

# The Facts Still Speak: Time to Reform Minnesota's Tax System

Policy choices matter in ensuring that Minnesota's tax system is both fair and raises enough revenue to fund the state's priorities. When considering how to improve the state and local tax structure, Minnesota policymakers should take into account two main facts:

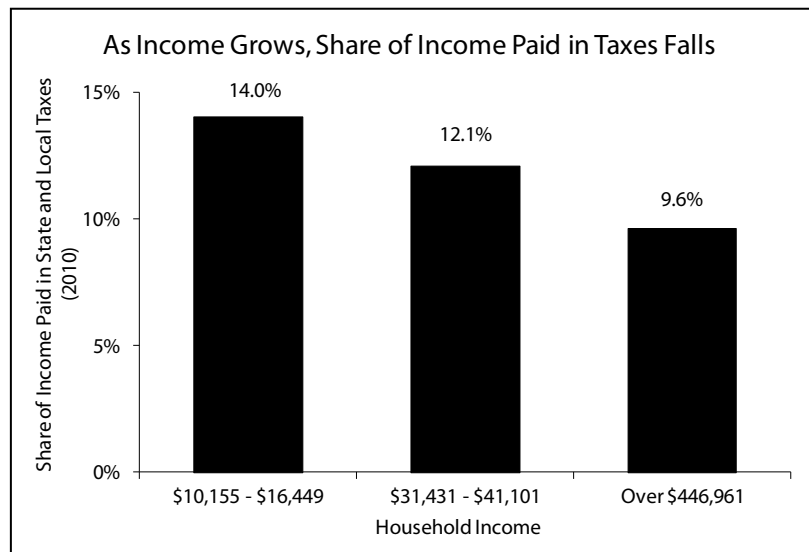
- The difference between the share of income that the wealthiest pay in taxes and the share that the average Minnesotan pays has grown since the early 1990s.
- Taxes are a lower share of Minnesotans' income today than in the mid-1990s, and are not raising adequate revenues to avoid persistent budget deficits.

## As Income Grows, the Share of Income Paid in Taxes Falls

The wealthiest one percent of Minnesotans (those with household incomes over \$446,961) paid 9.6 percent of their incomes in total state and local taxes in 2010. This is significantly less than the 12.1 percent paid by a middle-income household making \$31,431 to \$41,101.<sup>1</sup>

Since 1990, tax fairness in Minnesota has declined.<sup>2</sup> Two factors help explain the growing gap. One is rising income inequality. In other words, the benefits of economic growth have gone disproportionately to those with the highest incomes.<sup>3</sup>

But policy choices are also part of the picture, including the shift in the mix of taxes. Minnesota today relies less on state taxes and more on local property taxes, which are based on home value and not as closely linked to someone's ability to pay. In 2006, local taxes made up 26.4 percent of total state and local taxes in Minnesota.<sup>4</sup> They increased to 30.8 percent of total taxes in 2010.



## Taxes Have Become a Smaller Piece of Minnesotans' Budgets

Taxes are a smaller share of Minnesotans' household budgets today than in the 1990s. Tax cuts enacted in the late 1990s and early 2000s, coupled with income growth, mean that Minnesotans have seen a nearly 11 percent drop in the share of their incomes they are paying in taxes. In 1996, Minnesotans paid 12.9 percent of their incomes in state and local taxes. By 2010, this had fallen to 11.5 percent.

Between 1997 and 2001, policymakers passed a significant number of tax cuts. Cuts were made to property taxes, income taxes and motor vehicle registration taxes, and one-time rebates totaling \$3.7 billion were enacted in each legislative session between 1997 and 2001.<sup>5</sup>

Experience since that time demonstrates that those cuts went too far. Combined with revenue drops in response to tough economic times, Minnesota has faced frequent revenue shortfalls that have made it difficult to fund the state's priorities.

### Most Income Groups Pay in Proportion to their Share of Total Income

High-income Minnesotans pay a significant share of all taxes paid in the state, although it does not quite reflect their share of all income in the state.

Most Minnesota income groups pay in rough proportion to their share of total income, although low- and middle-income groups pay more than their proportionate share, and groups with incomes above \$129,114 pay less.<sup>6</sup>

The income group with the largest gap between its share of the state's income and its share of total taxes is households with incomes over \$446,961 (the wealthiest one percent). This group of Minnesotans had 16.0 percent of all income in the state, but paid 13.4 percent of total taxes.

<b>Household Income Group</b>	<b>Share of Total Income</b>	<b>Share of Total Taxes Paid</b>
<b>\$10,155 - \$16,449</b>	2.0 percent	2.4 percent
<b>\$16,450 - \$23,476</b>	2.9 percent	3.1 percent
<b>\$23,477 - \$31,430</b>	4.0 percent	4.1 percent
<b>\$31,431 - \$41,101</b>	5.3 percent	5.6 percent
<b>\$41,102 - \$53,071</b>	6.9 percent	7.4 percent
<b>\$53,072 - \$68,773</b>	8.9 percent	9.4 percent
<b>\$68,774 - \$89,746</b>	11.5 percent	12.1 percent
<b>\$89,747 - \$129,113</b>	15.7 percent	15.9 percent
<b>\$129,114 - \$178,170</b>	11.0 percent	10.5 percent
<b>\$178,171 - \$446,961</b>	14.9 percent	13.7 percent
<b>Over \$446,961</b>	16.0 percent	13.4 percent

### Some Taxes are Distributed More Evenly Than Others

How much of each tax Minnesota households pay varies with their incomes. The sales tax makes up the largest share of the total tax bill for low-income Minnesotans, while property taxes make up the largest piece of total state and local taxes for middle-income Minnesotans, and higher-income Minnesotans pay more through the state income tax.

Minnesota's estate tax and individual income tax are the state's only progressive taxes – meaning that the higher one's income, the larger the share of income paid for the tax. All other taxes that Minnesotans pay are regressive, where low- and middle-income households pay a higher share of their income in those taxes. Taxes on gambling and on cigarettes and tobacco products are the most regressive.

In Minnesota, the income tax only partially offsets the impact of other state and local taxes on low- and middle-income households. Overall, Minnesota's state and local tax system is regressive, with a Suits Index of -0.060. The Suits Index measures the degree to which a tax is progressive or regressive. A Suits Index between 0 and +1 means the tax is progressive, and a Suits Index between 0 and -1 is regressive. Each tax type has a Suits Index that illustrates how regressive or progressive it is, as shown in Table 2 below.

The state's tax system would be substantially more regressive without refundable income tax credits and property tax refunds. These include the Working Family Credit (the state's version of the federal Earned Income Tax Credit), the Dependent Care Credit and the K-12 Education Credit that are part of the state's income tax system; and the Property Tax Refund, known as the Circuit Breaker for homeowners and the Renters' Credit for Renters. Absent these credits, Minnesota's tax system would have a Suits index of -0.083.

Minnesota can do better. A slightly different methodology that allows for comparisons among states finds that 14 states have state and local tax systems that are less regressive than Minnesota's.<sup>7</sup>

Because taxes vary in their Suits Indexes, changes in a particular tax will not be evenly felt across the board. It's also the case that a change in a tax may not have the same incidence as the current tax.

### Tax Reform Can Make the Tax System More Adequate and More Fair

Minnesota's tax system is not meeting our needs. Tax reform should ensure that the tax system raises enough revenue to end the cycle of budget deficits and gimmicks that have plagued our state. And tax reform is needed so that low- and middle-income Minnesotans aren't asked to pay more than their fair share.

In order to make Minnesota's tax system less regressive, tax reform should focus on the one major tax based on ability to pay: the income tax. A targeted income tax increase is a critical component to make the share of income that the highest-income Minnesotans pay in state and local taxes more similar to what other Minnesotans pay. To the extent that comprehensive tax reform includes increases in regressive taxes, it should not rely on those regressive taxes too heavily, and should use tools such as refundable tax credits to offset some of the increases on low-income Minnesotans.

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<b>Tax</b>	<b>Suits Index</b>
Estate Tax	0.832
Individual Income Tax	0.230
State Taxes Only	-0.008
Motor Vehicle Sales Tax	-0.058
<b>Total State and Local Taxes</b>	<b>-0.060</b>
Mortgage and Deed Taxes	-0.105
Statewide Property Tax	-0.125
Homeowner Property Taxes with Impact of Property Tax Refunds	-0.133
Rental Housing Property Taxes with Impact of Property Tax Refunds	-0.148
Homeowner Property Taxes without Impact of Property Tax Refunds	-0.176
Local Property Taxes	-0.181
Local Taxes Only	-0.182
Corporate Franchise Tax	-0.199
Alcoholic Beverage Excise Tax	-0.225
General Sales and Use Tax	-0.245
Rental Housing Property Taxes without Impact of Property Tax Refunds	-0.277
MinnesotaCare Taxes	-0.314
Motor Fuels Excise Tax (Gas Tax)	-0.338
Motor Vehicle Registration Tax	-0.362
Gambling Taxes	-0.503
Cigarette and Tobacco Excise Taxes	-0.598

<sup>1</sup> The data in this analysis come from the Minnesota Department of Revenue, [2013 Minnesota Tax Incidence Study](#), and refer to taxes paid in 2010, the most current data available. The Tax Incidence Study includes over 99 percent of the \$24.3 billion in taxes paid in Minnesota in 2010. The distributional analysis in the study includes the \$20.2 billion in taxes ultimately paid by Minnesota residents, or 83.1 percent of the total. The distributional analysis includes estimates of how taxes paid by businesses are shifted to consumers as higher prices, to labor as lower wages, and on owners of capital in the form of lower rates of return. The study does not include the impact of fees, except for the state's Health Impact Fee. This fee differs from the state's cigarette and tobacco taxes in name only. 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 is defined as "one or two people entitled to file one income tax return or property tax return, plus any dependents." This definition of a household 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 has a larger number of households than the Census, and the median household income is less than reported by the Census.

<sup>2</sup> The erosion of fairness is demonstrated by the long-term decline in the Suits Index for Minnesota's state and local tax system, which dropped from -0.007 in 1990 to -0.056 in 2010. The system is expected to improve in 2015 as the economy recovers, but will still be regressive at a Suits Index of -0.044. (These figures use a traditional method of calculating the Suits Index using 10 data points, which allows for comparison to past studies. The Suits Indexes used elsewhere in this analysis use the more accurate "full sample" method that uses more than 100,000 data points.)

<sup>3</sup> See Minnesota Budget Project, [Income Inequality Grows in Minnesota](#), November 2012.

<sup>4</sup> Minnesota Department of Revenue, 2011 Minnesota Tax Incidence Study, March 2011.

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<sup>5</sup> One-time rebates totaling \$3.7 billion were enacted in each legislative session between 1997 and 2001. Permanent tax cuts were made in each year from 1997 to 2001: property taxes were cut in the 1997, 1998, 1999 and 2001 Legislative Sessions; income taxes were cut in 1999 and 2000; and motor vehicle registration taxes were cut in 1999.

<sup>6</sup> The Tax Incidence Study divides the population into ten groups containing an equal number of households, called deciles. Data concerns regarding the first decile results in the Tax Incidence Study overstating the level of taxation for this group. For this reason, the first decile is not included in graphs and tables in this analysis.

<sup>7</sup> This uses the Institute on Taxation and Economic Policy's analysis of tax incidence of non-senior households in all 50 states, reported in the 2013 Tax Incidence Study.