Fiscal Analysis Department
Minnesota House of Representatives

ISSUE BRIEF

State General Property Tax
Forecast Changes and Implementation Issues
(January 2003)

The state general property tax on business[1] and seasonal recreational residential property[2] was enacted in 2001 as part of a broader package of property tax reforms that included class rate reductions, the state takeover of transit levies, and replacement of the state-determined school district general education property tax levy with direct state-aid payments. Prior to 2002, the state last levied a statewide property tax in 1967.

The 2002 state tax levy was set by statute at $592 million. Statute directs that the levy, for 2003 and each year thereafter, grow by one plus the growth, if any, in the "implicit price deflator (IPD) for government consumption expenditures and gross investment for state and local governments", a widely used measure of local government price growth developed by the United States Department of Commerce. Current levy projections for 2003 and beyond are lower than previously forecast due to lower IPD projections. In addition, the annual revenue generated by the tax will be less than levy amounts due to the timing of collections and the unique application of the tax on certain types of property, such as utility transmission and distribution lines.

Levies

As shown in Table 1 (next page), the 2003 state tax levy will be $595 million, or 0.5% percent higher than the 2002 levy. Of the $595 million levy, $564 million will be levied on commercial property and $31 million on seasonal recreational residential property. Although the levy will grow from 2002 to 2003, the state tax rate will decline from 57.933 in 2002 to 54.447 in 2003 because the tax base is growing faster than is the levy. The levy is projected to increase to $661 million by 2007, an average annual increase of 2.2 percent.

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[1] Commercial and industrial land and buildings, unmined iron ore property, and utility real and personal property with the exception that electric generation equipment is not subject to the tax. Real and personal property of the St. Paul and Twin-Cities International airports is also exempt.
[2] Class 4c(1) property (cabins and seasonal recreational resorts) except that the first $76,000 of value of cabins is taxed at only 40 percent of the state rate. The tax does not apply to homesteaded residential resort property.

Table 1 **Projected State General Property Tax Levies and Revenues*** ***(in millions)***							
LEVIES			*REVENUES*				
Year	**Amount**		**Fiscal Year**	**Education Reserve**	**General Fund**	**Total**	
2002	$592		**2002**	$0	$306	$306	
2003	595		**2003**	0	588	588	
2004	607		**2004**	9	588	597	
2005	622		**2005**	22	588	610	
2006	641		**2006**	40	588	628	
2007	661		**2007**	59	588	647	

* Based on the November 2002 forecast.

Revenues

Revenues collected for a single calendar year are split across two state fiscal years because most collections occur in May and October and the state fiscal year ends June 30. As also shown in Table 1, unrestricted general fund revenues from the state property tax totaled $306 million in FY 2002 and are expected to total $588 million in FY 2003. Unrestricted general fund revenues will remain at $588 million in FY 2004 and thereafter because statute directs that, beginning in FY 2004, revenues in excess of FY 2003 amounts be deposited into an education reserve account. Amounts in the reserve account do not lapse and remain in the fund until appropriated for education aid or higher education funding. No such appropriations have yet been made. In the absence of appropriations or other uses, the reserve will grow to $130 million by the end of FY 2007.

Projected Revenues lower than Previous Estimates

State property tax revenues, shown in Table 2, are currently forecast to be $894 million in FY 2002-03, or $2 million less than originally estimated at the end of the 2001 legislative session. Further, revenues for FY 2004-05 are now projected to be $1.207 billion, or $38 million less than originally estimated.

Table 2 **Comparison of Forecasted Revenues** ***(in millions)***		
Fiscal Year	**End-of-Session 2001**	**Current (11-02 Fcst.)**
2002	$296	$306
2003	600	588
2002-03	***896***	***894***
2004	615	597
2005	630	610
2004-05	***1,245***	***$1,207***

The declines in projected revenues are primarily attributable to: lower levies as a result of lower growth rates; the unique characteristics of the tax base to which the tax is applied; the uncollectability of a portion of the amount levied; and the timing of property tax payments.

Growth Rates

At the time the state general property tax was enacted, revenue estimates assumed levy growth of 2.5 percent annually. As shown in Table 3, levies are now projected to grow by 0.5 percent in 2003, 2.07 percent in 2004 and 2.44 percent in 2005.

Table 3
Comparison of Levy Growth Rates
(in millions)

Year	End-of-Session 2001	Current (11-02 Fcst.)
2002		
2003	2.50 %	0.50 %
2004	2.50	2.07
2005	2.50	2.44

As summarized in Table 4, lower IPD growth rates result in lower levy projections, including \$11.9 million lower in 2003, \$14.8 million lower in 2004, and \$15.6 million lower in 2005.

Table 4
Reconciliation of 2001 End-of-Session Cost Estimates to Nov. 2002 Forecast
(000's)

LEVIES	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
2001 EOS Levy Projection	592,000	606,800	622,000	637,600	635,500	669,800
Revised Levy Growth		(11,858)	(14,755)	(15,562)	(12,167)	(8,739)
Airport Error	(3,052)					
Abstract Tax Base Changes	(3,605)	(3,600)	(3,600)	(3,600)	(3,600)	(3,600)
Utility property and manuf. buildings not in tax base	2,379	2,391	2,441	2,500	2,578	2,658
Delinquencies	(8,800)	(3,512)	(3,585)	(3,673)	(3,788)	(3,905)
Nov. 2002 Levy Forecast	578,922	590,221	602,501	617,265	636,523	656,214
REVENUES	**FY2002**	**FY2003**	**FY2004**	**FY2005**	**FY2006**	**FY2007**
2001 EOS Revenue Estimate	296,000	599,400	614,400	629,800	645,550	661,650
Above Adjustments.	(6,539)	(14,829)	(18,039)	(19,917)	(18,656)	(15,281)
Payment Timing Adjs.	16,112	3,693	410	493	643	657
Nov. 2002 Revenue Forecast	305,573	588,264	596,771	610,376	627,537	647,026

Tax Base Characteristics

Application of the Tax Rate: The state property tax rate, once established, is also applied to certain manufactured buildings and public utility distribution lines and equipment. However, because the tax capacity of these properties is not included in the tax base when setting the rate, the revenue collected from these properties increases revenues relative to the levy. As shown in Table 4, $2.4 million was collected from such properties in 2002.

Uncollectability of a Portion of Taxes Levied

Error Correction: The tax base used to calculate the 2002 certified state tax rate included major municipal airport personal property even though such property is exempt from the tax. As a result, the rate was lower than it should have been. Consequently, $3.1 million in levy was not assessed in 2002. Although this is a one-time event that will not affect levies for 2003 or after, the error will depress FY 2003 revenues below what would have otherwise been the case, and therefore, increase education reserve account allocations beginning in FY 2004.

Adjustments to Net Tax Capacity: It is common for abatements, tax court adjustments, omissions, and error corrections to occur after submission of the final property tax abstract, upon which the final certified state tax rate is based. These changes generally reduce the tax base, resulting in somewhat lower collections. As shown in Table 4, such adjustments lowered collections by $3.6 million in 2002 and similar adjustments are assumed to continue in subsequent years.

Timing of Tax Collections

Late payments, delinquencies, and non-payments: Because a portion of the state tax is paid late or is not collected until years later, there is a reoccurring shortfall in collections relative to the amount levied. As shown in Table 4, $8.8 million was expected to be delinquent in 2002. The combination of past due collections and current year delinquencies are expected to lower net revenues by approximately $3.5 million annually beginning in 2003.

Payment date requirements: Original estimates assumed that 100 percent of the levy would be collected in the year levied and that that revenue would be evenly split across state fiscal years. However, while most property taxes are paid in two equal payments (May and October), owners of public utility property (except personal property on leased land) are required to pay their property taxes in one payment in May. As shown in Table 4, net adjustments for payment due dates results in a $16.1 million shift forward of revenues in FY 2002.

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