

Minnesota's Taxes: Who Pays and How Much

Overview of Minnesota's State and Local Tax System

- Minnesotans paid an average of 11.3% of their incomes in total state and local taxes in 2002, the most recent year for which comprehensive data is available.¹
- The highest-income Minnesotans contribute a smaller share of their incomes in total state and local taxes than other Minnesotans. In other words, Minnesota's tax system is slightly regressive.
- Minnesotans pay a significantly smaller share of their incomes in total state and local taxes than in the past. Minnesota's taxes in 2002 were 12.4% lower than in 1994, measured as a share of income.
- How Minnesotans pay their taxes varies with income. Lower-income Minnesotans pay a larger share of their incomes in sales and property taxes. Higher-income people pay more of their income in income taxes.

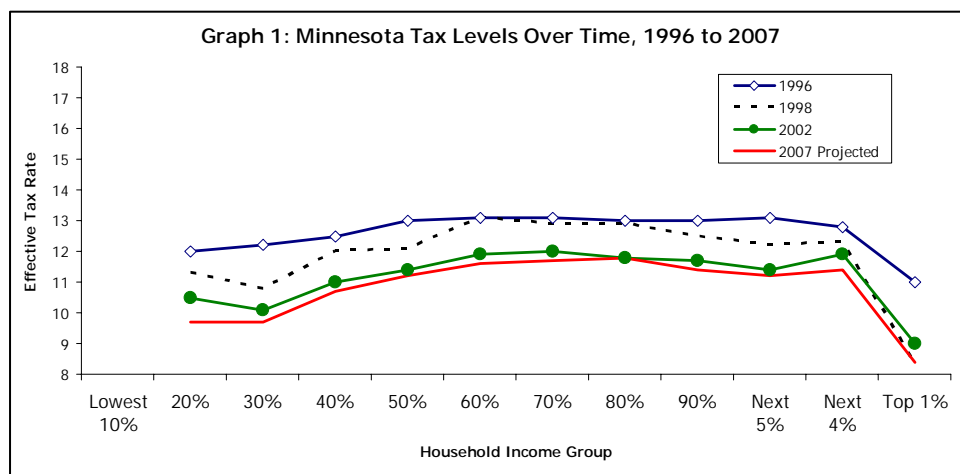
Minnesota's Tax System is Slightly Regressive

Taxes can be described as regressive or progressive. A tax is regressive if taxpayers with lower incomes pay a higher share of their income for that tax than those with higher incomes do. In contrast, if those with higher incomes pay a higher percentage of income for a tax, that tax is progressive. Minnesota's state and local tax system is slightly regressive. Although Minnesota's tax system is sometimes described as proportional, meaning all Minnesotans pay about the same percentage of their incomes in total taxes, that label no longer fits Minnesota's tax system as well as it once did.

Changes Over Time: Lower Taxes Overall, Fairness Begins to Erode

Since 1996, two significant and related changes have occurred in Minnesota's tax system. One is that the share of income paid in taxes — or effective tax rate — has been reduced for all income groups. The other is that tax fairness is eroding. Both of these trends are shown in Graph 1.²

Over the surplus years of 1997 to 2001, Minnesota's taxes were cut significantly by the Legislature. One-time rebates totaling \$3.7 billion



¹ Except where noted, all data in this fact sheet come from current or past editions of the Minnesota Department of Revenue's *Tax Incidence Study*, www.taxes.state.mn.us/legal_policy/research_reports/content/incidence.shtml.

² There are a number of data concerns regarding the 10% of Minnesotans with the lowest incomes, which results in the Tax Incidence Study overstating the level of taxation for this group. For this reason, the results from that income group are generally disregarded when making statements about the tax system as a whole, and we follow that practice in this analysis.

were enacted in each legislative session between 1997 and 2001. Permanent tax cuts were made in each of the surplus years: property taxes were cut in the 1997, 1998, 1999, and 2001 legislative sessions, income taxes in 1999 and 2000, and motor vehicle registration taxes in 1999.

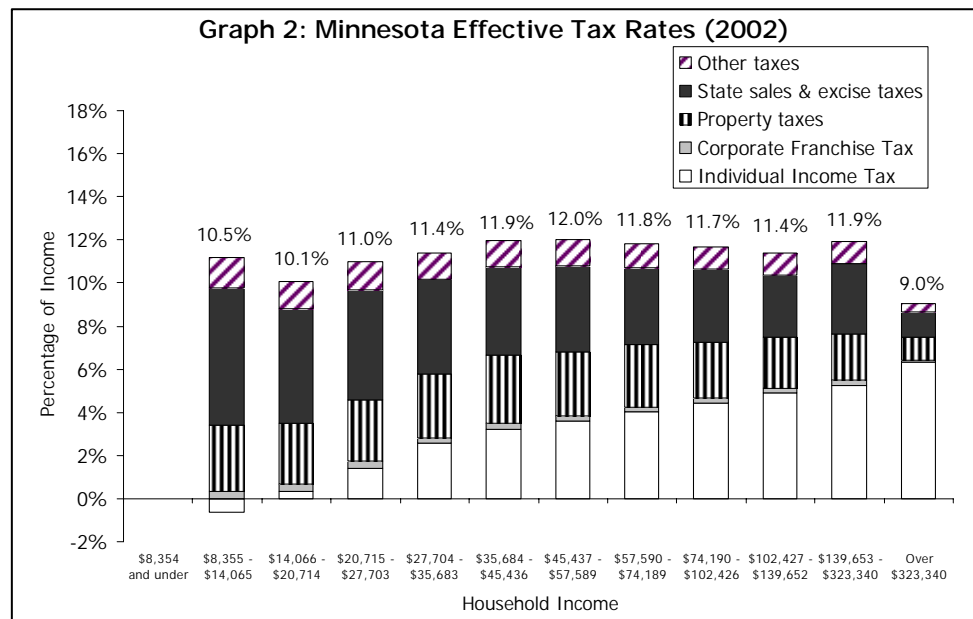
Not surprisingly, there has been a corresponding steady decline in the percentage of income Minnesotans pay in total state and local taxes, from 12.9% in 1994 to 11.3% in 2002.³ The share of income going to taxes has dropped by 12.4%.

The second change is that, although Minnesota’s state and local tax system is still not strongly progressive or regressive, when tax levels are graphed, it looks less like the “flat line” pattern associated with a proportional tax. Instead, a hill-shaped pattern is emerging in which Minnesota’s tax system is progressive from the lower to middle incomes, but regressive from the middle to upper incomes.

Minnesota’s Taxes: Who Pays and How Much?

In 2002, Minnesotans paid an average of 11.3% of their incomes in total state and local taxes. State taxes account for 75% of the total taxes paid by Minnesotans and local taxes make up 25%. As shown in Graph 2, most Minnesotans pay roughly the same percentage of their incomes in state and local taxes, with some variation. Low-income households and the highest income households pay less than the average, with all other income groups paying more.⁴

Graph 2 puts households of the same income level together, but the actual taxes paid by any particular household will depend on factors such as family size, marital status, whether one is a homeowner or a renter, and eligibility for various tax deductions and credits.



While most Minnesotans pay about the same share of income in total state and local taxes, the way in which a household pays their taxes varies with income. Lower-income Minnesotans pay a larger share of their incomes in sales and property taxes, while higher-income Minnesotans pay a larger share in income taxes. This difference is important to keep in mind when evaluating proposals

³ Over time, the Tax Incidence Study has been expanded to include more of the total state and local tax system. For example, the 2003 Tax Incidence Study included the estate tax, waste taxes, local sales taxes, taconite taxes, and local gross receipts taxes for the first time. This added 1.9% to total measured taxes, which means that average tax levels for previous years is understated, and the actual drop in taxes from 1994 to 2002 is larger than indicated here.

⁴ The Tax Incidence Study divides the population into ten groups containing an equal number of households, called deciles. For example, the first decile contains the 10% of Minnesotans with the lowest incomes. The income figures shown in Graph 2 correspond to the 1st through 9th deciles, and then the 10th decile is divided into the first 5%, next 4%, and top 1%.

to change a certain tax. The impact will not be evenly felt “across the board,” but will depend on how much that tax contributes to the taxpayer’s total tax bill.

Another way of measuring tax distribution is by comparing how much each group pays in relation to its share of total income. This information is shown in Table 1. Table 1 demonstrates that each income group in Minnesota pays roughly in proportion to its share of total income.

Each Tax Varies in its Impact

In Minnesota, the progressive income tax balances the regressivity of other taxes. Minnesota is unusual in the degree to which it relies on the income tax, but this helps make Minnesota’s state and local tax system less regressive than is seen in other states.

Income	Share of all Income	Share of all Taxes Paid
\$8,354 and under	1.0%	1.6%
\$8,355 - \$14,065	2.1%	1.9%
\$14,066 - \$20,714	3.2%	2.8%
\$20,715 - \$27,703	4.5%	4.3%
\$27,704 - \$35,683	5.8%	5.8%
\$35,684 - \$45,436	7.4%	7.8%
\$45,437 - \$57,589	9.4%	10.0%
\$57,590 - \$74,189	12.0%	12.5%
\$74,190 - \$102,426	15.8%	16.3%
\$102,427 and over	38.8%	36.8%

The degree to which a tax is regressive or progressive is measured by the Suits Index, which is a number between –1.0 and 1.0. 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. Minnesota’s total state and local tax system had a Suits Index of –0.018 in 2002, indicating that it is slightly regressive.

As shown in Table 2, individual taxes have very different Suits Indexes, with Minnesota’s estate tax and individual income taxes being the most progressive and gambling taxes and cigarette and tobacco taxes being the most regressive.

Estate Tax	0.281
Individual Income Tax	0.199
Total State and Local Taxes	-0.018
Motor Vehicle Registration Tax	-0.107
Residential Property Taxes after impact of Property Tax Refunds	-0.107
Mortgage and Deed Taxes	-0.111
Corporate Franchise Tax	-0.116
General Sales and Use Taxes	-0.143
Motor Vehicle Sales Tax	-0.145
Alcoholic Beverage Excise Tax	-0.170
Local Property Taxes	-0.174
Motor Fuels Excise Tax (Gas Tax)	-0.240
MinnesotaCare Taxes	-0.266
Gambling Taxes	-0.350
Cigarette and Tobacco Taxes	-0.515

Policy Implications

Tax fairness is created and maintained through ongoing attention to how the tax system is structured. When evaluating tax proposals, Minnesotans should bear in mind the main features of our tax system: Minnesota’s tax system is slightly regressive, individual tax types vary in their impact, and the share of Minnesotans’ incomes going to state and local taxes is significantly lower than in the past. Tax debates should include an understanding of the implications for tax fairness. Otherwise, unintended consequences may contribute to additional regressivity in the system.

The most recent tax incidence study does not take to account policy decisions made in the 2005 Legislative Session, which included increases in cigarette and tobacco taxes and property taxes, both of which are likely to make the total tax system more regressive.

Methodology

To determine who pays Minnesota's taxes, the Minnesota Department of Revenue releases a comprehensive *Tax Incidence Study* every two years. Determining ***tax incidence*** means identifying where taxes 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.

In the *Tax Incidence Study*, ***income*** includes taxable income as well as nontaxable income such as public assistance, tax-exempt interest, and nontaxable social security and pension income. A ***household*** in the tax incidence study is defined as "an actual or potential income tax filer and all dependents, even if not all living under the same roof." This varies from the Census, which defines a household as all persons who live together in a housing unit. For this reason, the *Tax Incidence Study* includes more households than the Census, and the median household income is less than reported by the Census.