



MINNESOTA BUDGET PROJECT

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Proposed “Small Business” Tax Cuts Miss the Mark

The 2016 Legislative Session presents an opportunity for investments in our communities and local economies that build the quality workforce and high standard of living that have been some of the keystones of Minnesota’s economic success. That’s because the state of Minnesota’s recent economic and budget forecast projects a \$900 million surplus for the current two-year budget cycle.

Unfortunately, some have proposed large tax cuts instead of investing. One example is the Minnesota House of Representatives’ 2015 tax bill, which will be up for consideration again in 2016, and includes \$2 billion in tax cuts instead of making those crucial investments in our schools, workforce and other critical services.¹ Its eventual cost goes well beyond that initial price tag because it includes “phased in” tax cuts that take several years to be fully implemented, some of which more than double in size.

Some argue that tax cuts are needed to support Minnesota’s small businesses. But a closer look at some of the proposed tax cuts finds they don’t measure up to the hype. Most small businesses would not see any benefit from cutting the estate tax or exempting business profits from the 4th tier income tax rate. Eliminating the state property tax would ultimately provide the largest tax cuts to the highest-value business properties. And the high cost of these tax cuts would crowd out important investments in broader economic prosperity.

Estate Tax Cuts

The estate tax impacts very few Minnesotans: fewer than 2 percent of estates pay the estate tax, or about 800 estates in 2015.² Yet millions of dollars of estate tax cuts are on the table.

Minnesota already provides special estate tax treatment to small businesses. Family-owned businesses and farms can exempt up to \$5 million of qualifying small business and farm property from the estate tax if they keep the business or farm in the family.³ The 2015 House tax bill would essentially allow all estates to get the exemption amount that today is only available to small family businesses. Over four years, the bill would increase the amount of an estate exempted from the estate tax to \$5 million, and then the exemption would increase further after that. In all, the estate tax changes proposed in the House tax bill would give a small number of the largest estates tax cuts totaling \$20 million that would grow to over \$66 million a year.

4th Tier Income Tax Exemption

Another expensive and poorly targeted tax cut touted for small businesses would exempt active business income from the state’s top income tax rate (which is sometimes called the “4th tier.”) This proposal would cost more than \$170 million in tax cuts per year, but benefit only 33,100 households with incomes high enough to be in the top income tax bracket.⁴ That leaves out most small business owners.⁵

While this is often described as a tax cut for “small businesses,” what determines whether a business pays taxes on its profits through the corporate franchise tax or the individual income tax is not its size, but the legal structure that its owners have chosen. Businesses that pay taxes on their profits through the individual income tax aren’t only the family restaurant or neighborhood hardware store; these businesses can be quite large.

Statewide Property Tax Repeal

Another proposal in the 2015 House tax bill is to eliminate the statewide property tax, providing a massive tax cut that would cost around \$1 billion per year when fully phased in – that’s about the same as what the state

of Minnesota spends each year on public safety. It's another one of those tax cuts that takes several years to fully be in effect, and when it does, it provides the largest tax cuts to the highest-valued business properties, not to small businesses.⁶ By one analysis, properties with values slightly below \$500,000 make up 75 percent of all commercial-industrial properties in Minnesota, but would only receive 14 percent of the tax cuts going to commercial-industrial properties resulting from eliminating the state property tax.⁷

And a substantial amount of this \$1 billion tax cut could flow out of state: 54 percent of the state business property tax is ultimately paid by non-Minnesotans.⁸

Time for Investments, Not Poorly Targeted Tax Cuts

Minnesota should prioritize making investments in expanding economic prosperity across the state. For example, improving access to credit would support local small business development by addressing a substantial barrier to growth facing Minnesota entrepreneurs. Policymakers should help small businesses get the employees they need through strengthening education and training, and by bringing down the cost of child care, which can keep good workers out of the labor pool. Strengthening these building blocks of a strong economy should be the priorities for our state, rather than costly tax cuts that give the biggest benefit to the highest-value estates, highest-income households, or the highest-value business properties.

By Nan Madden

¹ House File 848. House and Senate Fiscal Staff, Omnibus Tax Bill Summary Comparison, May 12, 2015.

² House Research, [The Minnesota Estate Tax](#), June 2015; and Minnesota Department of Revenue, Analysis of H.F. 958.

³ Requirements in order to access this higher exemption are that the decedent or spouse must have owned the qualifying business or farm property for three years before the date of death, and the heirs must own and use the property in the business (or as a farm homestead) for three years after the date of death. (House Research: The Minnesota Estate Tax)

⁴ Minnesota Department of Revenue, Analysis of H.F. 63, January 19, 2015.

⁵ In 2013, when the 4th tier was enacted, it was estimated that only 6 percent of households with pass-through income have taxable income high enough to be in the 4th tier. The proposed exemption only applies to a subset of those: those with active business income.

⁶ Commercial and industrial properties pay two kinds of property taxes: local property taxes that fund schools, public safety and other services in their city, county and school district; and the state general levy, which funds services at the state level. The majority (95 percent) of the state general levy is paid by commercial-industrial properties, and the remaining 5 percent is paid by seasonal recreational properties (cabins and seasonal resorts).

⁷ North Star Policy Institute, [Small Business Tax Relief? Not So Much](#), March 2016.

⁸ Minnesota Department of Revenue, [2015 Minnesota Tax Incidence Study](#), March 2015.