



# Minnesota Taxes: Who Pays and How Much

## An Explanation of Tax Incidence

When talking about taxes, who pays and how much is a central issue. Minnesota's state and local tax system has the following characteristics:

- Minnesota's tax system is roughly proportional, taking approximately the same percentage of income in taxes from people of all income levels.
- Each type of tax varies in its impact. Lower-income Minnesotans pay more of their tax burden as sales and excise taxes; upper-income people pay more of their tax burden as income taxes.
- Each income group in Minnesota pays taxes in rough proportion to its share of total income. For example, the wealthiest 10% of Minnesotans receive 41.8% of total state income. This group pays 37.7% of total state and local taxes.
- Recent tax changes, while reducing taxes for all income levels, have been most advantageous to those in the bottom and top income levels, with smaller benefits for those in the middle.

### The Tax Incidence Study

To determine who pays Minnesota taxes, the Minnesota Department of Revenue releases a comprehensive tax incidence study every two years. Determining **tax incidence** means identifying where tax burdens ultimately fall, regardless of who is legally required to pay the tax. For example, although the owner of an apartment building is required to pay the property tax on it, a portion of the tax is shifted to renters in the form of higher rents. Likewise, taxes paid by businesses may be shifted onto workers as lower wages, onto consumers as higher prices, or onto owners as a smaller return on their investment.

The tax incidence study divides the population by income into ten groups containing an equal number of households, called deciles. For example, the bottom decile contains the 10% of Minnesotans with the lowest incomes.<sup>1</sup> The study looks at actual taxes paid and calculates its **effective tax rate**, which is what percentage of income each decile spends on taxes. The 2001 Tax Incidence Study covers taxes paid in 1998 and estimates taxes to be paid in 2003.

### Minnesota's Tax System is Roughly Proportional

Tax systems are frequently measured in terms of regressivity or progressivity. A **regressive** tax takes a higher percentage of income from those with lower incomes. If a tax takes a higher percentage of income from those with higher incomes, that tax is said to be **progressive**. Minnesota's overall tax system is roughly **proportional**, meaning all Minnesotans pay about the same percentage of their incomes in total state and local taxes.

Regressivity is often measured by the Suits Index, which is a number between -1.00 and 1.00. A proportional tax has a Suits Index of 0. A progressive tax has a positive Suits Index and a regressive tax has a negative Suits index.

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<sup>1</sup> There are a number of data issues regarding the bottom decile, which overstates the level of taxation. For this reason, it is common to disregard the first decile in analysis. Although the results for the first decile are shown in this document, the results from the first decile are disregarded when making statements about the tax system as a whole.

While overall Minnesota's tax system is roughly proportional and had a Suits Index of -0.04 in 1998, individual taxes show a wide variation in their Suits Indexes.

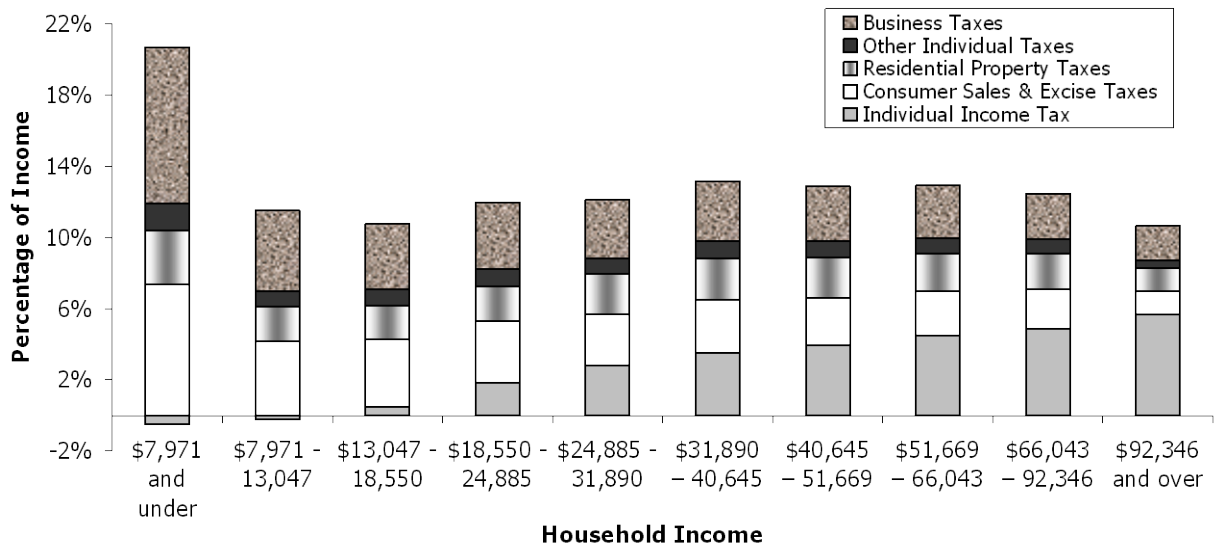
Tax Category	1998 Suits Index
Individual Income Tax	0.173
Motor Vehicle Registration Taxes	-0.130
Total Local Property Taxes (includes property tax refunds)	-0.135
Corporate Franchise Tax	-0.144
General Sales/Use Tax	-0.175
Motor Vehicle Sales Tax	-0.197
Alcoholic Beverage Excise Tax	-0.207
MinnesotaCare Taxes	-0.220
Motor Fuels Excise Tax (Gas Tax)	-0.249
Cigarette and Tobacco Excise Taxes	-0.528

### Minnesota's Tax Distribution

In 1998, Minnesotans paid an average of 11.8% of income in state and local taxes, with 8.9% of income being paid for state taxes and 2.9% for local property taxes. After the 2001 legislative session, total state and local taxes for 2003 were estimated to drop to 10.7% of income.

Although all Minnesotans pay about the same percentage for total taxes, the way in which Minnesotans pay their taxes varies greatly. As income grows, sales and excise taxes become a smaller part of the tax burden and income taxes become larger. This difference is important to keep in mind when decisions are made to change a certain tax. The impact will not be evenly distributed across the board, but will depend on how much that tax contributes to the taxpayer's total tax burden.

### 1998 Effective Tax Rates



The graph above groups families of the same income level together, but within each decile there will be families of different sizes. Within each decile, the actual tax burden faced by any particular family could vary significantly from the average. Actual taxes owed depends on such factors as family size, marital status, and whether one is a homeowner or a renter.

Another way of measuring tax distribution is by comparing how much each group pays in relation to its share of total income. In Minnesota, although the upper deciles pay a larger share of taxes in relation to their share of population, all deciles pay roughly in proportion to their share of the state's total income. For example, the wealthiest 10% of Minnesotans pay 37.7% of state and local taxes, but they receive 41.8% of total income.

<b>Percentage of Income and Percent of Taxes Paid (1998)</b>			
<b>Decile</b>	<b>Income</b>	<b>Percent of all Income</b>	<b>Percentage of all Taxes Paid</b>
1	\$7,971 and under	1%	1.6%
2	\$7,971 - 13,047	2.1%	2.0%
3	\$13,047 - 18,550	3.1%	2.8%
4	\$18,550 - 24,885	4.2%	4.3%
5	\$24,885 - 31,890	5.5%	5.7%
6	\$31,890 - 40,645	7.0%	7.8%
7	\$40,645 - 51,669	8.9%	9.7%
8	\$51,669 - 66,043	11.4%	12.5%
9	\$66,043 - 92,346	15.1%	16.0%
10	\$92,346 and over	41.8%	37.7%

### Changes in Incidence Over Time

Over the past several years, Minnesota's taxes have been cut significantly. Because some of these tax cuts were not yet in effect in 1998, the tax incidence study estimates taxes for 2003, at which time all tax cuts enacted in the 2000 and 2001 legislative sessions will be in effect.

Recent tax reductions have reduced the overall level of taxation for all income levels, but the distribution of taxes has been changing. Although the overall measurement of the tax system still shows that it is neither strongly regressive nor progressive, a pattern is emerging in which low-income and upper-income households pay a smaller percentage of income in state and local taxes while households in the middle pay a higher percentage.

### Tax incidence trends, 1996 to 2003

