July 9, 2012 – Regional Council of Mayors
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

As of February 2012, state unemployment was down 75,000 jobs from the 2008 high, up 81,000 jobs from the 2009 low.

Changing number of jobs drives big swings in state revenue

Jobs matter to the state budget

- **Number of Jobs**: 4.7% swing from Trough to Peak, 5% swing from Peak to 2010
- **Sales Tax**: -5.7%
- **Income Tax**: 23%
- **Corporate Tax**: 92%

Tax revenue by fiscal year. Sales tax includes General Fund only and excludes motor vehicle sales tax.
Taxes tell part of the story...
State and local tax revenue as a percent of personal income

Minnesota collected tax revenues at or above the national average for 45 years through 2002 but below the national average seven of the last eight years.
...But taxes don’t tell the whole story
Minnesota has gone from 26th in per-capita income in 1950 to 10th in 2010 (and reaching as high as 7th in 2004). Our per-capita income in 1956 was 91% of the national average; 107% in 2010 (109% in 2004).
Take a closer look...
Consumers are spending more as a share of their income on services, less on goods

Source: U.S. Bureau of Economic Analysis
Estimated annual lost tax revenue from consumer e-commerce sales

Losses grew by 800% in just 11 years!

2000: -$17
2004: -$54
2011: -$149

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

1. Competitiveness of State and Local Business Taxes on New Investment, Ernst and Young, April, 2011
2. Small Business & Entrepreneurship Council’s Business Tax Index 2011
Demographic change is coming

Percent change in age groups, 2007 - 2035

- Total population increase by 2035: 1.2 million
- 850,000 more age 60 and over
- Only 60,000 more ages 35-59

Source: Minnesota State Demographer
Demographics impact income tax revenue

2007 average income taxes paid per MN taxpayer by age

Tax revenue declines 40-50% after retirement.
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.

The tax burden is being shifted to those with the least ability to pay
The middle class is paying a larger share of Minnesota taxes

Population-decile suits index, all taxes

Overall Suits Index

Base Year


-0.059 -0.054 -0.031 -0.018 -0.017 -0.017 -0.007 0.011 0 0

The middle class is paying a larger share of Minnesota taxes.
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)

Percent of Income Paid to Taxes

Sources: Minnesota Tax Incidence Study 2011 (Tax Year 2008), MN Dept. of Revenue. (Annual income amounts rounded)
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
More forms

1987:
M1, M1CD, M1CR, M1LS, M1MT, M15

2010:
M1, M1CD, M1CR, M1LS, M1MT, M15

M1B, M1C, M1ED, M1H, M1LTI, M1M, M1MTC, M1R, M1W, M1WFC, JOBZ, ETP

Number of possible forms for a resident's initial return: 24
### 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 |

### 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 |
| Equals: | Minnesota taxable income |
| Subtract: | Non-refundable tax credits  
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) |

For the Individual Income Tax, the number of adjustments and credits has risen from 9 to 50!
Expanding number of property classes and tiers

More fair or just more complicated?

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So you want agricultural homestead?
Tax expenditures: Minnesota’s hidden spending
“Swiss cheese” tax policy?

Bigger block, lots of holes

Smaller block, not as many holes
For every dollar of state tax revenue without preferences...

60¢

go to education, health care and other public expenditures

40¢

go to tax expenditures and loopholes
What do we value in a tax system?

- Fair
- Simple
- Supports Growth
What will it take to achieve tax reform in Minnesota?
What are your ideas for tax reform?

Tell us!

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