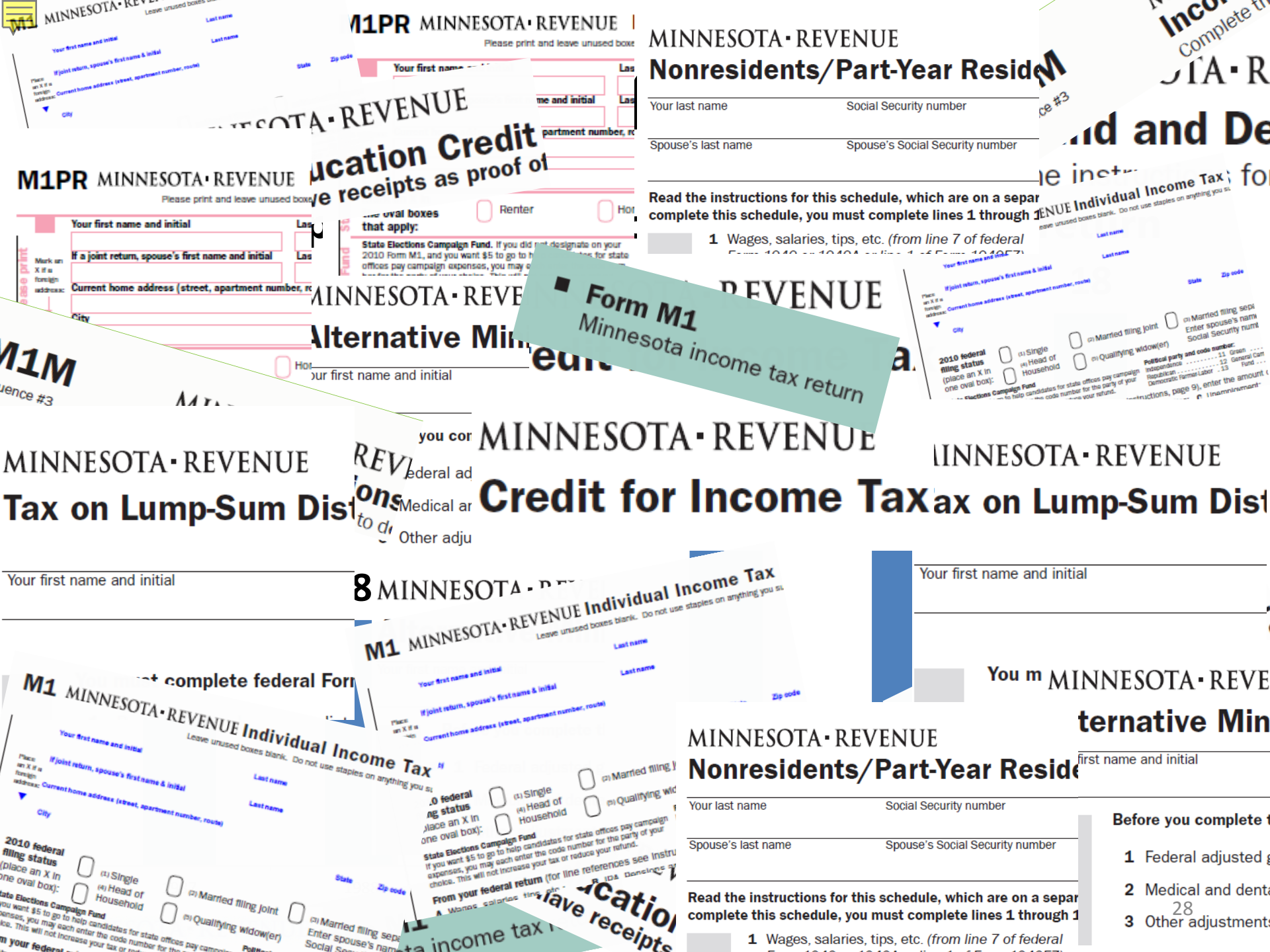
**Property Tax
40%**

**Income Tax
33%**

**Sales Tax
27%**



**Our tax system is becoming
more complex**



Form M1
Minnesota income tax return



1987 Income Tax Calculation

Start with:	Federal taxable income
Add:	Itemized deduction for state income taxes State and municipal bond interest Capital gain portion of lump-sum distribution
Subtract:	State income tax refund U.S. Bond interest Dependent K-12 education expenses
Equals:	Minnesota taxable income
Subtract:	Non-refundable tax credits Credit for income taxes paid to another state Credit for the elderly or disabled Refundable tax credits Child and dependent care credit

For the Individual
Income Tax, the
number of
adjustments and
credits has risen
from 9 to **50!**

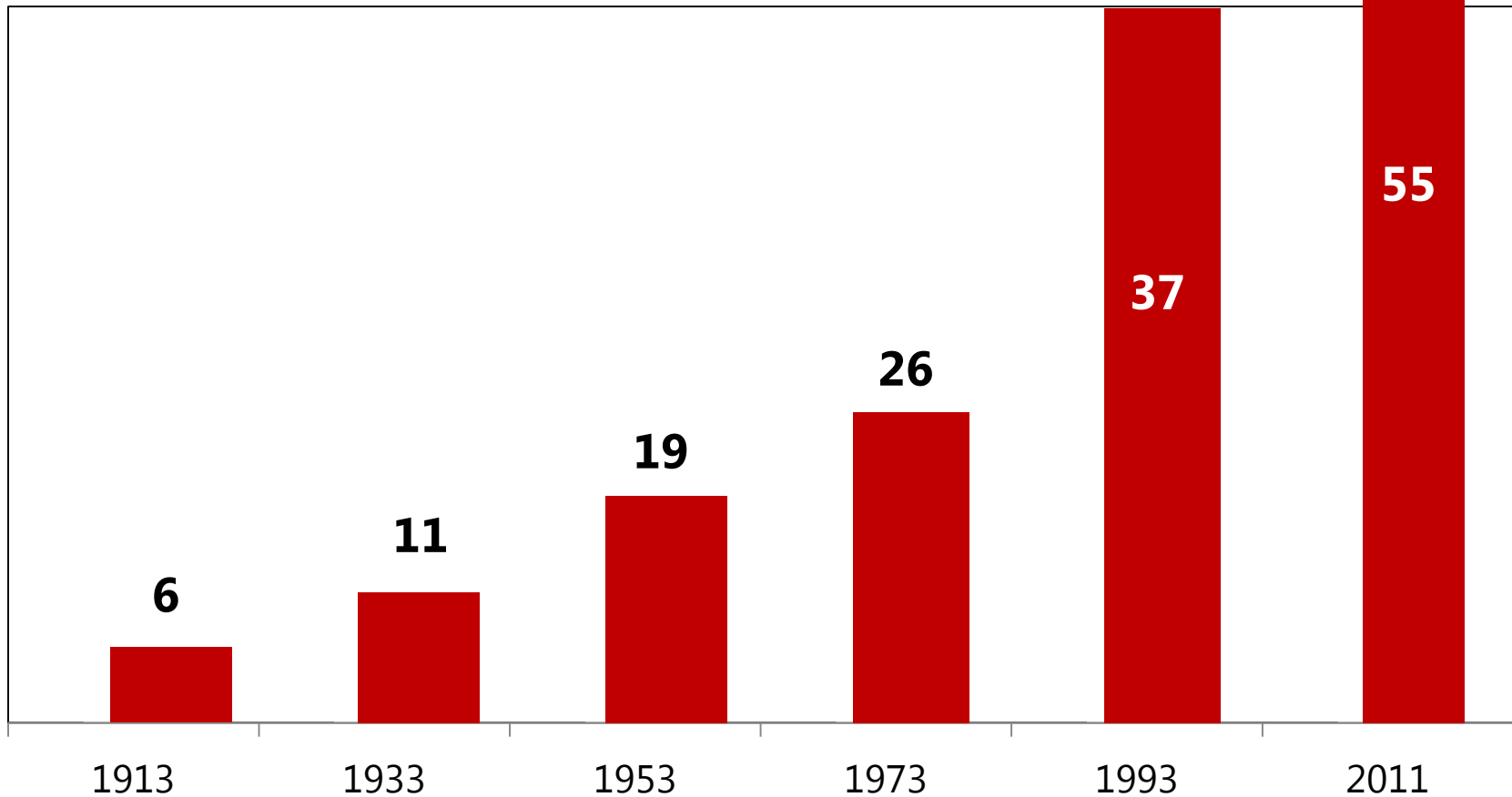
2010 Income Tax Calculation

Start with:	Federal taxable income
Add:	Itemized deduction for state income taxes Non-Minnesota state and municipal bond interest 80% of bonus depreciation taken federally 80% of increased federal Section 179 expensing taken federally Federal deduction for domestic production activities Additional federal standard deduction for real estate taxes or motor vehicle sales tax Expenses deducted federally on income not taxed by Minnesota Federally-exempt subsidy to employers with prescription drug coverage for their retirees Fines, fees, and penalties deducted federally as a trade or business expense Federally-exempt suspended losses generated by bonus depreciation Federally-exempt discharge of indebtedness Capital gain portion of a lump-sum distribution Net operating loss carryover adjustment for 2010
Subtract:	State income tax refund (if itemized in 2009) U.S. bond interest Dependent K-12 education expenses 50% of charitable contributions over \$500 for non-itemizers 20% of 2004-2009 addition for bonus depreciation 20% of 2006-2009 addition for 179 expensing Income of the elderly or disabled (limited) Railroad retirement income For American Indians, income earned on a reservation while living on the reservation Federal active duty military pay taxed federally (nonresidents) Federal active duty military pay taxed federally (residents) National Guard pay for service in Minnesota Organ donor expenses Income taxes paid to a subnational level of a foreign country other than Canada JOBZ business and investment income Gain from the sale of farm property by an insolvent farmer Post-service education award from AmeriCorps Net operating loss carryover adjustment from 2008 and 2009 Prior add-back of reacquisition of business indebtedness
Equals:	Minnesota taxable income
Subtract:	Non-refundable tax credits Marriage credit Credit for income taxes paid to another state Credit for long-term care insurance premiums Credit for past military service Credit for nonresident partners on taxes paid to home state Employer transit pass credit Credit for new participants in a Section 125 employer health insurance plan Alternative minimum tax credit SEED capital investment credit Refundable Tax Credits Child and dependent care credit Minnesota working family credit K-12 education credit Research credit Angel investment credit Historic rehabilitation credit JOBZ jobs credit Credit for tuberculosis testing in cattle Enterprise zone credit Credit for military service in a combat zone (administered off-form)



Expanding number of property classes and tiers

More fair or just more complicated?



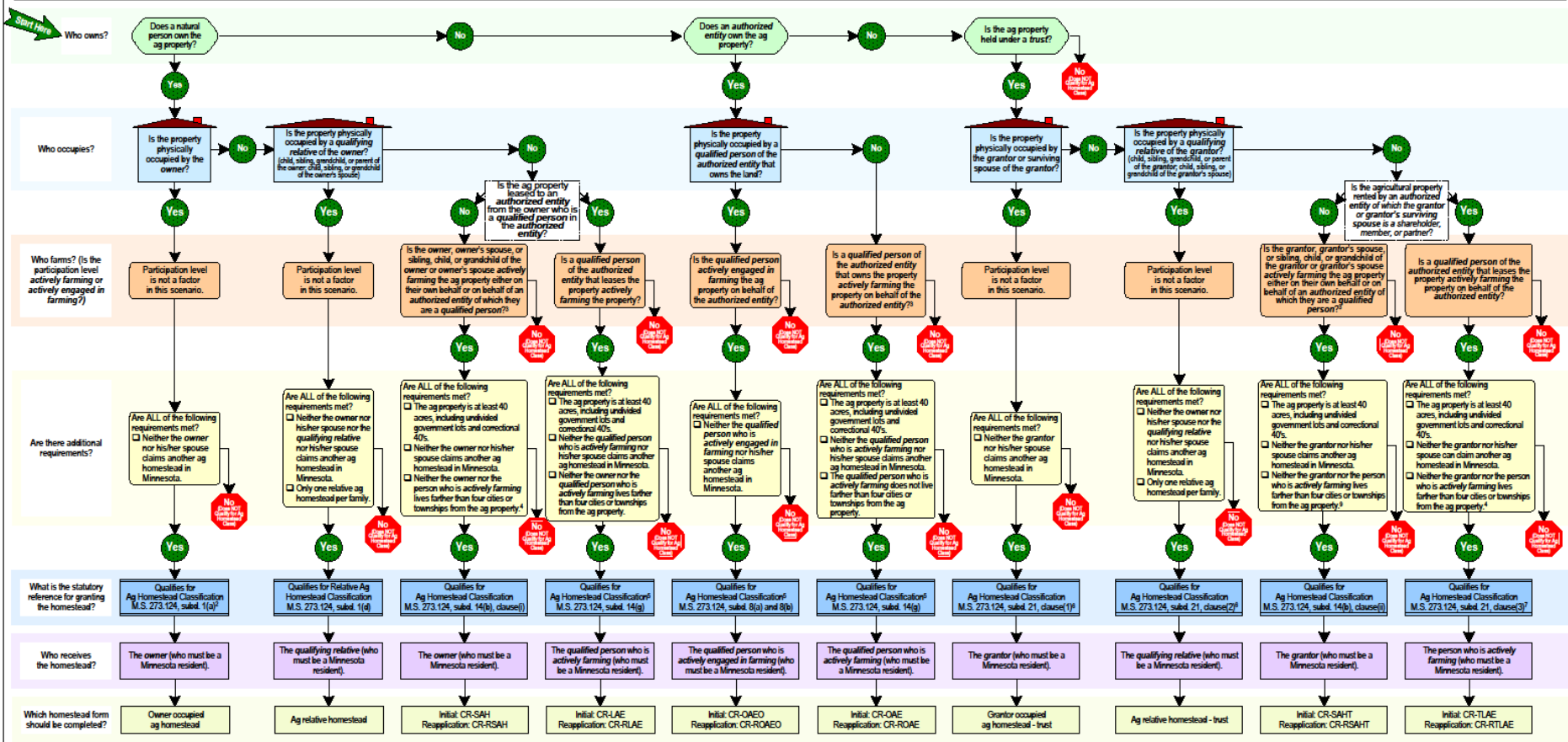
So you want agricultural homestead?

MINNESOTA • REVENUE

Determining if property qualifies for the agricultural homestead¹ classification

2009 Revisions

Note: Terms in **bold**, *italic font* are defined in the glossary.



Footnotes

Note: Terms in **bold**, *italic font* are defined in the glossary.

- The property must first properly qualify as agricultural pursuant to M.S. 273.13, subd. 23.
- If the entire property including the HGA is leased, the property must meet the requirements of M.S. 273.124, subd. 8(c) to qualify as an owner occupied ag homestead.
- In some cases, the Farm Service Agency number may be in an authorized entity's name when the person *actively farming* is doing so on behalf of the authorized entity.

- If the owner or the owner's spouse (or grantor or grantor's spouse) is required by their employer to live in employer-provided housing, the owner or owner's spouse, who is *actively farming* the agricultural property, may live more than four townships or cities from the agricultural property.
- This is limited to authorized entities with 12 or fewer members, shareholders, or partners. If the entire property including the HGA is leased, the property must qualify under M.S. 273.124, subd. 21, clause (3) to qualify as an owner occupied ag homestead.

This statute was amended by Laws 2005, Chapter 151, Article 5, Section 21. Previously, this provision required a *qualified person of the authorized entity* to occupy the property and *actively farm* it on behalf of the *authorized entity* to receive homestead (the qualified person did not have to be the grantor, spouse of the grantor or son or daughter of the grantor). Those receiving homestead under this clause for taxes payable in 2005, but no longer qualify due to the 2005 law change, may continue to receive homestead as long as the requirements of this clause as it existed for taxes payable in 2005 are met.

Glossary

Note: Terms used in the flow chart are defined below. See the full glossary in the agricultural bulletin for definitions of **bold**, *italic* words listed below.

actively engaged in farming - participation on the farm on a regular and substantial basis. The person who is actively engaged in farming must be a Minnesota resident.

authorized entity - can be a *family farm corporation*, *joint family farm venture*, *limited liability company*, or *partnership* operating a *family farm* (M.S. 273.124, subdivision 8(a)). This is limited to authorized entities with 12 or fewer members, shareholders, or partners. The following entities would be eligible for homestead treatment: *authorized farm limited liability company* (operating a *family farm*), *authorized farm partnership* (operating a *family farm*), *family farm limited liability company* (operating a *family farm*), *family farm partnership* (operating a *family farm*), *family farm partnership* (operating a *family farm*).

grantor - is defined as the person creating or establishing a testamentary, *inter vivos*, *revocable* or *irrevocable trust* by written instrument or through the exercise of a power of appointment (M.S. 273.124, subdivision 21). For property that is held under a trust to receive an agricultural homestead, the grantor must be a Minnesota resident and neither the grantor nor the spouse of the grantor can claim another agricultural homestead.

owner - is defined as an individual person or multiple people who own the property (i.e., not owned by a business or entity). To receive an agricultural homestead, the owner must be a Minnesota resident, and neither the owner nor the spouse of the owner can claim another agricultural homestead.

qualified person - must be a Minnesota resident and can be a member in an authorized entity, a shareholder in an authorized entity, or a partner in an authorized entity.

qualifying relative or surviving relative - must be a Minnesota resident. The definition depends on the type of property: **Residential property**: a qualified relative of the owner or grantor can be a parent, stepparent, child, stepchild, grandparent, grandchild, sibling, aunt/uncle, or niece/nephew (M.S. 273.124, subdivision 14(b)). **Agricultural property**: a qualified relative can be a child, sibling, grandchild or parent of the owner or grantor of the agricultural property or a child, sibling or grandchild of the spouse of the owner or grantor of the agricultural property (M.S. 273.124, subdivision 14(d)).

trust - a fiduciary relationship under which one party holds property for the benefit of another party.

trustee - means the party that holds property rights for the benefit of another party through a trust.

Tax expenditures: Minnesota's hidden spending



“Swiss cheese” tax policy?



Bigger block,
lots of holes



Smaller block,
not as many holes



Total state tax revenue before preferences

\$11b Tax expenditures and loopholes

tax expenditures and loopholes

= \$16b

Annual state tax revenue (2010)

For every dollar of state tax revenue without preferences...



60¢

goes to education, health care and other public expenditures

40¢

goes to tax expenditures and loopholes

What do we value in a tax system?



Fair



Simple



Supports Growth



Minnesotans

Minnesotans

Minnesotans

Minnesotans

Minnesotans

Governor

**Legislative
Champions**

Minnesotans

**What will it take to
achieve tax reform in
Minnesota?**

**Committed Staff
& Organizations**

Minnesotans

Minnesotans

YOU!

Minnesotans

Minnesotans

Minnesotans

Minnesotans

What are your ideas for tax reform?

Tell us!

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Commissioner of Revenue
651-556-6003

revenue@state.mn.us

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