Minneapolis City Council Study Session

Friday, August 24, 2012

10 AM

City Council Chambers

AGENDA

1. Call to Order
2. Introductions
3. Presentation: Minnesota Commissioner of Revenue Myron Frans "Planning for Tax Reform"
4. Discussion/Questions
5. Other
6. Adjournment

GOVERNOR DAYTON'S

Tax Reform

FOR A BETTER MINNESOTA

Presentation to the City of Minneapolis, City Council Workgroup
August 24, 2012

Governor Dayton's Priorities

Getting Minnesota Working Again

Governor's Priority #1

Create jobs and improve Minnesota's competitiveness

Governor's Priority #2

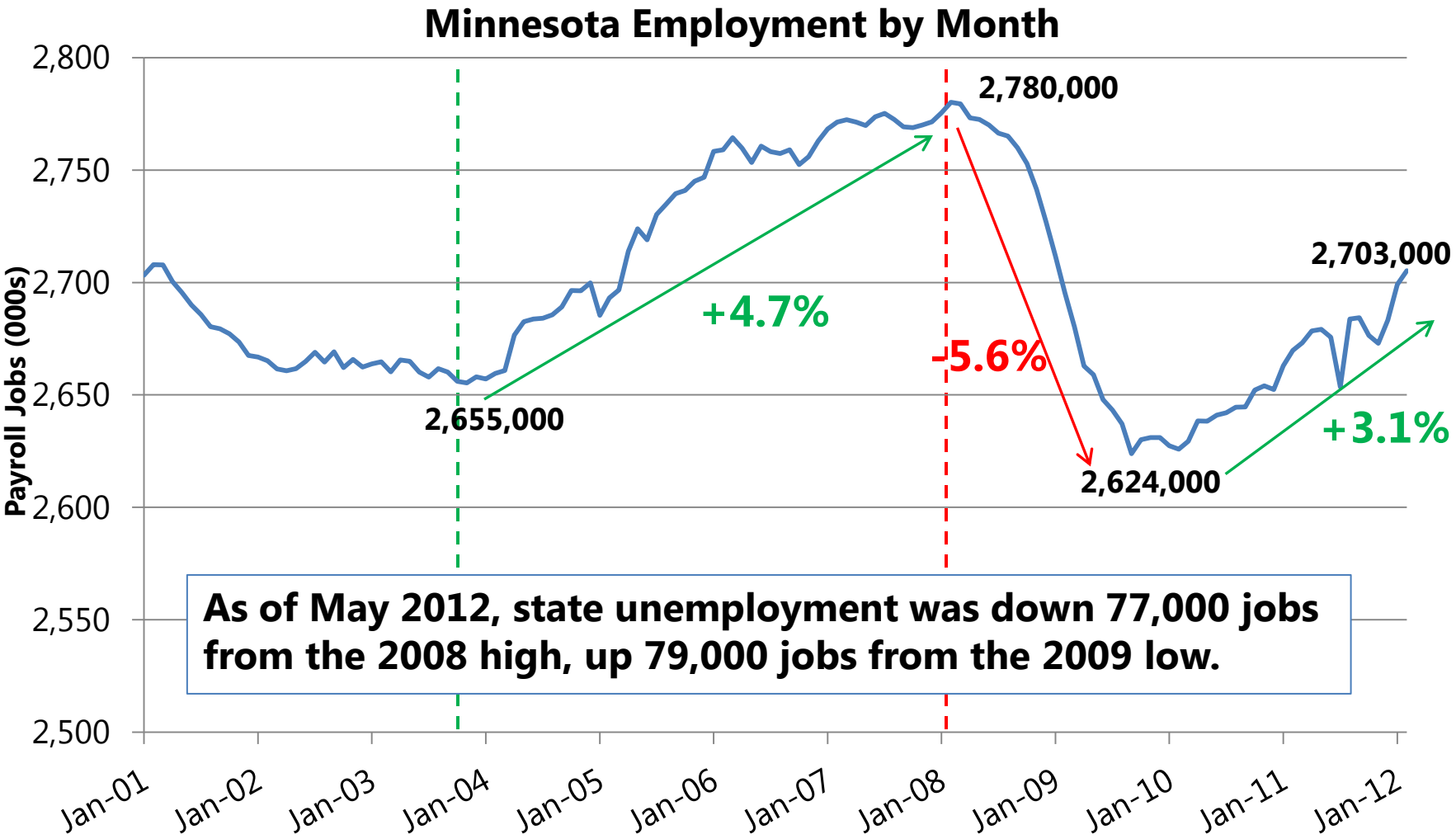
Improve how state government works to deliver the best services at the best price

Governor's Priority #3

Make Minnesota's tax system more fair

TAX REFORM

The number of jobs matter

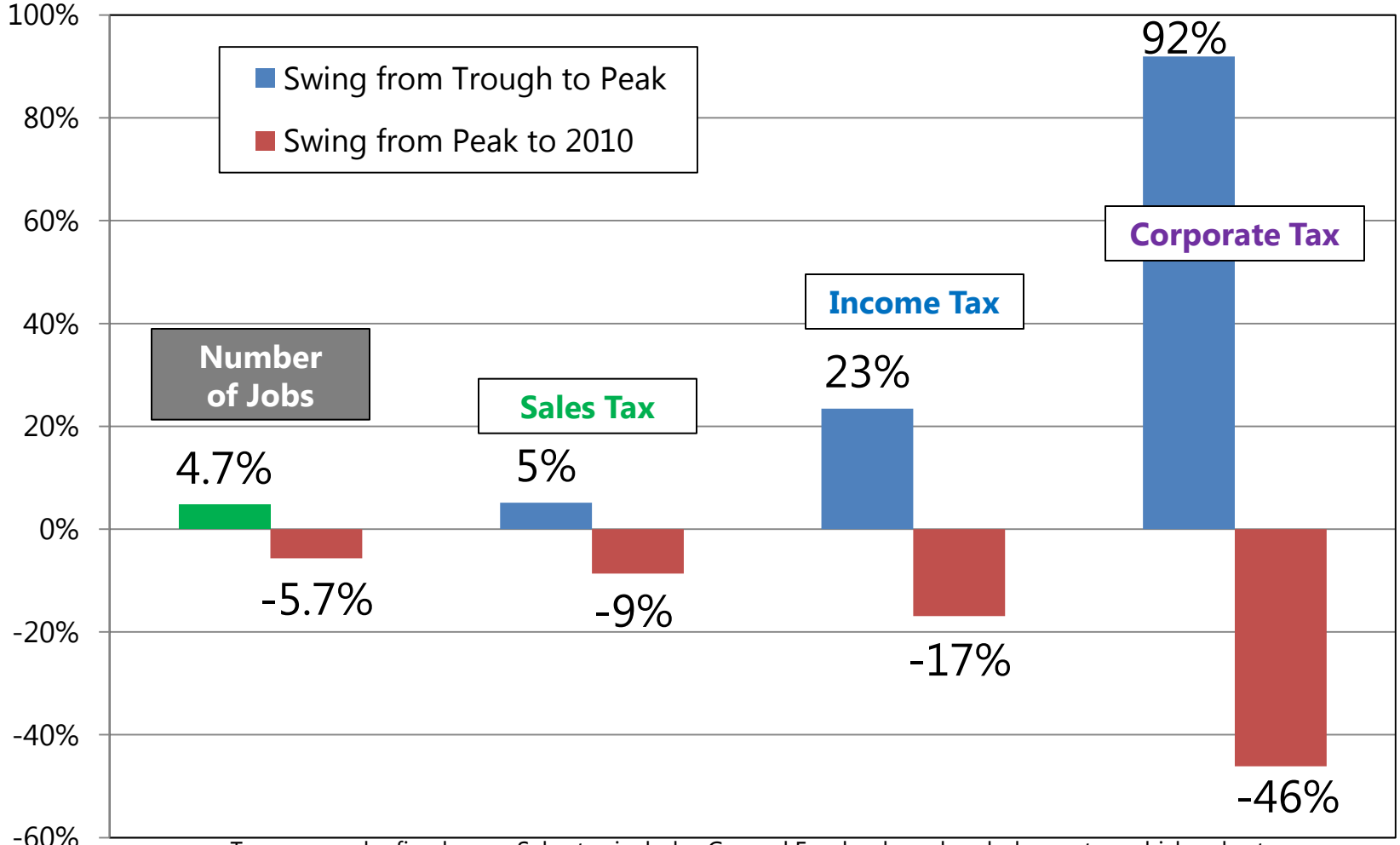


As of May 2012, state unemployment was down 77,000 jobs from the 2008 high, up 79,000 jobs from the 2009 low.

Source: CES Employment, U.S. Bureau of Labor Statistics

Jobs matter to the state budget

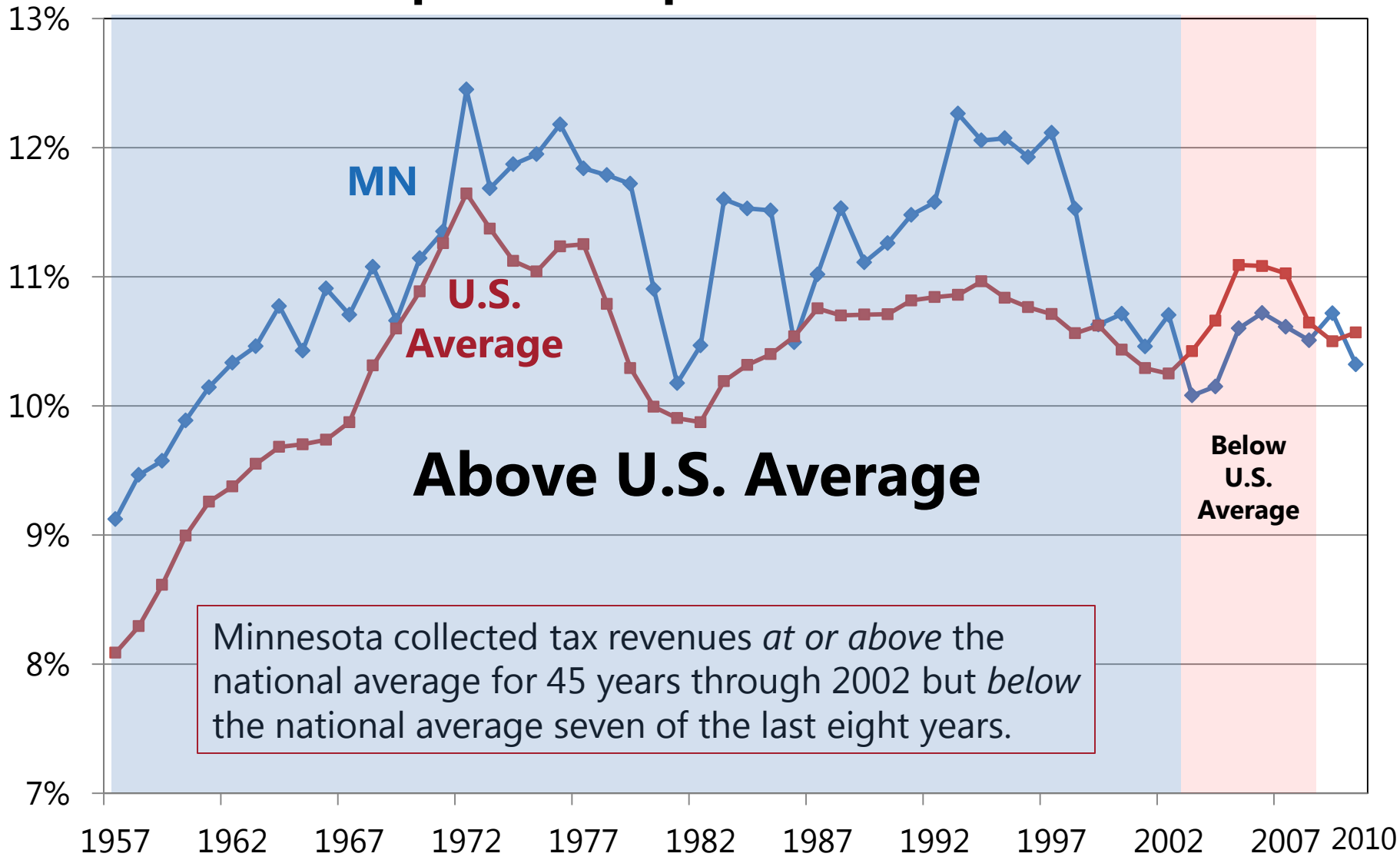
Changing number of jobs drives big swings in state revenue



Tax revenue by fiscal year. Sales tax includes General Fund only and excludes motor vehicle sales tax.

Taxes tell part of the story…

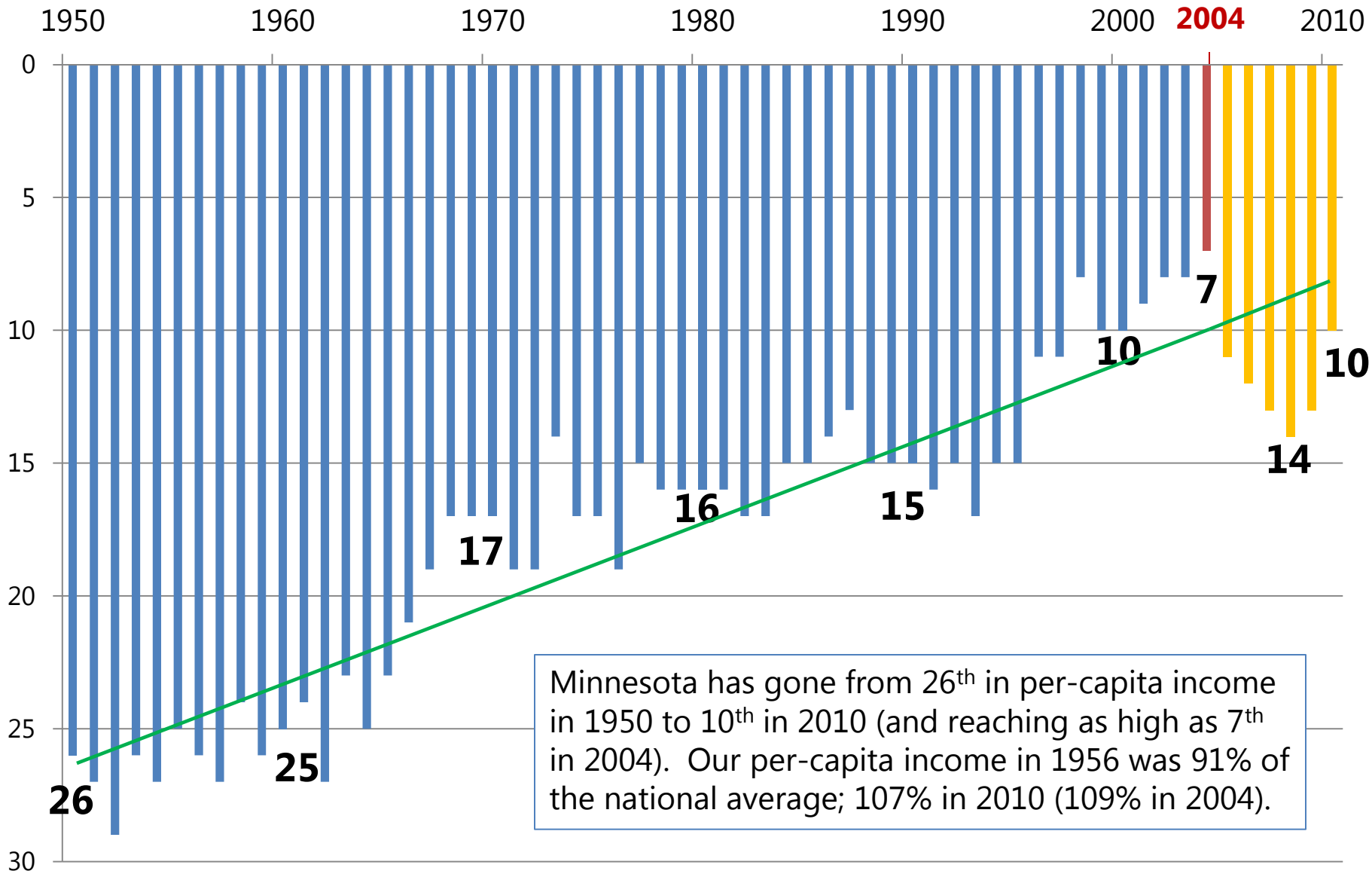
State and local tax revenue as a percent of personal income



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

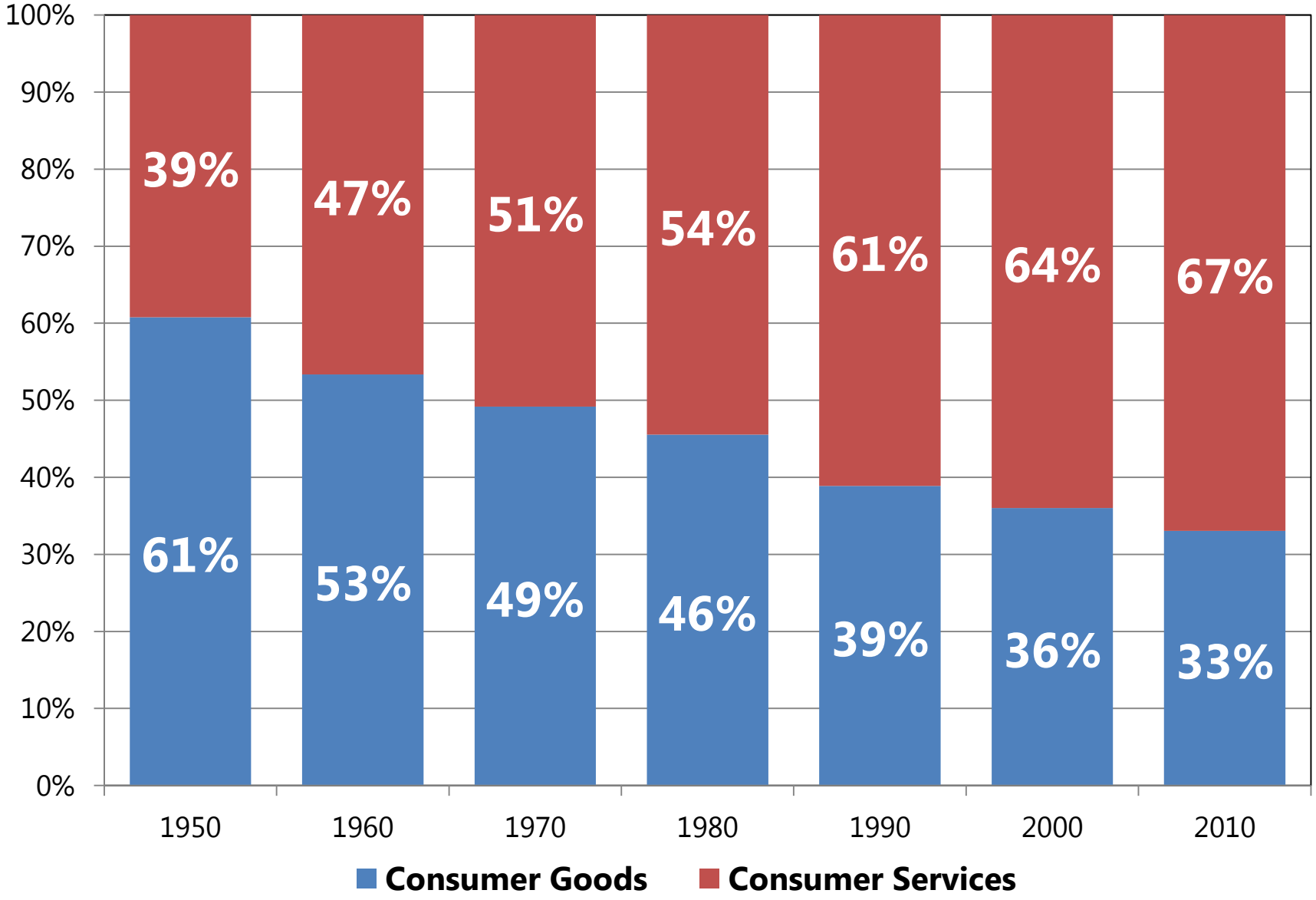
Minnesota per-capita income rank among 50 states



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).

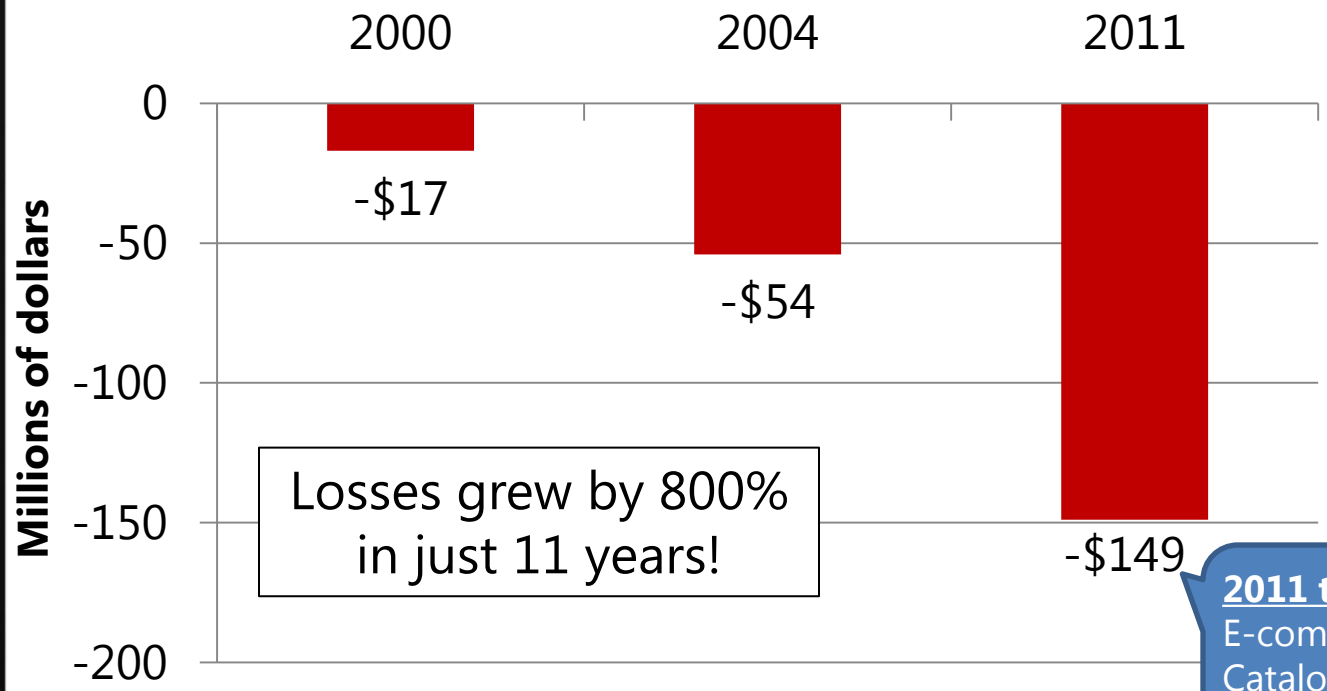
Take a closer look…

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!

2011 total loss = $400 m

E-commerce	$149 m
Catalogs	$ 55 m
Remote seller	$190 m

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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]

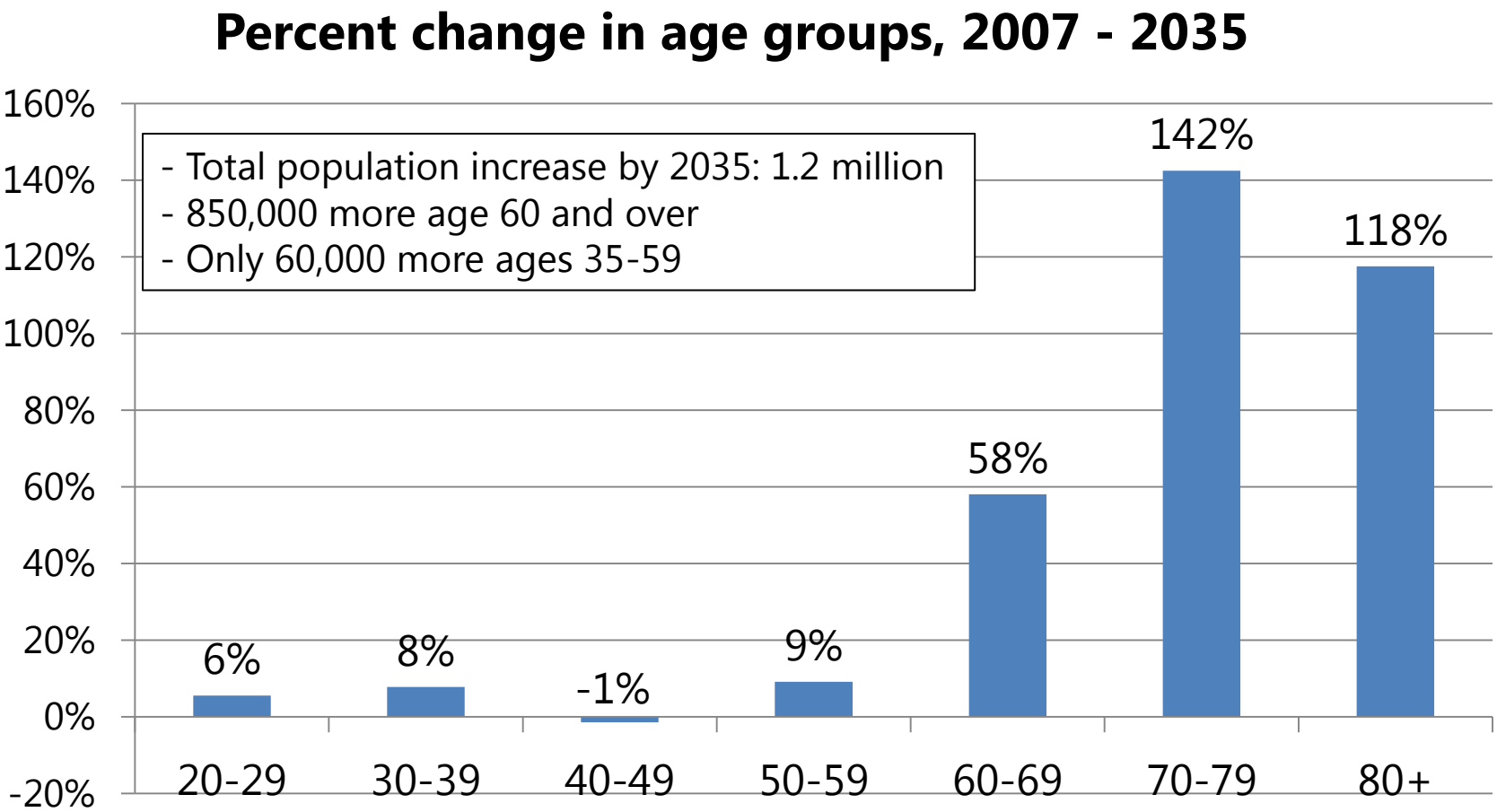
- Single sales apportionment factor
- Personal property exemption
- Capital equipment exemption
- R&D tax credit

…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]

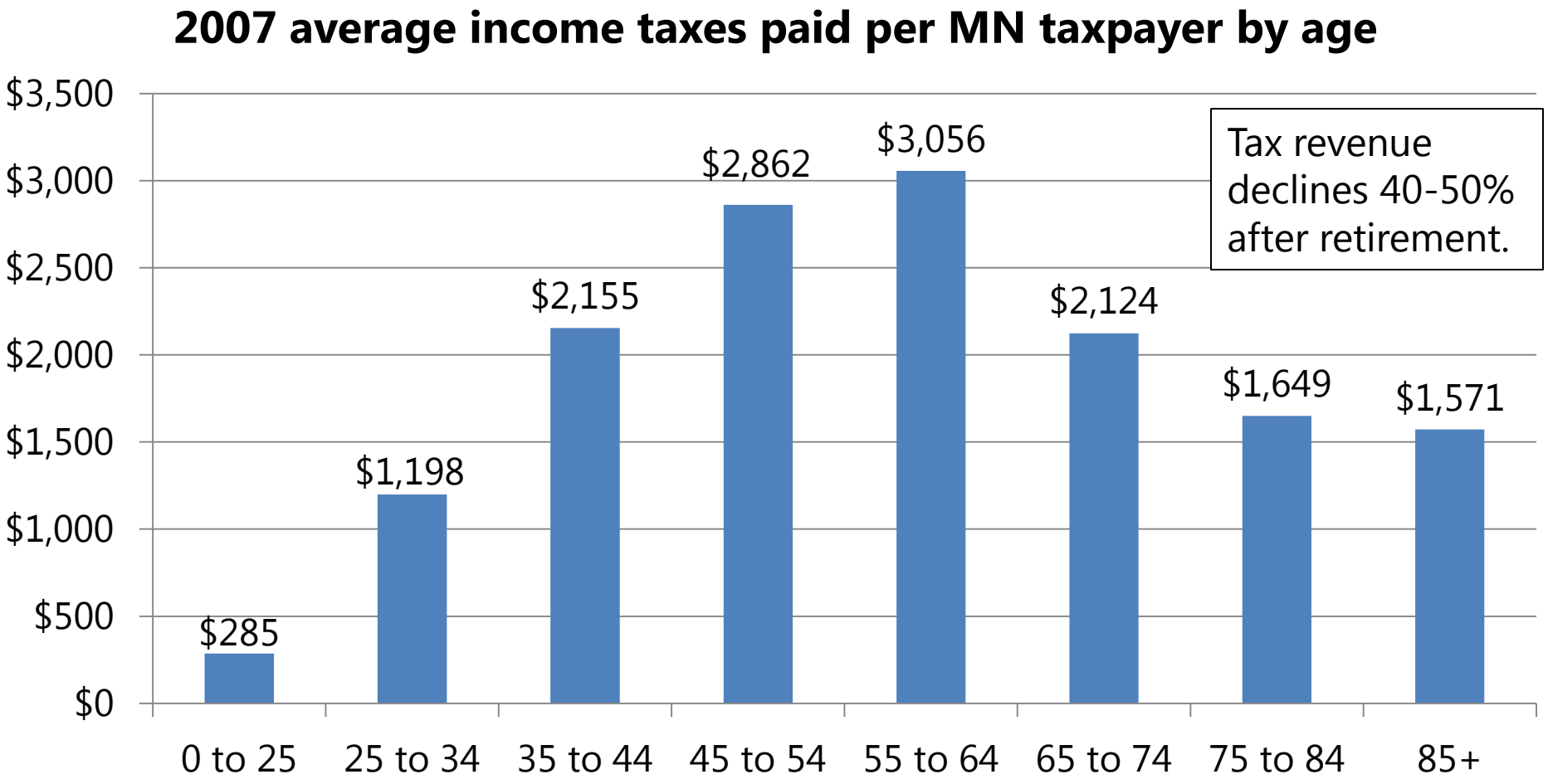
1. *Competitiveness of State and Local Business Taxes on New Investment*, Ernst and Young, April, 2011
2. Small Business & Entrepreneurship Council's Business Tax Index 2011

Demographic change is coming



Source: Minnesota State Demographer

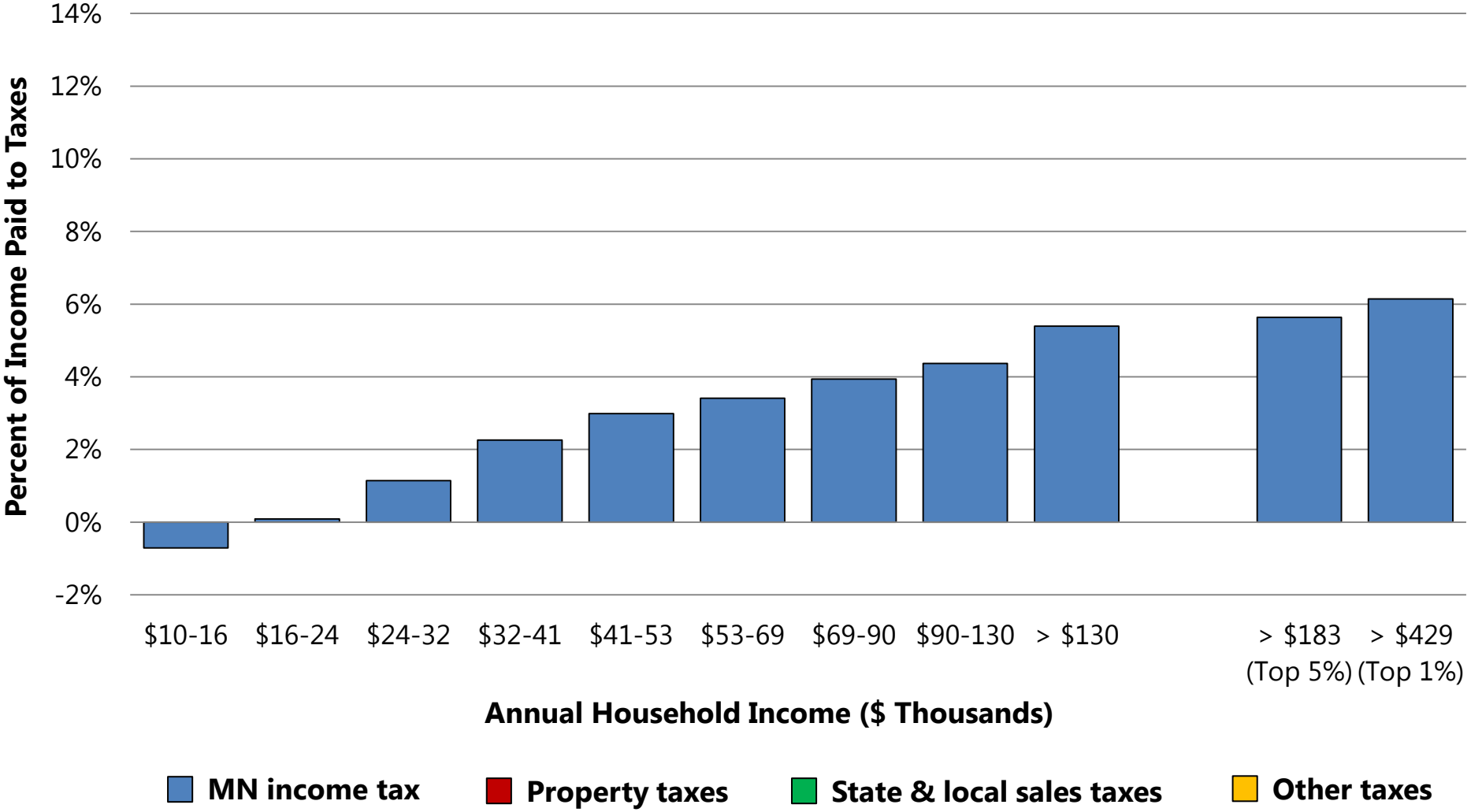
Demographics impact income tax revenue



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)



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

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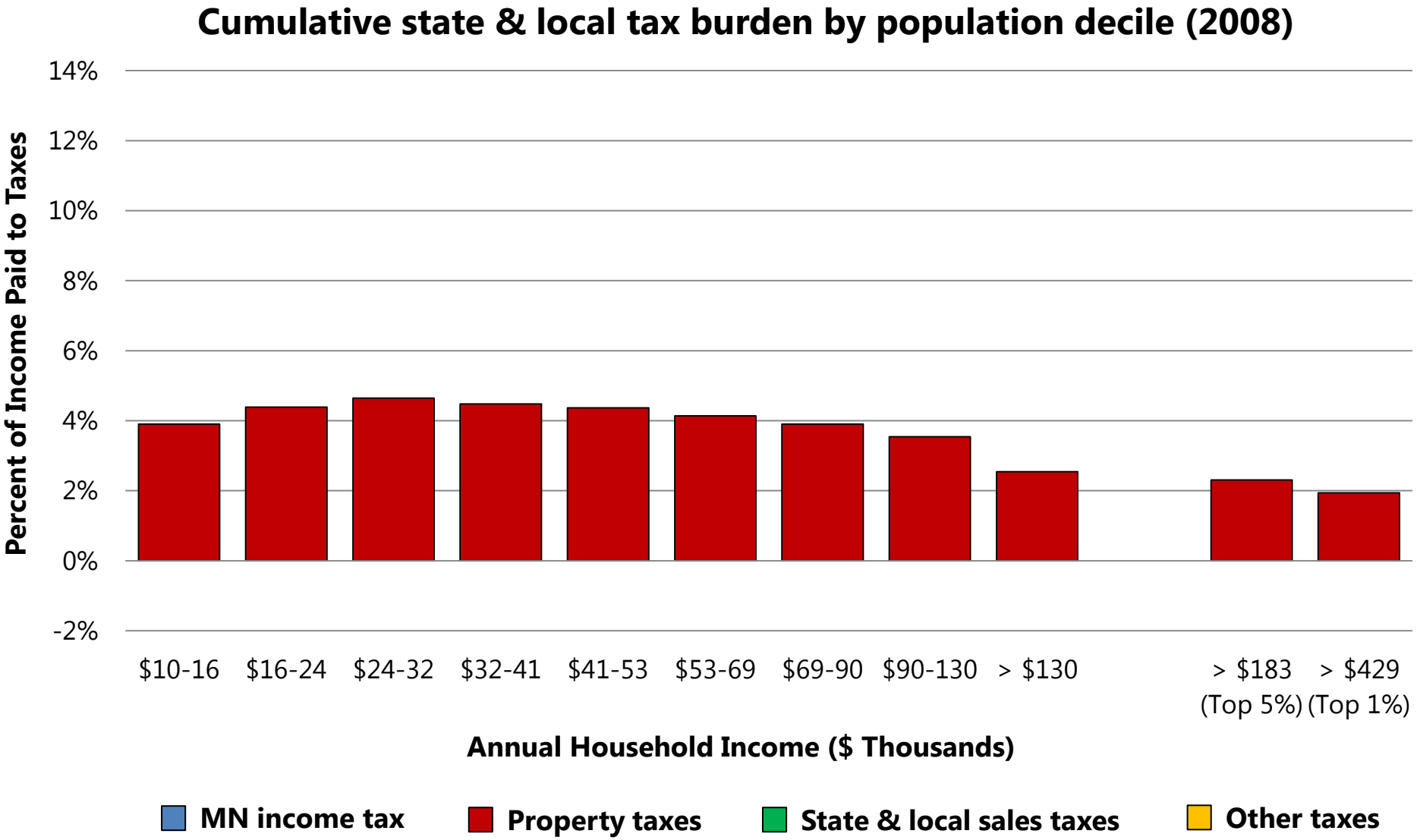

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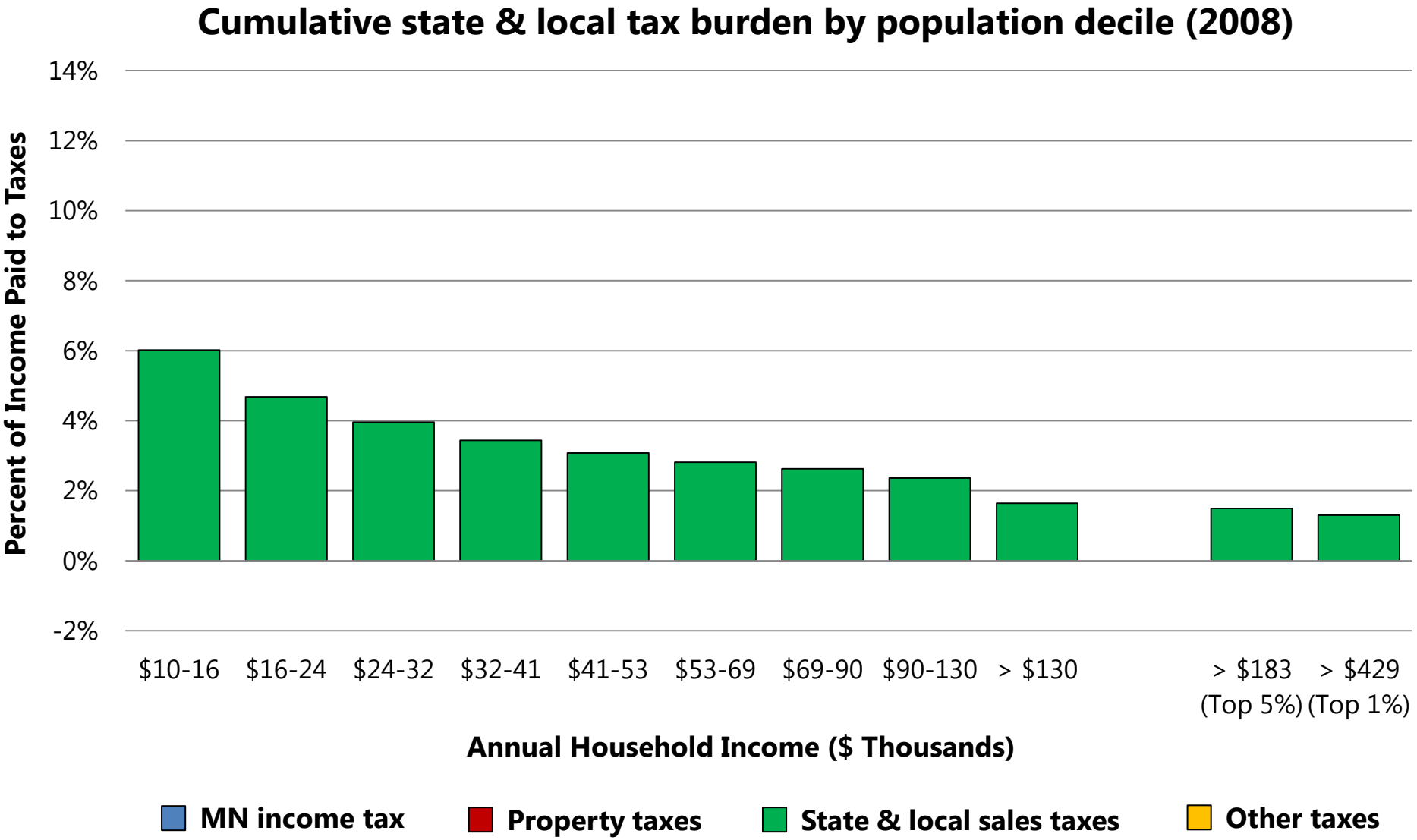

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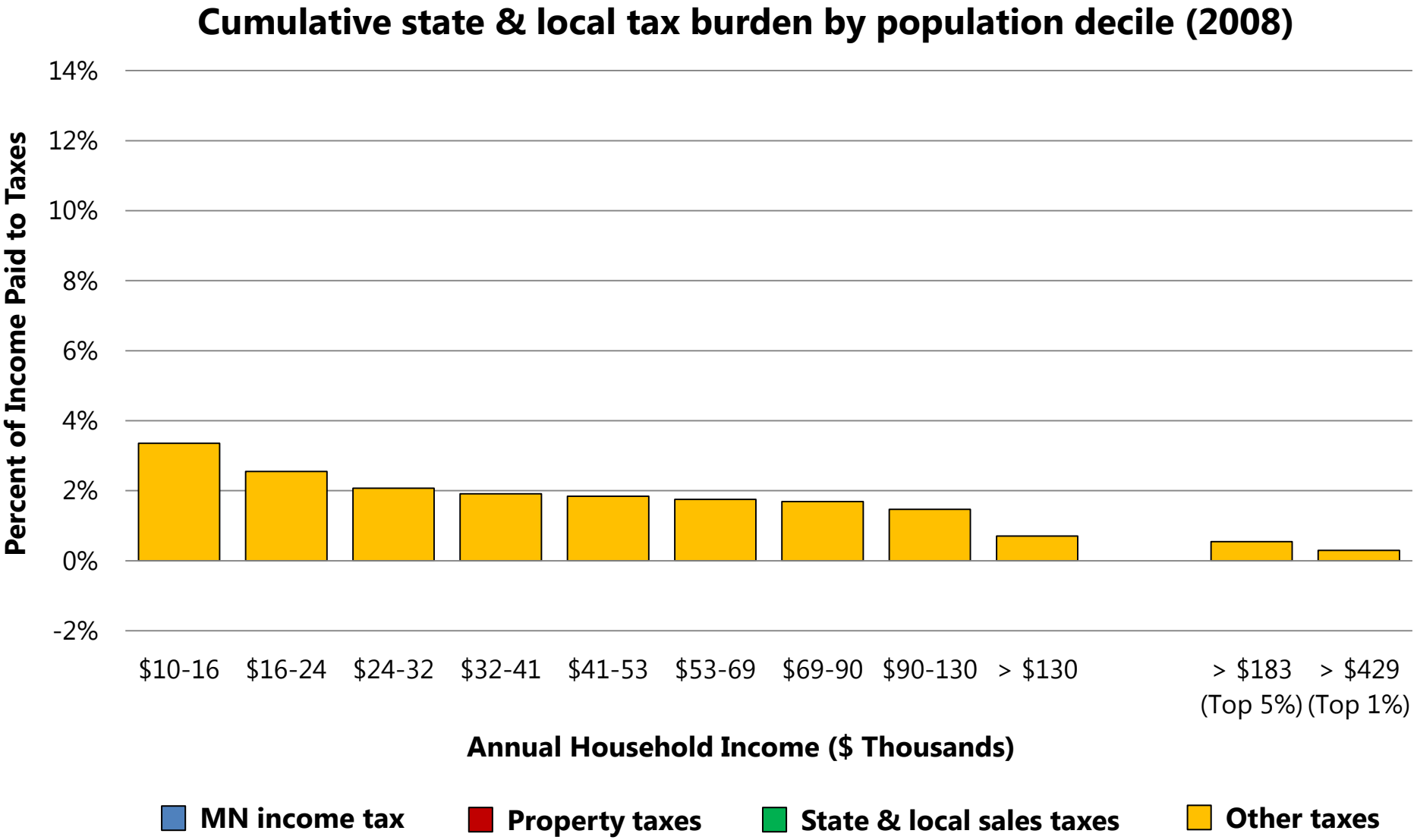

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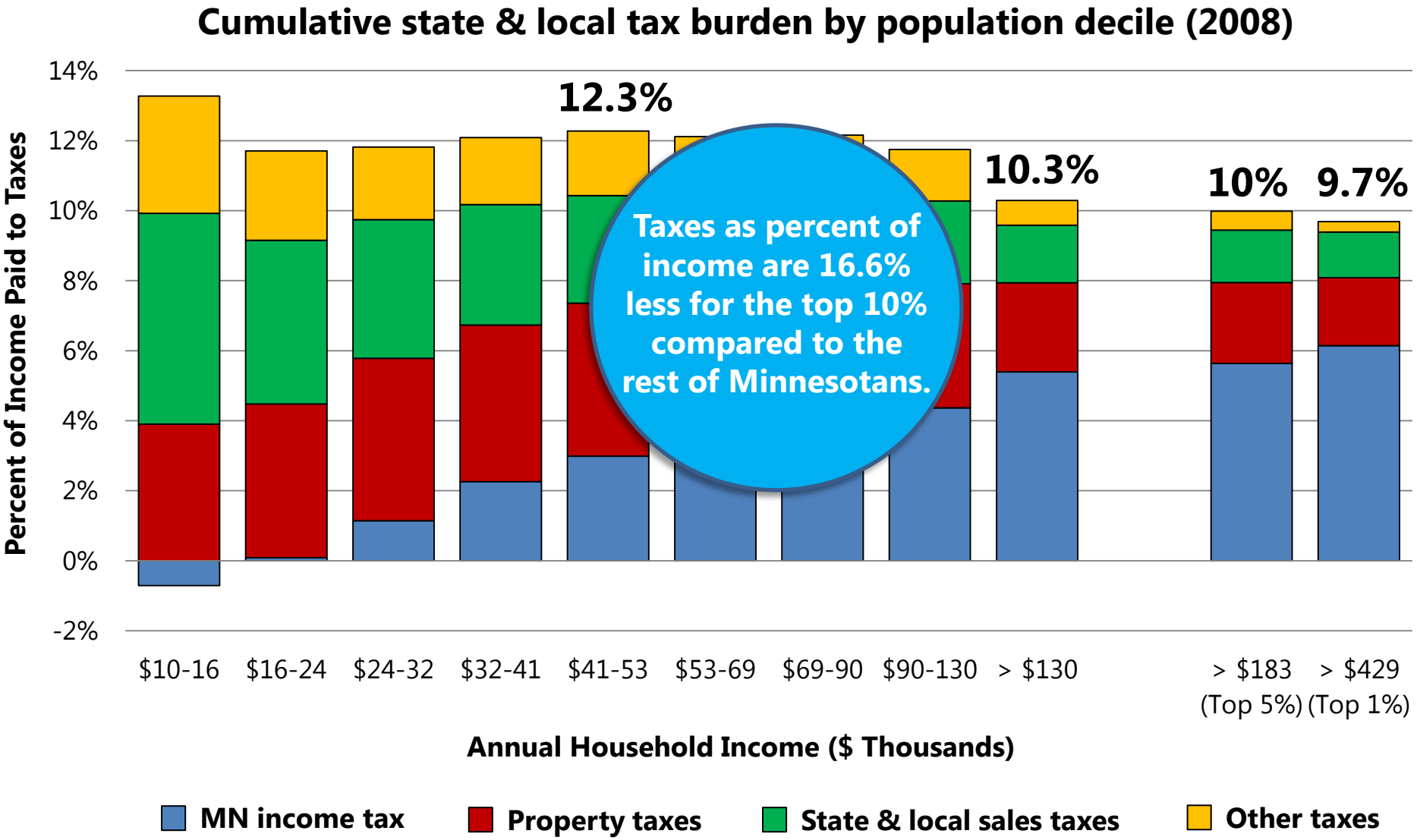

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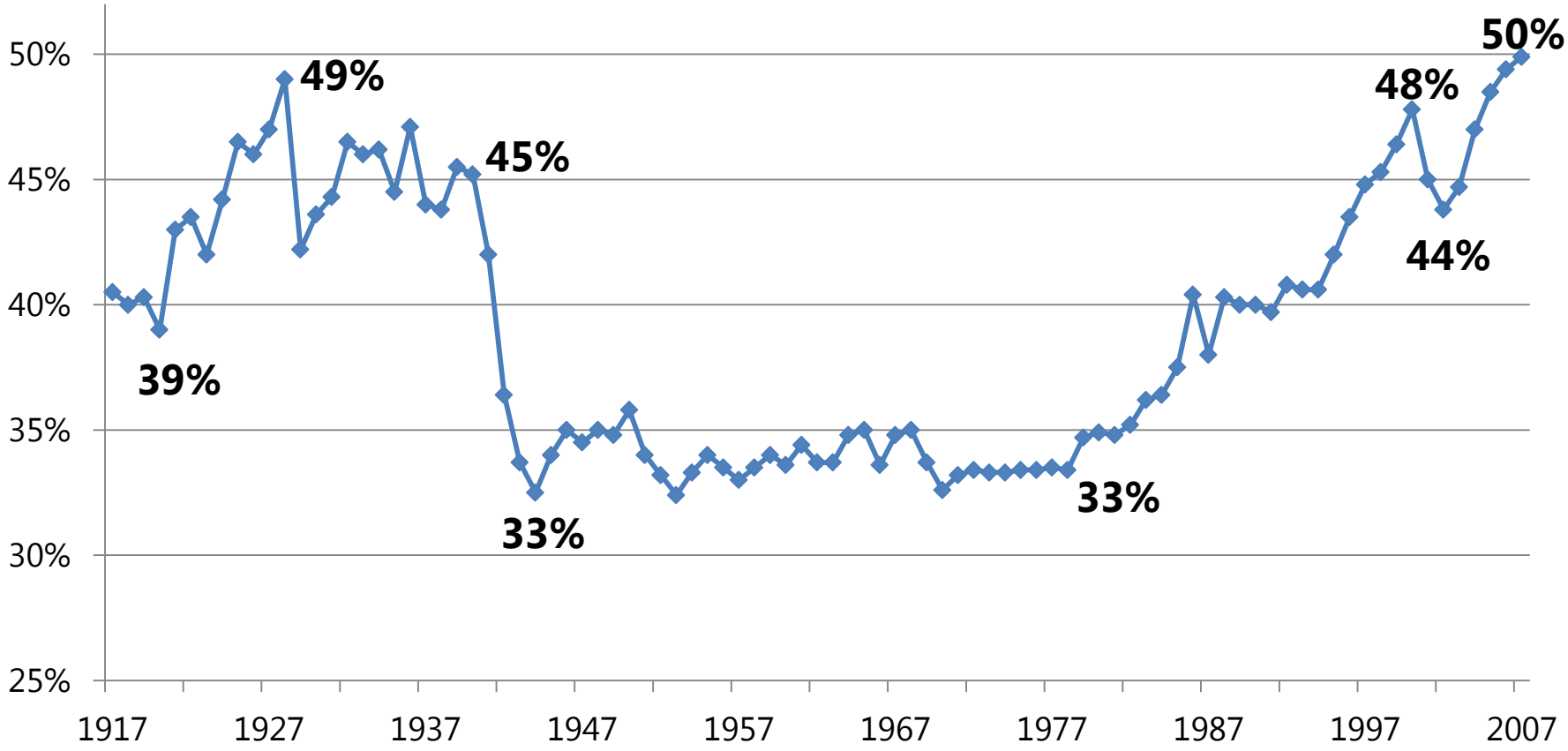
Sources: Minnesota Tax Incidence Study 2011 (Tax Year 2008), MN Dept. of Revenue. (Annual income amounts rounded.)

While income is increasingly concentrated at the top…

Growing income disparity

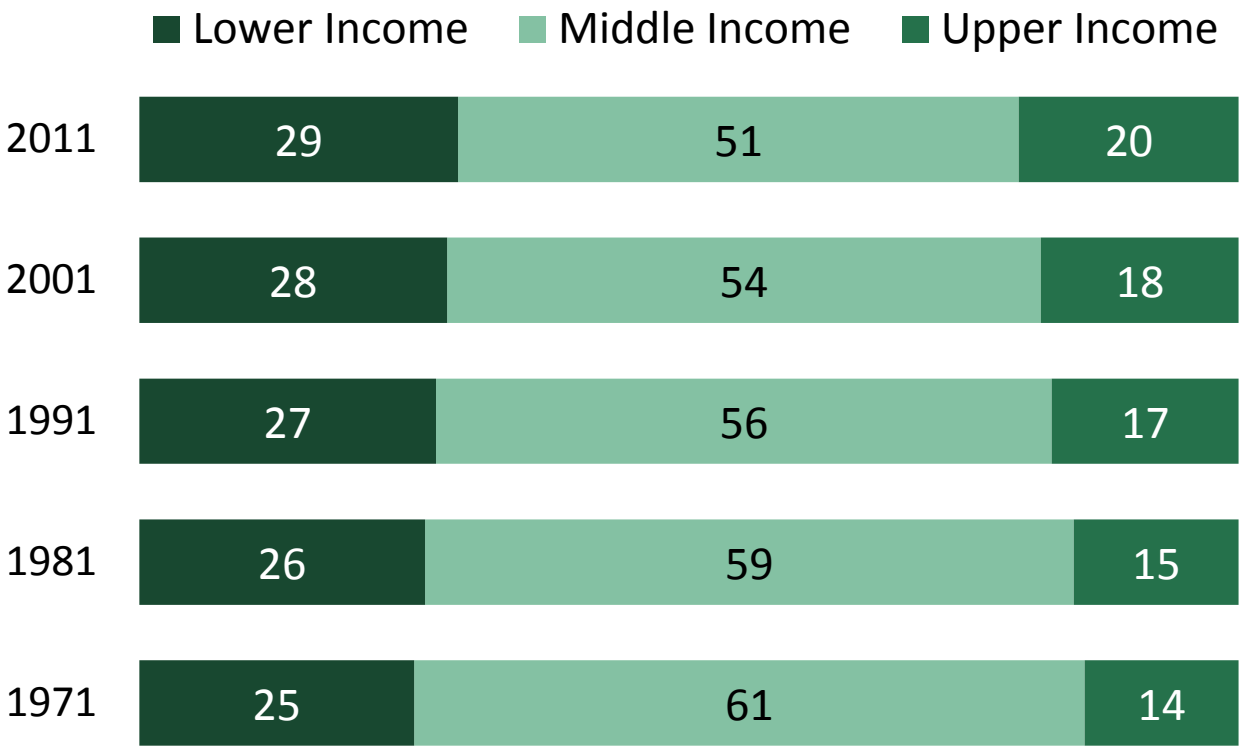
Top 10% now has 50% share of income (U.S.)



In 2007, top decile includes all U.S. families with annual income above $109,600.

Sources: *Piketty & Saez (2003), series updated to 2007, Journal of Economic Literature, Vol. XLIX (Mar -11)*

Percentage Distribution of Adults by Income Category, 1971-2011



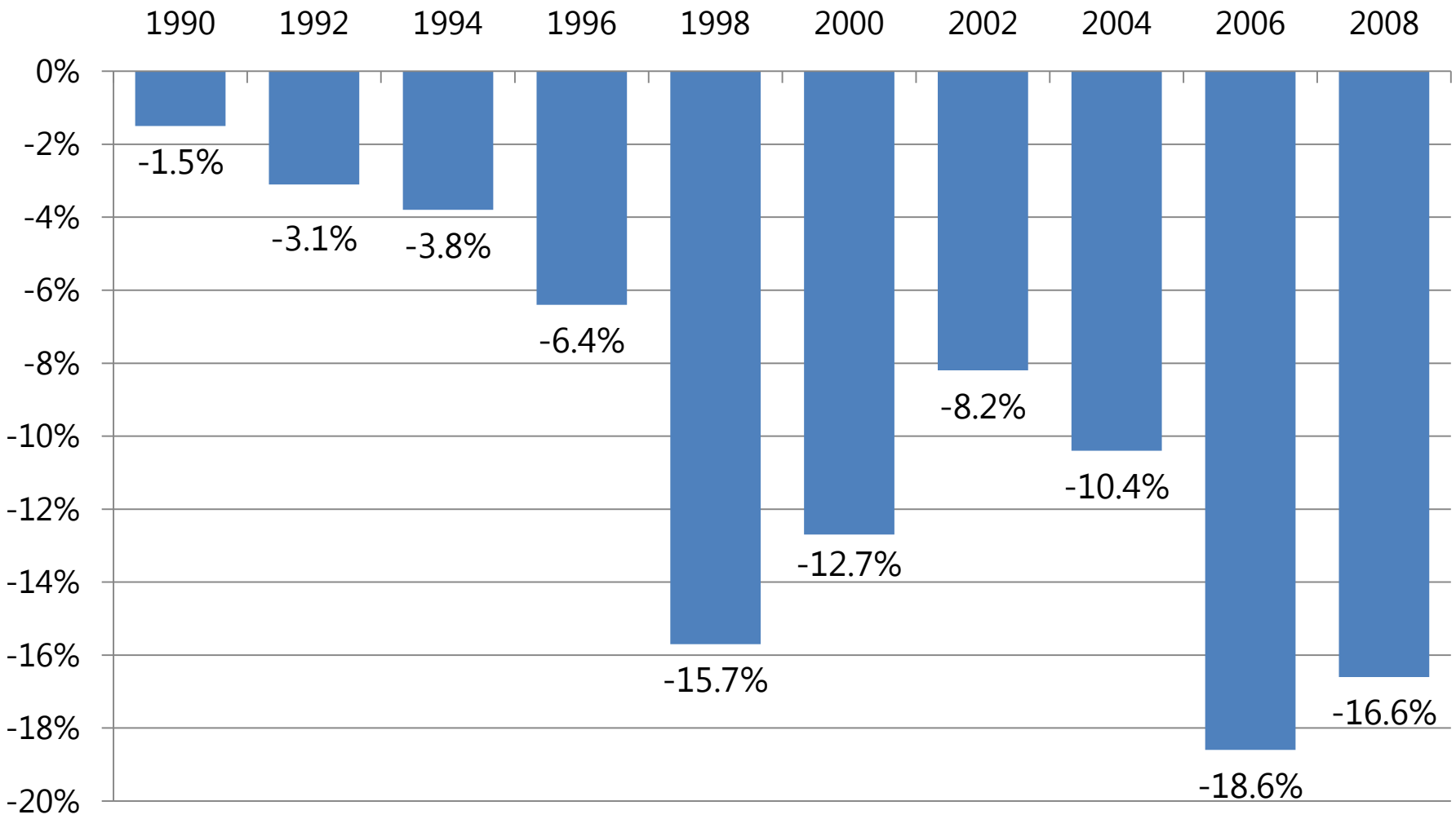
Note: Adults are assigned to income categories based on their size-adjusted household income in the calendar year prior to the survey year (e.g., 2010 income is from the 2011 survey).

Source: Pew Research Center tabulations of the Current Population Survey, Annual Social and Economic Supplements, 1971-2011

PEW RESEARCH CENTER

The tax burden is being shifted to those with the least ability to pay

As a percent of income, the top 10 percent pay less than the rest of Minnesotans (and increasingly so!)



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Over time, the mix of taxes in Minnesota has become unbalanced

The three legged stool

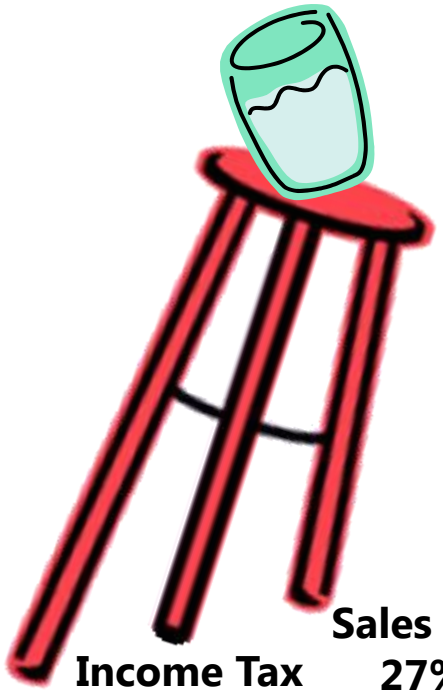
"Balanced"

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

Form M1
Minnesota income tax return

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Nonresidents/Part-Year Resident

Your last name | Social Security number

Spouse's last name | Spouse's Social Security number

Read the instructions for this schedule, which are on a separ
complete this schedule, you must complete lines 1 through 1

1 Wages, salaries, tips, etc. *(from line 7 of federal*

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Credit for Income Tax

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Tax on Lump-Sum Dist

Your first name and initial

M1 MINNESOTA · REVENUE **Individual Income Tax**

Leave unused boxes blank. Do not use staples on anything you su

Your first name and initial | Last name

If joint return, spouse's first name & initial | Last name

Current home address (street, apartment number, route)

City | State | Zip code

2010 federal filing status (place an X in one oval box): (1) Single (4) Head of Household (2) Married filing joint (5) Qualifying widow(er) (3) Married filing sepe

State Elections Campaign Fund
If you want $5 to go to help candidates for state offices pay campaign expenses, you may each enter the code number for the party of your choice. This will not increase your tax or reduce your refund.

Political party and code number: Independence 11, Republican 12, Democratic Farmer Labor 13, Green Fund

From your federal return (for line references see instructions, page 9), enter the amount c

M1PR MINNESOTA · REVENUE

Please print and leave unused boxes

Your first name and initial | Last name

If a joint return, spouse's first name and initial | Last name

Current home address (street, apartment number, route)

City | State | Zip code

Place an X if a foreign address

Mark an X if a foreign address

Renter

State Elections Campaign Fund. If you did not designate on your 2010 Form M1, and you want $5 to go to h for state offices pay campaign expenses, you may e

M1M

Your first name and initial

Nonresidents/Part-Year Resid

Read the instructions for this schedule, which are on a separ

complete this schedule, you must complete lines 1 through 1

1 Wages, salaries, tips, etc. (from line 7 of federal

Before you complete t

1 Federal adjusted g

2 Medical and denta

3 Other adjustments

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

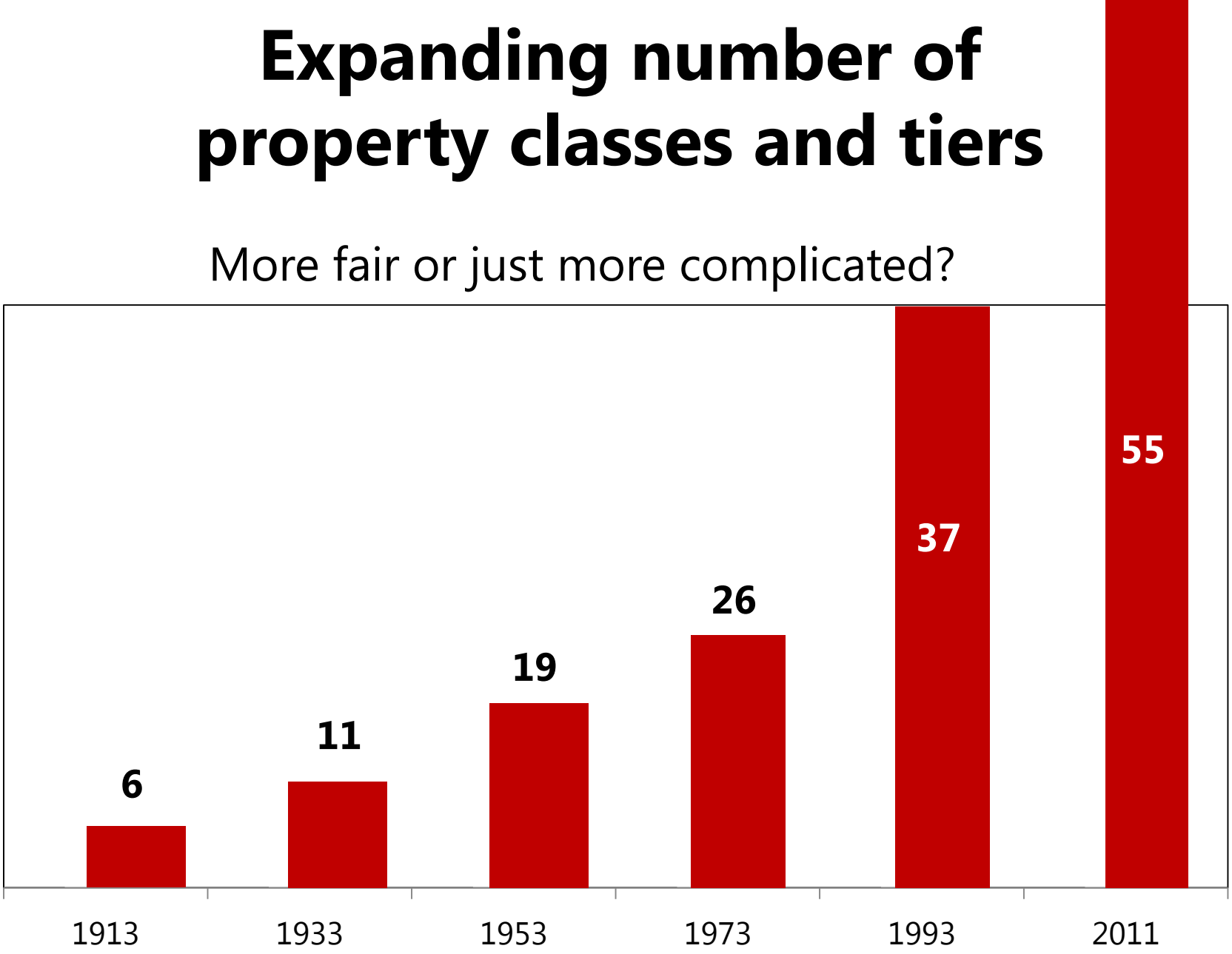
2010 Income Tax Calculation

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
Net operating loss carryover adjustment from 2008 and 2009
Prior add-back of reacquisition of business indebtedness
Equals: **Minnesota taxable income**
Subtract: Non-refundable tax credits
Marriage credit
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?



So you want agricultural homestead?

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Determining if property qualifies for the agricultural homestead[1] classification

2009 Revisions

Note: Terms in ***bold, italic font*** are defined in the glossary.

Start Here

Who owns?

Does a natural person own the ag property? → No → Does an *authorized entity* own the ag property? → No → Is the ag property held under a *trust*? → No (Stop: Do NOT Qualify for Ag Homestead Class)

Yes → Yes → Yes

Who occupies?

Is the property physically occupied by the *owner*? → No → Is the property physically occupied by a *qualifying relative* of the *owner*? (child, sibling, grandchild, or parent of the owner; child, sibling, or grandchild of the owner's spouse) → No → Is the ag property leased to an *authorized entity* from the owner who is a *qualified person* in the *authorized entity*? → No → Is the property physically occupied by a *qualified person* of the *authorized entity* that owns the land? → No → Is the property physically occupied by the *grantor* or surviving spouse of the *grantor*? → No → Is the property physically occupied by a *qualifying relative* of the *grantor*? (child, sibling, grandchild, or parent of the *grantor*; child, sibling, or grandchild of the *grantor's* spouse) → No → Is the agricultural property rented by an *authorized entity* of which the *grantor* or *grantor's surviving spouse* is a shareholder, member, or partner? → No

Yes → Yes → Yes → Yes → Yes → Yes → Yes → Yes → Yes

Who farms? (Is the participation level *actively farming* or *actively engaged in farming*?)

Participation level is not a factor in this scenario. → Participation level is not a factor in this scenario. → Is the *owner*, *owner's* spouse, or sibling, child, or grandchild of the *owner* or *owner's* spouse *actively farming* the ag property either on their own behalf or on behalf of an *authorized entity* of which they are a *qualified person*?[2] → Is a *qualified person* of the *authorized entity* that leases the property *actively farming* the property? → Is the *qualified person* *actively engaged in farming* the ag property on behalf of the *authorized entity*? → Is a *qualified person* of the *authorized entity* that owns the property *actively farming* the property on behalf of the *authorized entity*?[2] → Participation level is not a factor in this scenario. → Participation level is not a factor in this scenario. → Is the *grantor*, *grantor's* spouse, or sibling, child, or grandchild of the *grantor* or *grantor's* spouse *actively farming* the ag property either on their own behalf or on behalf of an *authorized entity* of which they are a *qualified person*? → Is a *qualified person* of the *authorized entity* that leases the property *actively farming* the property on behalf of the *authorized entity*?

Yes → Yes → Yes → Yes → Yes → Yes → Yes → Yes →

Tax expenditures: Minnesota's hidden spending

“Swiss cheese” tax policy?

Bigger block,
lots of holes

Smaller block,
not as many holes

$27b

Total state tax revenue before preferences

me Tax Federal Exclusions: Lodging - Housing Allowances for Ministers - Employer-Provided Dependent Care - Employee Awards - Employer Pension Plans - Contributions by Employers for Medical Insurance Premiums and Medical Care - Employer-Paid Accident and Disability Premiums - Employ
up Term - Life Insurance Premiums - Employer-Paid Transportation Benefits - Cafeteria Plans - Employer-Provided Adoption Assistance - Employer-Provided Education Assistance - Miscellaneous Employee Fringe Benefits - Income Earned Abroad by U.S. Citizens and Foreign Housing Costs - Certain
vances for Federal Employees Abroad Benefits and Allowances to Armed Forces Personnel - Medical Care and Tricare Medical Insurance for Military Dependents and Retirees Veterans' Benefits Military Disability Pensions - Workers' Compensation Benefits - Special Benefits For Disabled Coal Min
al Security Benefits - Medicare Benefits - Foster Care Payments - Public Assistance - Scholarship and Fellowship Income - Education Savings Accounts - Qualified Tuition Plans - Certain Agricultural Cost-Sharing Payments - Discharge of Indebtedness Income for Certain Farmers Investment Income o
rance and Annuity Contracts - Interest on Minnesota State and Local Government Bonds - Capital Gains on Home Sales - Capital Gains at Death - Capital Gains on Gifts - Exemptions from Imputed Interest Rules - Like-Kind Exchanges - Special Rules for Magazine, Paperback, and Record Returns - En
servation Subsidies Provided by Public Utilities - Accelerated Depreciation - Expensing Depreciable Business Property - Excess of Percentage Over Cost Depletion - Five-Year Amortization of Business Organizational and Start-Up Costs - Expensing of Research and Development Costs Expensing of M
ulation Expenditures - Expensing of Exploration and Development Costs - Cash Accounting and Expensing for Agriculture - Expensing of Multiperiod Timber Growing Costs Special Rules for Mining Reclamation Reserves - Cash Accounting Other than Agriculture - Installment Sales - Completed Con
s - Employee Stock Ownership Plans - Indiv al Retirement Accounts - Keogh Plans - Health Savings Accounts - Self-Employed Health Insurance - Interest on Student Loans - Per Diem Amounts Paid to State Legislators - Federal Personal Deductions 1.60 Additional Standard Deduction for the Elder
d - Medical Expenses - Real Estate Taxe s - Home Mort terest - Charitable utions and osses. **Income Tax Minnesota Subtractions:** K-12 Education Expenses - Charitable Contributions for Non izers - Income of the Elderly or Disabled - Active Duty Military Servic
onal Guard and Reserve Pay - Exper n Dono rtunity Build ne - Dispos Farm Property - AmeriCorps National ervice Education Awards - Preferential Computation - Five-Year veraging of Lump Sum Distributions - Marriage Credit - Credit for Long-Te
rance Premiums - Employer Trans Cr t - Credit for Pa Mil rvice - Credi Ne icipants in a n 125 Employer Health Insurance Pla Ch nd ender Co t on Credit Credit K 12 ucation Ex dit for Military Service in a Combat Zo
ortunity Building Zone Jobs Credit rp Zone Employer Tax C Credit for Bovine T losis Testin er otor Fuels - Exempt Orga za ance C r x e ed al ks: ers ns ns ted Interest Rules - Investment Incor
Insurance and Annuity Contracts - xchanges - Special Rul Magazine, Paperbac Record Retu **Federal Deductions**: Accelerated Depreciation - Expensing D preciable Business Property Excess of Percentage Over Cost Depletion (Mining Occupation Tax) - Amo
rganizational and Start-Up Costs - Exp earch and Devel t Costs - Expensing azine Circul xpenditu pensing of Exploration and Development Costs - Cash Accounting and Expensing for Agriculture - Expensing of Multiperiod Timber Growing Costs - Special Rules f
ng Reclamation Cash Accountin n Agriculture llment Sales - Comp ontract Rul aritable C tions - Employee Stock Ownership Plan Cap l Construction Funds of Sh ping Compa Apportionment - Weighted Apportionment - Throwback Sales - Singl
ortionment for Mail Order Companies **Corp ate Minnesota Su ons:** Dividend Rece eduction - F Source R - Foreign Operating Opportunity Building Zone Jobs Credit Zone mpl ax Credits - or Bovine Tuberculo sting **Estate clusions** surance Proceeds A earch and Development Credit - Employer Transit Pass C
Wearing Apparel - Drugs and Med vices - F es - B hine s and Burial Vaults – Publications - Textbooks Required for School U e - Personal Computers Required for School Use - De Minimis Use Tax Exemption for Individua
or Fuels - Residential Heating Fuels - Water Servic - Man elect al Equipment - Accessory Tools – Tooling - Telecommunications Equipment - Recovery Equipment - Used Motor Oil - Taconite Production Materials - Wind Energy Con
ems - Air Cooling Equipment - Solar Energy stems - Airflight Equipment - Large Ships 1992 $100,000 $100,000 $100,000 $100,000 4.31 Repair and Replacement Parts for Ships and Vessels - Light Rail Transit Vehicles and Parts - Commuter Rail Vehicles and Parts - Petroleum Products Used by Tra
ems Petroleum Products Used in Passenger Snowmobiles - Ski Area Equipment - Logging Equipment - Farm Machinery - Repair and Replacement Parts for Farm Machinery Petroleum Products Used to Improve Agricultural Land - Farm Conservation Programs – Horses - Prizes at Carnivals and Fairs
vision - Advertising Materials - Court Reporter Documents - Patent, Trademark, and Copyright Drawings - Packing Materials - Property for Business Use Outside Minnesota - Automatic Fire-Safety Sprinkler Systems - Firefighter Personal Protective – Equipment - Building Materials for Residences of
bled Veterans - Chair Lifts, Ramps, and Elevators in Homesteads - Parts and Accessories to Make Motor Vehicles Handicapped Accessible - Maintenance of Cemetery Grounds - Trade-In Allowance **Sales and Use Tax Exemptions - Sales to Particular Purchasers**: Local Governments - Nonprofit Orga
spitals and Outpatient Surgical Centers - Veterans' Organizations - Construction Materials for Low-Income Housing - Public Safety Radio Systems - Biosolids Processing Equipment - Ambulances Leased to Private Ambulance Services - Certain Purchases by Private Ambulance Services - Job Opportu
ding Zones - Enterprise Zone Construction Materials Waste Recovery Facilities - Hydroelectric Generating Facility - Minnesota Twins Ballpark - University of Minnesota Football Stadium - Central Corridor Construction Materials Exemptions - **Sales by Particular Sellers:** Isolated or Occasional Sales -
tutional Meals - Fundraising Sales by Nonprofit - Organizations to Artistic Events - Admission to School-Sponsored Events - Admission to the Minnesota Zoo - Cross Country Ski Passes for Public Trails - YMCA, YWCA, and JCC Membership Dues - Minnesota Amateur Sports Commission Events - Adm
itable Golf Tournaments - Candy Sales by Certain Organizations - Sacramental Wine Sold by Religious Organizations - Reduced Sales Price New Manufactured Homes Local **Property Tax Exemptions:** Exempt Real Property - Opportunity Building Zone Property **Preferential Valuations:** Classificatio
een Acres Treatment of Agricultural Land - Open Space Property - Metropolitan Agricultural Preserves Land - Tax Increment Financing - Preferential Computation - Auxiliary Forest Tax **Credits**: Taconite Homestead Credit - Powerline Credit - Metropolitan Agricultural Preserves Credit - Conservatio

-$11b

Tax expenditures and loopholes

=$16b

Annual state tax revenue (2010)

For every dollar of state tax revenue without preferences…

60¢

goes to education, health care and other public expenditures

40¢

goes 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?

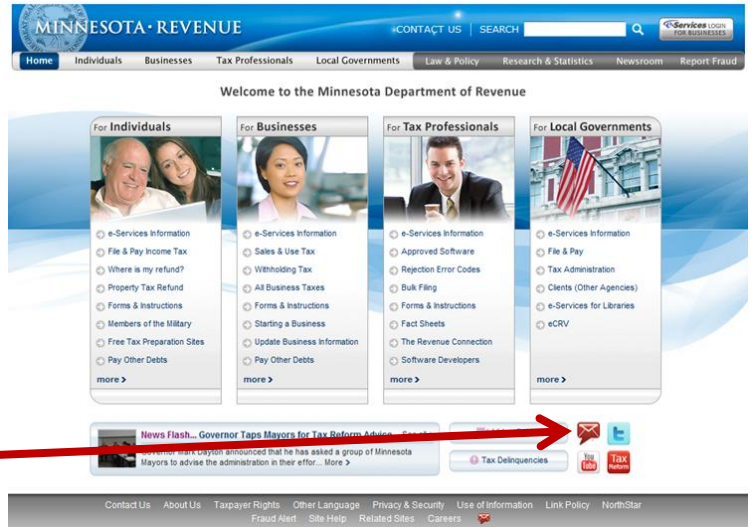
What are your ideas for tax reform?

Tell us!

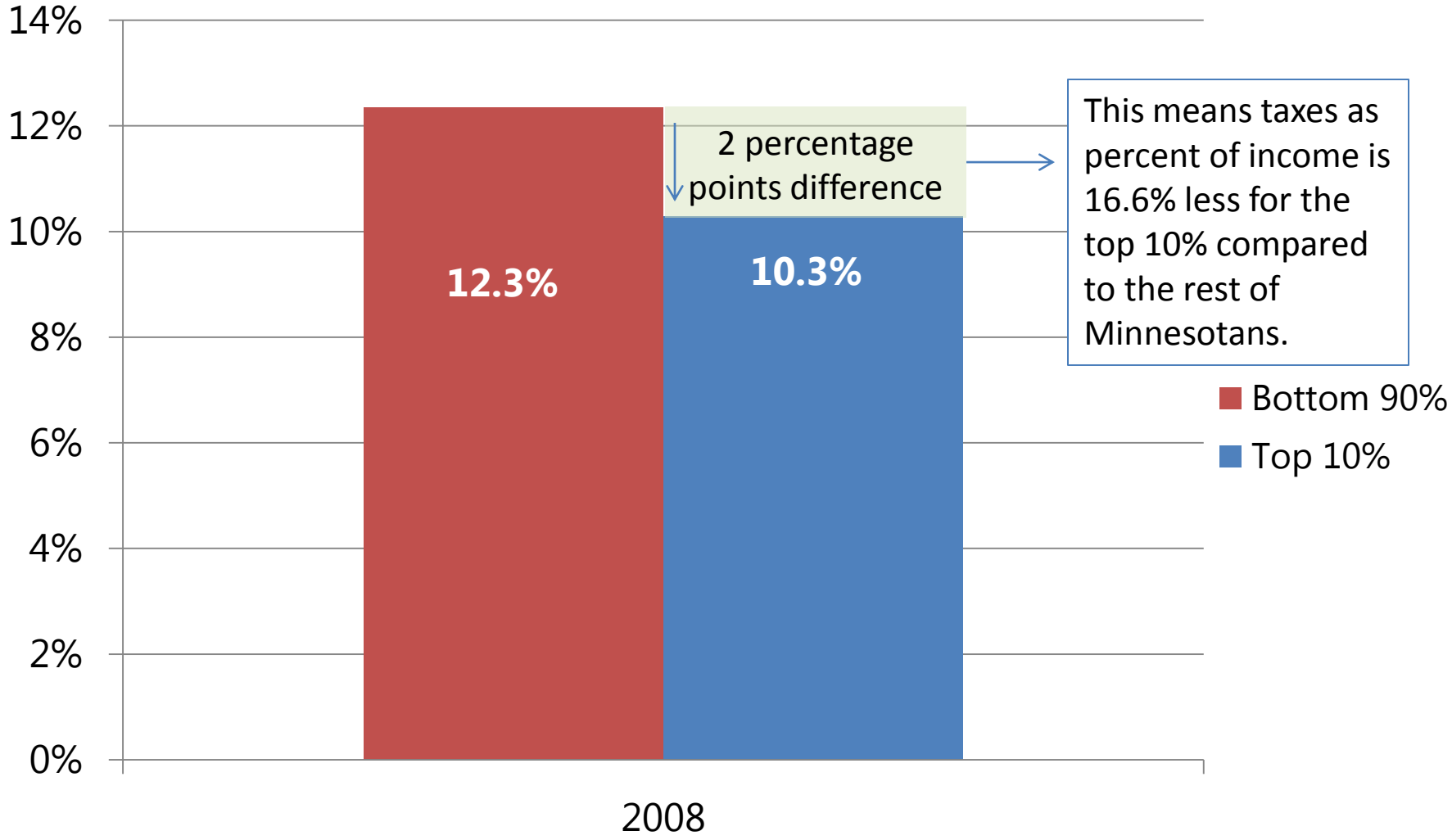
Myron Frans
Commissioner of Revenue
651-556-6003
revenue@state.mn.us
http://bit.ly/TaxReformMN
twitter @MNRevenue

#MNTaxReform

Sign up for email updates



Total Minnesota state and local taxes as percent of income: top 10% compared to the rest of Minnesotans



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