

MINNESOTA Department of Revenue

Property Tax Division

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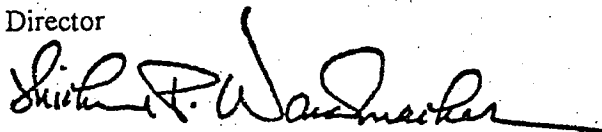
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Date: January 24, 1995

To: ALL COUNTY AUDITORS and TREASURERS

From: MIKE WANDMACHER, Director  
Property Tax Division



As I am sure most of you know, the 1994 Legislature required the Department of Revenue to conduct a study of delivering the homeowner's regular property tax refund and the targeted homestead refund as a property tax credit on the property tax statement. We have submitted this study to the legislature but there is still one last piece of information which the study requires and that is the cost to the counties of implementing and administering the tax credit proposals. These costs are to include the initial start up costs, ongoing administrative expenses, programming, form design, data entry and computer hardware costs.

Along with this letter you will find a copy of the six-page study which was submitted to the legislature yesterday.

We would ask that you review the study and then attempt to give us an estimate of what it would cost to implement and administer the program. Since we do not have any specific Legislation at this point, we recognize that you can only provide a ballpark estimate and you may need to give us a range. The three major computer consortiums (MCCC, MSCC, MCIS) have already been provided with copies of the study. If you are a member of one of those consortiums, please coordinate your estimate with the consortium and any county data processing people you may have. If your county does not belong to one of the three major consortiums, it will be necessary for you to talk to your county data processing people about programming, data entry and computer hardware costs. We need to have one estimate (or range) for each county.

Please fax your estimate to our office at (612) 297-2166 by Tuesday, February 7, 1995.

If you have any questions, please feel free to call Bill Speckman at (612) 296-5138. Bill will be making a presentation regarding the study at the MACO conference at 8:30 a.m. on Thursday, February 2.

Please be sure that both the county auditor and the county treasurer receive a copy of this fax.

# STUDY OF HOMESTEAD PROPERTY TAX RELIEF

A Report to the Minnesota State Legislature  
as authorized by  
Laws of 1994, Chapter 587, Article 5, Section 29.

This report is in response to the Legislative requirement that the commissioner of revenue conduct a study of the methods of delivering property tax relief to homeowners. The study was charged to consider the administrative feasibility, policy implications, and state revenue (or expenditure) impacts of several alternative delivery mechanisms.

## **I. Paying the Regular and Special Property Tax Refunds as State Paid Credits on the Property Tax Statement:**

Among the specific topics to be considered in the study were the proposals to pay the income-sensitive regular refund and the percentage-increase special refund as credits on the property tax statement. Current law creates a linkage between the two forms of relief to homeowners because the regular refund (if any) reduces the net basis upon which the special refund is calculated. The special refund is scheduled to expire after payable 1996. For reasons discussed later, the earliest feasible date for delivering the refund as a credit on the tax statement is payable 1997. Separate consideration of the regular and special refunds as credits therefore seemed moot, for only the regular refund will exist in 1997.

## **II. Calculating the Special Refund Before the Regular Refund:**

A related issue to be addressed in the study was the effect of calculating and deducting the special refund before the regular refund was calculated. In return year 1992, the latest year for which data is available, eighteen percent of applicants received both forms of refund. The average combined refund for this population was \$420.84. Reversing the order of calculation would have increased the average combined refund to \$570.59. The aggregate increase in refund expenditures would have been almost \$8,500,000. The primary reason for the increase is that many taxpayers would still qualify for the \$400 maximum regular refund after the special refund capped at \$1,500 was calculated. If the new ceiling of \$1000 had been in effect for 1992, the aggregate refund increase would have been approximately \$8,100,000.

### **III. Feasibility of Applying the Refund as a Credit on the Current Year Property Tax Statement:**

The original proposal specified in the draft legislation was to apply the refund as a credit on the second-half payment of the current year. The department was to give the county auditors the refund amount by July 1, which was then to be reflected on a second-half property tax statement to be mailed no later than August 31. Even if the required filing date for taxpayers were moved up from the current August 15 date and homeowner refunds processed before renter refunds, there is neither sufficient time nor processing capacity between completion of income tax returns and July 1 to meet the schedule.

Another set of difficulties, and consequent costs, arises from applying a credit in the middle of an ongoing tax year. Escrow accounts would fall out of balance; full-year payers would be due refunds from the counties; abatements and classification changes would affect the current tax payable. If the refund is based upon elements subject to change, every actual change imposes a significant reversal cost to undo and correct a routine action taken. Such costs are impossible to identify with precision because they are distributed throughout the various public and private entities involved in the property tax system. Banks and mortgage companies, no less than county assessors and auditors, would bear these costs. Even if the processing difficulties could be resolved by expanding departmental capacity, the errors and reversal problems would remain.

A third consideration is that the mechanism of a second-half property tax statement doubles the recurring annual cost of billing the taxpayer. Various counties estimate unit costs ranging from forty cents to \$1.50, depending upon economies of scale and technical expertise. Assuming an average cost of a dollar per statement, statewide annual recurring costs would increase by \$1,200,000 from this new requirement alone. A large part of the increase cannot simply be absorbed because it is out-of-pocket expenditure for materials and postage.

### **IV. Feasibility of Changing the Basis of the Regular Refund:**

Faced with these operational and expense problems, the department investigated the feasibility of changing the basis of the regular refund. Currently the calculation is driven by the previous year's income and the current year's property tax payable. If the basis were the previous year's income and the previous year's tax actually paid, the refund could be applied to next year's tax payable. Such a procedure would buy the time necessary to process the applications within the current constraints, avoid almost all the operational problems stemming from applying a credit to the current tax year, and permit the credit to be spread evenly across both payments on a single statement. It may also be possible to present the refund credit on the notice of proposed property taxes.

The current system is a true refund for renters and a quasi-advance for homeowners. The department examined the refund history files to determine whether the

suggested change would adversely affect claimants. Assuming they apply when first eligible, taxpayers would have to wait an additional year before receiving relief. All eligible homeowners would receive the economic benefit of the refund later than they do now. If the refund is to be represented on the tax statement, the price of feasible and efficient administration is delaying its delivery into the next tax year.

If the refund formula were not changed, most eligible claimants would receive a smaller refund. The formula can be adjusted to neutralize these effects. One adjustment might be to introduce a multiplier into the calculation that would reflect any increase between last year's taxes paid and this year's taxes payable. In effect, the refund would be indexed for any increase in taxes. Another adjustment might be to increase the refund by the time value of the delayed benefit. Such adjustments would be troublesome if claimants were performing the calculation themselves. As part of an automated formula, however, they pose no particular difficulty.

#### **V. Data Needed to Implement the Proposals:**

The crucial information that initiates the entire refund process is the determination of household income. The claimant must provide this information through some type of application because it cannot be derived from other sources. Most homeowners report federal adjusted gross income as part of their household income. That suggests gathering household income as part of the M-1 state income tax return. To do so, however, might force the M-1 form to be longer than one page. If the Legislature decides to authorize the proposed changes in the refund program, the most efficient and effective way to obtain household income will emerge from the detailed design phase of the project.

Data needed from the county property records include the following for all homesteads:

- property identification number
- name, address, and social security number of owners
- name, address, and social security number of non-owner spouse, if any
- last year's qualifying tax amount paid
- this year's qualifying tax amount payable
- farm linkage indicators among separate parcels, if any

The required data can be consolidated with the information necessary to perform the homestead match and delivered as a single annual submission from the counties to the department. The reported data should reflect the property's status as of the assessment date. Year-to-year comparisons of the files will identify ownership and status changes.

There is evidence to indicate that perhaps four percent of the social security numbers carried on the county property records are erroneous. Given a population of 2,000,000 homesteaders, as many as 80,000 social security numbers may be incorrect. Moreover, close to 100,000 homesteads change ownership each year, each one a potential new source of error. The accuracy of the social security number/property identification number cross-reference is essential to the administration of the proposed new homeowner

refund program. The size of this problem and the time required to resolve it will probably delay any implementation of the proposed system until at least pay 1997.

Another round of homestead applications will probably not clean up the data. Instead, a progressive winnowing technique--one that first identifies the problem records, then uses various matching techniques to cure as many records as possible, then resorts to direct mailings to the remaining homesteads--would probably yield better results at a lower cost. Obtaining the names and social security numbers of non-owner spouses can probably be incorporated into this process.

Certain types of homesteads are likely to require special attention. Linked farm parcels are now typically assembled by the individual claimant. An automated system deriving its data from county property records must have some way of handling farm linkages comparable to the task now performed by the claimant. Similarly, split classification properties and fractional homesteads may need special handling. Until detailed design work in conjunction with the counties is undertaken, the size of these special situations, and therefore the most cost-effective methods of treating them, remain unknown.

#### **VI. Implementation Strategy and Policy Implications:**

If the proposal to deliver income-sensitive property tax relief to homeowners is enacted in the manner described, the major economic effect falls upon first-time and intermittent claimants. The current system typically provides the benefit approximately nine months after the close of the claimant's qualifying low income year, around the first of October. The proposed system would provide the benefit as a credit several months later than that, on May 15 and October 15 of the succeeding year. As discussed earlier, appropriate adjustments in the refund formula can neutralize any real reduction in the refund. Yet the sheer delay will doubtless cause distress to some number of eligible homeowners. The policy question is whether this is a reasonable price to pay in exchange for a manageable system that puts the refund on the property tax statement.

A study conducted by the department in 1994 found that "the level of non-participation by eligible homeowners in the PTR program is about 11 percent of current filers (Jim Benson, "Minnesota Tax Revenue & Policy Review," June 1994, p. 6)." It is not likely that every eligible taxpayer will apply; but increased taxpayer awareness and easier application procedures will almost certainly result in greater participation. If half the eligible non-filers had applied for 1992, the additional outlay for homeowner refunds would have amounted to about \$3,000,000.

The department incurs approximately \$750,000 in direct costs to administer the homeowner portion of the current refund system. The only cost to the counties is the extra property tax statement to be filed with the application. Although it appears nowhere in any public budget, the largest single cost under the current system is probably the fee paid by applicants to preparers. Almost sixty percent of homeowner applications indicate

the use of a paid preparer. At an average fee of twenty dollars, homeowners may have spent in excess of \$3,000,000 in preparer fees to submit their applications for 1992. A simplified procedure would presumably reduce this cost, though there is no basis for estimating how much.

One policy question may stand in the way of implementing the refund as a credit on the tax statement, no matter how feasible and desirable the proposal may otherwise be. Property records are public information; income information is private. It would not be difficult to reverse the refund formula and derive approximate household income from public records. The legal ramifications of this issue are beyond the department's power to resolve. There may be federal requirements that the Legislature cannot overcome. It may be possible to devise a property tax statement that showed the tax amount on the body of the form and listed the credit only on the payment coupon. The cost to the counties of such a solution, assuming its legal adequacy, is unknown at this time.

One further modification of the implementation strategy would accomplish the goal of placing the refund as a credit on the tax statement. The present system of application and processing would continue on the same schedule. Instead of sending checks to claimants, however, the department would prepare a list of refund amounts to be reported to the counties. The counties would in turn apply the refunds as credits on next year's tax statements. This scheme would not put additional pressure on departmental processing, nor would it cause operational difficulties at the county level. The social security number problem could be alleviated by including the property identification number in the department's data entry, thereby providing two links between county property records and the department's records. The potential savings resulting from a simplified and more automated system would not be realized, however; the only thing that would change is the final delivery of the benefit as a credit instead of a check.

Finally, an additional policy issue that is important to consider, regardless of the implementation strategy chosen, is the potential long run impact on state and local expenditures from including the property tax refund on the property tax and truth in taxation statements. As already noted, expanded participation in the homeowner refund program under a streamlined process will by itself probably impose some additional costs to the state.

A potentially more significant budget impact could arise if incorporating the refund as a property tax credit has the effect of stimulating higher spending and property tax levies by local governments and, through linkage between local levies and state costs in the property tax refund formula, increasing state expenditures for property tax relief. The potential for stimulating local government spending becomes greater as the property tax relief program is expanded both in terms of the number of participants and the average refund amount. The old homestead credit formula was perceived to be stimulative because the credit was based on a percentage of gross property tax liability (54%). The PTR under current law has the same potential to be stimulative because the refund is based on both an eligibility threshold of property tax to income and on a state co-payment

percentage. To the extent that the eligibility thresholds are reduced and the state co-payment percentages are increased, the state's property tax refund cost becomes increasingly tied to local government tax and spending decisions.

Under the current system, the truth in taxation and property tax statements show property tax amounts before state paid aids, thereby suggesting to taxpayers the full impact of local levy decisions. If the relationship between local decisions and taxpayer costs is diluted or obscured by including the state regular or targeted homeowner refund, then local accountability is lessened and there is potential for both increased spending and property tax levies at the local level and higher payments for property tax relief at the state level.

#### **VII. Costs:**

Detailed cost estimates at the state and county levels are not yet complete. They will be submitted shortly.

#### **VIII. Summary:**

The department believes the goal of applying the property tax refund as a credit on the tax statement is achievable.

The proposal to apply the refund as a credit on the second-half payment exceeds the department's current processing capacity, causes major exception and error-handling difficulties, and builds in large recurring costs.

The proposal to apply the refund as a credit on next year's tax statement avoids most of the operational difficulties for both the department and the counties and simplifies the application procedure for the homeowner.

The earliest possible implementation date is pay 1997. If the Legislature decides to authorize the change, a phased commitment that could accommodate a later implementation should be considered.

The changed system will probably result in higher rates of participation, which in turn will increase state expenditures. A potentially significant longer run budgetary impact could arise if including the refund as a direct credit on the property tax statement has the effect of stimulating higher rates of growth in local property tax levies and associated state costs for property tax relief.