

# The Facts Speak: It's 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 the 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. Reversing that trend should be a priority.
- 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.

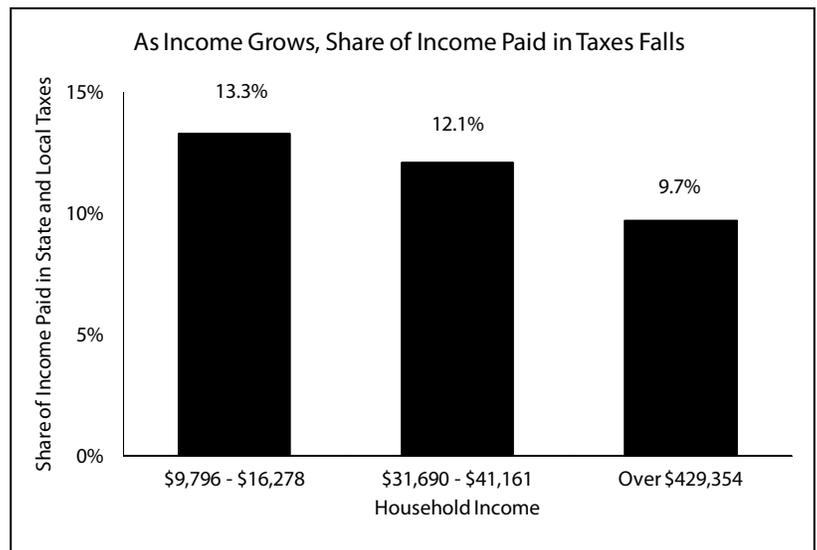
## As Income Grows, the Share of Income Paid in Taxes Falls

The wealthiest one percent of Minnesotans (those with household incomes over \$429,354) paid 9.7 percent of their incomes in total state and local taxes. This is significantly less than the 12.1 percent paid by a middle-income household making \$31,690 to \$41,161.<sup>1</sup>

Since 1990, tax fairness in Minnesota has declined.<sup>2</sup> Two factors explain the growing gap. One is growing 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. Perhaps the most important is the ongoing shift in the mix of taxes, away from state taxes to more reliance 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 taxes.

They increased to 29.1 percent of total taxes in 2008, and are projected to increase to 31.1 percent of total taxes in 2013.



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

Taxes are a smaller share of Minnesotans' household budgets today than in the mid-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 2008, 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>4</sup>

Experience since that time demonstrates that those cuts went too far. Combined with the revenue drops in response to tough economic times, Minnesota has faced frequent revenue shortfalls that 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. This reflects the fact that high-income Minnesotans have a significant share of all income in the state.

In fact, most Minnesota income groups pay in rough proportion to their share of total income, although middle-income groups tend to pay slightly more than their proportionate share and the highest income groups pay less.

The income group with the largest gap between its share of the state's income and its share of total taxes is those with incomes over \$429,354 (the wealthiest one percent). This group of Minnesotans had 16.2 percent of all income in the state, but paid 13.7 percent of total taxes.

Household Income Group	Share of Total Income	Share of Total Taxes Paid
<b>\$9,796 - \$16,278</b>	1.9 percent	2.2 percent
<b>\$16,279 - \$23,691</b>	2.9 percent	3.0 percent
<b>\$23,692 - \$31,689</b>	4.0 percent	4.2 percent
<b>\$31,690 - \$41,161</b>	5.3 percent	5.6 percent
<b>\$41,162 - \$53,314</b>	6.9 percent	7.3 percent
<b>\$53,315 - \$68,696</b>	8.9 percent	9.4 percent
<b>\$68,697 - \$89,936</b>	11.5 percent	12.2 percent
<b>\$89,937 - \$129,566</b>	15.6 percent	15.9 percent
<b>\$129,567 - \$182,829</b>	11.0 percent	10.7 percent
<b>\$182,830 - \$429,354</b>	14.9 percent	13.4 percent
<b>Over \$429,354</b>	16.2 percent	13.7 percent

### Some Taxes are Distributed More Evenly Than Others

While most Minnesotans pay about the same share of their incomes in taxes, how much of each tax they pay varies with their income. For lower-income Minnesotans, sales and property taxes make up the largest pieces of their tax bills, while higher-income Minnesotans pay more through the state income tax.

That means that changes in a particular tax will not be evenly felt across the board.

Minnesota's estate tax and individual income taxes are the state's only progressive taxes – meaning that the higher one's income, the larger share of that income paid for the tax. All other taxes that Minnesotans pay are regressive, taking a higher percentage of a low- or middle-income household's income than for the wealthiest households. Taxes on gambling and on cigarette and tobacco products do this to the greatest extent.

In Minnesota, the income tax only partially offsets the impact of other state and local taxes on low-

Tax	Suits Index
Estate Tax	0.413
Individual Income Tax	0.218
State Taxes Only	-0.004
<b>Total State and Local Taxes</b>	<b>-0.060</b>
Motor Vehicle Sales Tax	-0.088
Rental Property Taxes with Impact of Property Tax Refunds	-0.119
Mortgage and Deed Taxes	-0.141
Statewide Property Tax	-0.142
Alcoholic Beverage Excise Tax	-0.150
Homeowner Property Taxes with Impact of Property Tax Refunds	-0.161
Homeowner Property Taxes without Impact of Property Tax Refunds	-0.197
Local Property Taxes	-0.200
Local Taxes Only	-0.202
Corporate Franchise Tax	-0.208
General Sales and Use Taxes	-0.242
Motor Vehicle Registration Tax	-0.256
Rental Property Taxes without Impact of Property Tax Refunds	-0.300
MinnesotaCare Taxes	-0.318
Motor Fuels Excise Tax (Gas Tax)	-0.337
Gambling Taxes	-0.507
Cigarette and Tobacco Excise Taxes	-0.582

income and middle-income households.

Table 2 illustrates how regressive or progressive different taxes are, demonstrated by the Suits Index. A Suits Index above zero means the tax is progressive, and a Suits Index below zero means the tax is regressive.

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

Minnesota's tax system is not meeting our needs. Tax reform is needed so 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.

*By Nan Madden*

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<sup>1</sup> The data in this analysis come from the Minnesota Department of Revenue, [2011 Tax Incidence Study](#), and unless noted otherwise, refers to taxes paid in 2008, the most current data available. The Tax Incidence Study includes over 99 percent of the \$23.8 billion in taxes paid in Minnesota in 2008. The distributional analysis in the study includes the \$19.9 billion in taxes paid by Minnesota residents, or 84 percent of the total. 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 "an actual or potential income taxes filer and all dependents, even if not all living under the same roof." 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. 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>2</sup> The erosion of fairness is demonstrated by the Suits Index. The Suits Index assigns 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. The Tax Incidence Study finds a long-term decline in the Suits Index for Minnesota's state and local tax system. The Suits Index dropped from -0.007 in 1990 to -0.054 in 2008. The system is expected to improve slightly in 2013 to a Suits Index of -0.047. These figures may understate how regressive the state's tax system is. The Tax Incidence Study finds a Suits Index of -0.068 in 2008 and -0.052 in 2013 using an alternative methodology that uses the entire sample of more than 100,000 data points to calculate the Suits Index, in contrast to the traditional approach of using 10 data points. The Tax Incidence Study notes that the "full sample" method is theoretically preferable, but they use the traditional method so that results can be compared to past studies.

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

<sup>4</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>5</sup> These calculations use the full-sample Suits Index.