Overview of Property Taxes

A Presentation to the House Committee on Taxes

February 2009

by

Karen Baker
Steve Hinze
Pat Dalton
Research Department

and

Katherine Schill
Fiscal Analysis Department

Minnesota House of Representatives

Contents

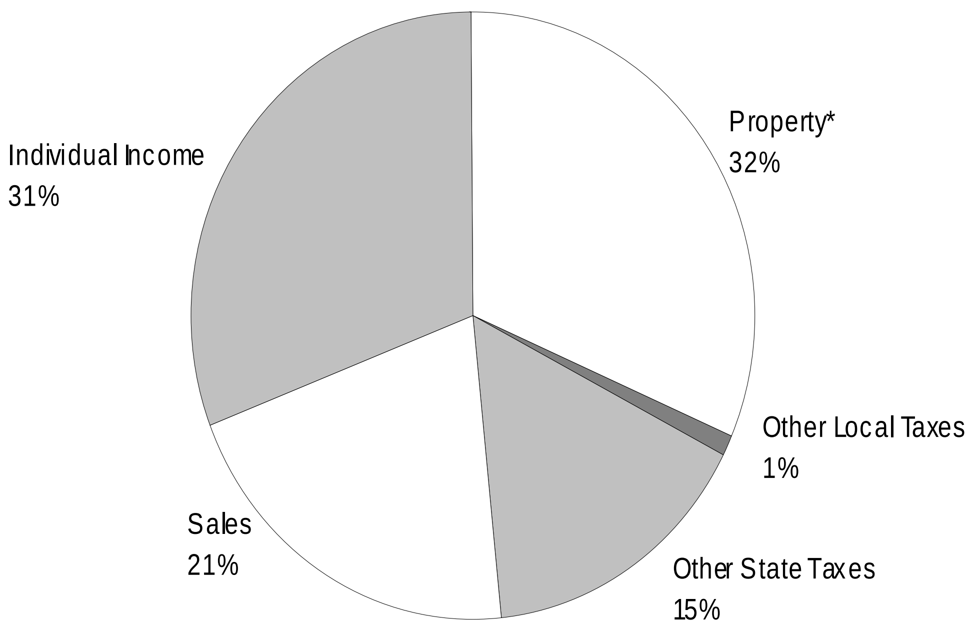
State and Local Taxes

Minnesota State and Local Tax Collections
($23,720 million in FY 2009)

000s

Individual Income	$7,376
Property	$7,528
Local Property Tax	$6,785
State Property Tax	$743
Sales (state only)	$4,889
Other State Taxes	$3,668
Other Local Taxes	$259
Total	**$23,720**

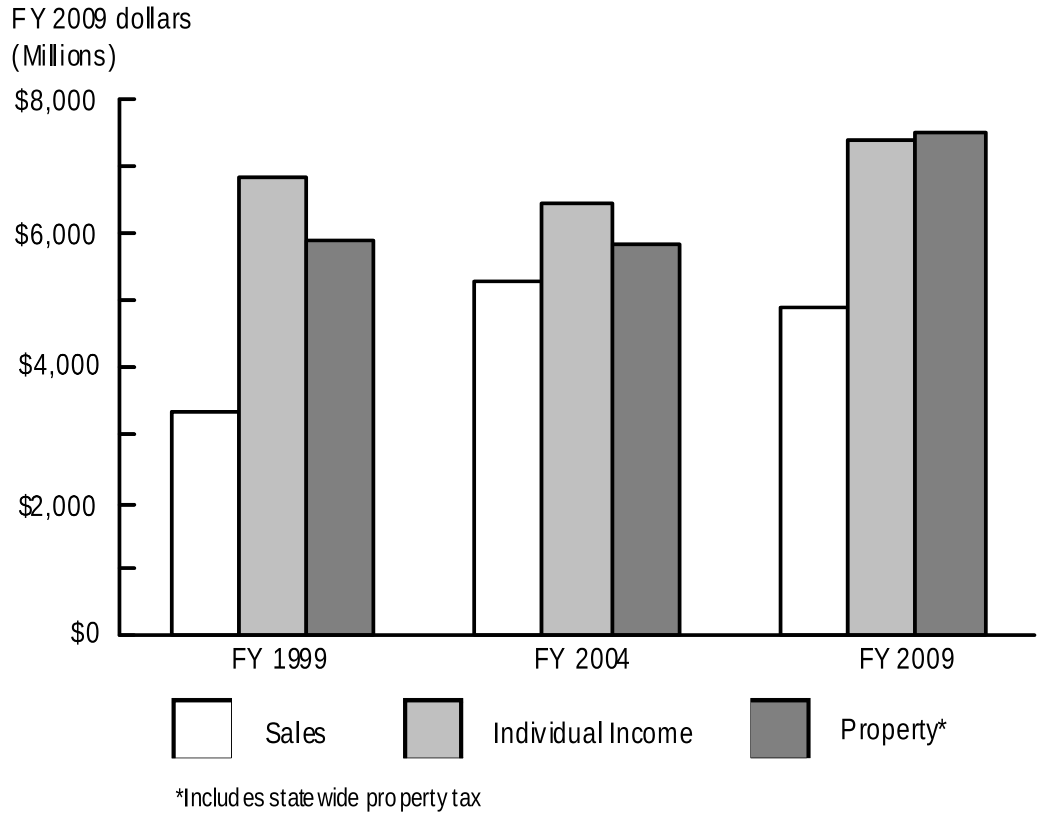
Of the $23.7 billion in state and local tax collections for FY 2009, $16.68 billion are state tax revenues and $7.04 billion are local tax revenues.



* Includes statewide property tax

House Research Graphics

Income, Sales, and Property Taxes



House Research Graphics

Ten Years of the Big Three

Current year $, 000s

	FY 1999	FY 2004	FY 2009
Sales	$3,347	$5,306	$4,889
Individual Income	$6,828	$6,481	$7,376
Property*	$5,878	$5,830	$7,528

* Includes statewide property tax, which began in CY 2001.

Of the $23.7 billion in state and local tax collections for FY 2009, the big three taxes—sales, individual income, and property—accounted for 83.5% of the total.

Property Tax Administration

Who does what

Counties are responsible for property tax administration; the Department of Revenue provides assistance and oversight. The list below shows each county office's responsibilities for property tax administration. In some counties these offices are merged and one or two offices may perform the functions.

Assessor
- Values property
- Determines proper classification
- Sends valuation notices to taxpayers

Auditor
- Determines each taxing jurisdiction's total tax capacity (i.e., its tax base)
- Calculates proposed and final tax rates
- Prepares truth-in-taxation notices (based on proposed levies)

Treasurer
- Prepares and mails out property tax statements
- Collects property tax payments
- Distributes property tax receipts to each taxing jurisdiction

Property tax timeline

The process of calculating, imposing, and collecting Minnesota property taxes for a year actually spans two full calendar years. As shown on the reverse side, the two-year cycle begins with the January 2 statutory assessment date and extends all the way through the next calendar year until the property taxes have been paid. For example, for taxes payable in 2009, the cycle begins on January 2, 2008, and doesn't end until the final payments are made in October/November 2009.

Appeal process

If a property owner disagrees with the assessor's valuation (shown on the valuation notice), the taxpayer can seek relief directly from the assessor. This may resolve the matter, so that no further action is necessary. If it does not, there are two separate avenues of appeal:

1. A three-step appeal process, consisting of an appeal to:
   - the local board of review; if not satisfied, appeal to,
   - the county board of equalization; if not satisfied, appeal to,
   - the Minnesota tax court.
2. A single-step appeal to the Minnesota tax court. There are two divisions:
   - The regular division, which can be used for any property. Proceedings are formal (an attorney is recommended), and the decision may be appealed to the Minnesota Supreme Court; or
   - The small claims division, which can be used only for homesteads (regardless of value) and other property where the market value is under $300,000. Proceedings are less formal, and decisions are final.

Property Tax System Timeline			
		Assessment Year 2007 Taxes Payable 2008	**Assessment Year 2008 Taxes Payable 2009**
2007	January	Assessment date (2nd)	
	March	Valuation notices mailed	
	April	Local boards of appeal and equalization	
	June	County board of appeal and equalization; state board of equalization	
	July	Certification of state aid amounts	
	September	Truth-in-taxation levy certifications (15th, 30th)	
	November	Truth-in-taxation notices mailed	
	December	Truth-in-taxation hearings; final levy certifications (27th)	
2008	January	County auditors compute tax rates	Assessment date (2nd)
	March	Property tax statements mailed	Valuation notices mailed
	April		Local boards of appeal and equalization
	May	1st half tax payments due (15th)	
	June		County board of appeal and equalization; state board of equalization
	July	1st half state aid payments made (20th)	Certification of state aid amounts
	September		Truth-in-taxation levy certifications (15th, 30th)
	October	2nd half tax payments due – except on agricultural property (15th)	
	November	2nd half tax payments due – on agricultural property (15th)	Truth-in-taxation notices mailed
	December	2nd half state aid payments made (26th)	Truth-in-taxation hearings; final levy certifications (27th)
2009	January		County auditors compute tax rates
	March		Property tax statements mailed
	May		1st half tax payments due (15th)
	July		1st half state aid payments made (20th)
	October		2nd half tax payments due – except on agricultural property (15th)
	November		2nd half tax payments due – on agricultural property (15th)
	December		2nd half state aid payments made (26th)

Truth in Taxation

"Truth in taxation" (TnT) is a process which the legislature enacted in 1988 to enhance public participation in Minnesota's property tax system. The components of TnT are:

- public advertisements on budget/levy of certain taxing jurisdictions,
- parcel-specific notices sent to the owner of the property,
- public hearings, and
- changes in the property tax statement.

The process was enacted by the 1988 Legislature and was phased in from 1989 to 1993. Full implementation of the process began with taxes payable in 1993, the same year as the repeal of the general property tax levy limitations for counties and cities.

Under the law prior to TnT, the main avenue for taxpayer involvement was on the valuation side of the system. Taxpayers received their market value notice early in the year, and then no further information was sent to the taxpayer until the property tax statement was received the **following** February or March—almost a whole year later. The legislature felt that TnT would improve local accountability by focusing taxpayers on the relationship between the budget process and property taxes.

The main purposes of TnT were:

- to enhance public participation in Minnesota's property tax system,
- to educate the public on how property taxes are determined,
- to encourage the public to understand the local government's budget process,
- to encourage the public to become involved in helping local officials set spending priorities.

Although there are some exceptions (i.e., referendums, court costs, etc.) the local government's final levy cannot be increased above the proposed levy amounts reflected on the TnT notices.

The basic components of the process are:

A <u>newspaper advertisement</u> is required for counties, cities over 2,500 population, school districts, and certain special taxing districts. A local government must include changes in its total spending, property tax levy, and what the proposed local tax rates would be if there was no levy increase.

The <u>TnT notice</u> shows the taxpayer how the current property taxes on their parcel compare to the proposed taxes for taxes payable in the following year, **if** the local governments adopt their proposed budgets (excluding any tax due to a referendum election held after proposed levies were certified).

A <u>public hearing</u> is required for all counties, cities over 500 population, school districts, and certain special taxing districts, if the jurisdiction's proposed levy is greater than its current year's levy, and that percentage increase is greater than the percentage increase in the implicit price deflator (IPD).

The property tax statement contains a comparison of the property's current year's valuation, state aids/credits and property taxes to the property's previous year's valuation, state aid/credits and property taxes. The taxpayer can analyze, at a glance, what changes have occurred on the parcel of property.

Basic Terms and Concepts

Estimated market value	The assessor determines each property's **estimated market value** based on sales of comparable properties, cost of construction minus depreciation, income generated by the property (if applicable), and other relevant available information.
Taxable and limited market value	**Estimated market value** and **taxable market value** are the same for most types of property. However, for residential homestead and nonhomestead property, agricultural property, and seasonal recreational property, the property's **taxable market value** may be restricted to its **limited market value**, which is a statutory limitation on the amount that the property's value can increase over the previous year's value.
Net tax capacity, class rate	A property's **net tax capacity** is determined by multiplying the property's taxable market value by the relevant **class rate** or rates. Class rates are set by statute, vary by property type, and are uniform statewide.
Levy	Each local taxing jurisdiction certifies a **levy** equal to the amount of revenue it desires to raise through the property tax in the upcoming year.
Levy limit	For some types of local taxing jurisdictions, the levy may be constrained by state-imposed **levy limits**. Levies for school districts and special taxing districts are limited. In some years, levies for counties and large cities (over 2,500 population) have been limited, although no limits are currently in effect for those types of jurisdictions. Generally, state imposed levy limits can be overridden by referendum.
Local tax rate	The **local tax rate** of a taxing jurisdiction is determined by dividing the jurisdiction's **levy** by the total **net tax capacity** of all properties within the jurisdiction.
Total local tax rate	The **total local tax rate** for an individual property is the sum of the local tax rates of all taxing jurisdictions allowed to levy taxes upon the property.
Market value-based levy and tax rate	Certain voter-approved levies must be levied against market value rather than net tax capacity. The **market value-based tax rate** is determined by dividing the jurisdiction's **market value-based levy** by the total **taxable market value** of all properties within the jurisdiction (excluding the value of property classified as agricultural or seasonal-recreational, since those property types are exempt from market value-based taxes).
Gross tax, property tax credits, net tax	**Property tax credits** reduce the **gross tax** that would otherwise be due upon a property. The remaining amount after subtraction of property tax credits is the **net tax**. The **homestead market value credit** and the **agricultural market value credit** are the two most common property tax credits and are based on formulas related to the market value of the property. Other property tax credits include the taconite homestead credit, the disparity reduction credit, and the power line credit.

Computation of Property Tax for a Hypothetical Property

1. Determine the property's ***taxable market value***	$120,000
2. Determine the ***class rate*** based on property type	Residential homestead: 1.0%
3. Multiply taxable market value by class rate to obtain the ***net tax capacity***	$120,000 X 1.0% = $1,200
4. Determine the ***total local tax rate*** by summing the tax rates of all jurisdictions authorized to levy property taxes upon the property (i.e., jurisdictions whose boundaries include the property)	County 50% City/town 35 School district 25 Special districts 5 Total 115%
5. Multiply net tax capacity by total tax rate to determine the net tax capacity-based portion of the ***gross tax***	$1,200 X 115% = $1,380
6. Determine the total ***market value tax rate*** by summing the market value tax rate for all taxing jurisdictions authorized to levy property taxes upon the property	County 0.0% City/town 0.0 School district 0.1 Special districts 0.0 Total 0.1%
7. Multiply taxable market value by total market value tax rate to determine the market value-based portion of the ***gross tax***	$120,000 X 0.1% = $120
8. Add the net tax capacity-based gross tax to market value-based gross tax to obtain the total ***gross tax***	$1,380 + $120 = $1,500
9. Determine the ***homestead market value credit*** amount for home of this value	$264
10. Subtract the homestead market value credit from the gross tax to obtain the ***net tax***	$1,500 - $264 = $1,236

Limited Market Value

What is limited market value?

Limited market value (LMV) is a limitation on the amount that a property's market value may grow from one year to the next for purposes of property taxation. It was enacted to help mitigate rising property taxes resulting from rapidly inflating property values.

What property does LMV apply to?

The following classes of property qualify for LMV:

- agricultural homestead and nonhomestead
- residential homestead and nonhomestead
- seasonal recreational residential property (i.e., cabins)
- timberland (beginning with the 2001 assessment)

Is it permanent?

LMV provisions were in effect from 1973 to 1979, and again from 1993 to the present. The 2001 Legislature phased out LMV over a six-year period—from assessment years 2002-2007. The 2005 Legislature extended the phaseout an additional two years. Beginning in assessment year 2009 (for taxes payable in 2010), all property will be valued at its estimated full market value for property tax purposes. The table at the bottom of the page shows the phase-out schedule.

Does the assessor continue valuing the property?

The assessor continues to determine the property's fair market value. This value is called the "estimated market value" (EMV). However, property that qualifies for treatment under LMV may not be taxed at the full value of the property if its growth exceeds the limits.

How does it work?

For qualifying property in assessment year 2008 (taxes payable in 2009), the increase in market value cannot exceed the **greater** of:

- 15 percent of the LMV in the preceding assessment year, or
- 50 percent of the difference between the current year's EMV and the previous year's LMV.

How does the phaseout work?

For each year, the maximum valuation increase is determined by calculating the increase allowed under columns (1) and (2), and choosing whichever is higher.

Assessment Year/ Payable Year	(1) Percentage of previous year's LMV	(2) Percentage of difference between previous year's LMV and current year's EMV
2002/2003	10%	15%
2003/2004	12	20
2004/2005	15	25
2005/2006	15	25
2006/2007	15	25
2007/2008	15	33
2008/2009	15	50

Example calculations

Assessment year 2008/payable year 2009
The LMV of a home is $100,000 for assessment year 2007. For assessment year 2008, the assessor determines that the EMV of the home is $120,000. The maximum market value increase for tax purposes is the greater of:

- 15 percent increase over the previous year, which is $15,000, or
- 50 percent of the $20,000 difference in value, which is $10,000.

Therefore, the home's LMV is $100,000 plus $15,000, or $115,000 for assessment year 2008 (for taxes payable in 2009).

How much has LMV grown?

The table below shows the amount of market value that LMV excluded from the tax rolls for tax years 1994-2008.

Taxes Payable Year	**EMV***	**LMV***	**Excluded Value***	
			Amount	**Percentage**
1994	$124.1	$123.5	$0.7	0.5%
1995	132.0	131.0	1.0	0.8
1996	142.1	140.4	1.6	1.1
1997	152.1	150.0	2.0	1.3
1998	163.6	161.1	2.5	1.5
1999	176.6	173.3	3.4	1.9
2000	202.6	197.0	5.6	2.8
2001	226.4	215.8	10.6	4.7
2002	260.4	239.4	21.0	8.1
2003	284.8	253.9	30.9	10.8
2004	319.8	288.0	31.8	9.9
2005	360.4	331.5	28.9	8.0
2006	404.8	377.7	27.1	6.7
2007	450.4	424.2	26.2	5.8
2008	476.4	458.5	17.9	3.8

* Affected property classes only. All amounts in billions.

How much are the classes of property affected by LMV?

Excluded Value by Property Class for Taxes Payable in 2008			
	Excluded Value under LMV (Billions)	Percentage of Total LMV Exclusion	Percentage Reduction Relative to Property Class
Residential Homestead	$5.07	28.3%	1.5%
Residential Nonhomestead	2.14	12.0	5.1
Agricultural	5.87	32.8	7.7
Seasonal Rec. Residential	4.81	26.9	17.1
Total	**$17.89**	**100.0%**	**3.8%**

Property Tax Variation by Property Type

What causes property taxes to vary by type of property?

The primary cause of variation in property tax burdens is Minnesota's classified property tax system. In a classified system, each class of property is assigned one or more *class rates*. The property's taxable market value is multiplied by the class rate(s) to determine the property's tax base, technically called its *net tax capacity*.

Besides the class rates, variations in tax by type of property also occur because the state general tax and school district operating referendum levies apply to some types of property but not to others. (All voter-approved levies, except school district levies for bonded debt, are levied on referendum market value. School district levies for bonded debt are levied on the net tax capacity of all types of property.) The table below shows class rates and the applicability of taxes by type of property.

Class Rate Schedule for Taxes Payable in 2009

Class	**Property Type (major property types only)**	**Class Rate**	**Subject to State Tax?**	**Subject to Referendum Levies?**
1	**Homestead**			
1a	Residential homestead:			
	Up to $500,000	1.00%	No	Yes
	Over $500,000	1.25	No	Yes
2	**Agricultural**			
2a	Agricultural homestead:			
	House, garage & 1 acre – same as residential homestead			
	Agricultural land & buildings:			
	Up to $890,000	0.50	No	No
	Over $890,000	1.00	No	No
2b	Agricultural nonhomestead	1.00	No	No
3	**Commercial/Industrial/Public Utility**			
3a	Commercial/Industrial/Public Utility:			
	Up to $150,000	1.50	Yes*	Yes
	Over $150,000	2.00	Yes*	Yes
	Electric generation attached machinery	2.00	No	Yes
4	**Other residential**			
4a	Market-rate apartments (4 or more units)	1.25	No	Yes
4bb	Residential nonhomestead single unit:			
	Up to $500,000	1.00	No	Yes
	Over $500,000	1.25	No	Yes
4b	Residential nonhomestead 2-3 unit and undeveloped land	1.25	No	Yes
4c	Seasonal recreational residential (noncommercial):			
	Up to $500,000	1.00	Yes**	No
	Over $500,000	1.25	Yes**	No
4d	Low-income apartments	0.75	No	Yes
*	Subject to state general tax at commercial-industrial rate.			
**	Subject to state general tax at seasonal recreational rate.			

What other factors cause property taxes to vary by type of property?

Variations also occur because certain types of property qualify for property tax credits that reduce the amount of tax that would otherwise be due. The two largest credit programs are the homestead market value credit and the agricultural market value credit, which apply to all residential homesteads and all agricultural homesteads. Other credits apply to property in some areas of the state but not to others.

Local variation also occurs because tax rates are determined separately for each taxing jurisdiction in the state, based on each jurisdiction's levy and tax base.

What is effective tax rate?

Effective tax rate is a measure of tax burden useful in making property tax comparisons. It is defined as net tax divided by market value (i.e., tax as a percent of market value). It allows comparison of tax burdens between properties of different values, different types, and different locations.

Comparison of Property Taxes on Various Types of Property, Within the Same Taxing Jurisdiction, Each with a Market Value of $200,000 (Property taxes payable in 2009)

Property Type	Class Rate(s)	Net Tax Capacity	Property Tax*		Effective Tax Rate
			Gross	Net	
Agricultural homestead**	0.5/1.0%	$1,250	$1,325	$798	0.40%
Agricultural nonhomestead	1.0	2,000	2,000	2,000	1.00
Residential homestead	1.0	2,000	2,300	2,108	1.05
Seasonal recreational residential (i.e., cabin)	1.0	2,000	2,293	2,293	1.15
Residential nonhomestead (1 unit)	1.0	2,000	2,300	2,300	1.15
Residential nonhomestead (2-3 units)	1.25	2,500	2,800	2,800	1.40
Apartment	1.25	2,500	2,800	2,800	1.40
Low-income apartment	0.75	1,500	1,725	1,725	0.86
Commercial/Industrial	1.5/2.0	3,250	5,045	5,045	2.52
Commercial/Industrial @ $2,000,000***	1.5/2.0	39,250	60,305	60,305	3.02

* These examples assume a total local net tax capacity tax rate of 100 percent, a state commercial-industrial tax rate of 46 percent, a state seasonal recreational tax rate of 19 percent, and a total market value tax rate of 0.15 percent.

** The agricultural homestead is assumed to consist of a house valued at $50,000 and agricultural land and buildings valued at $150,000.

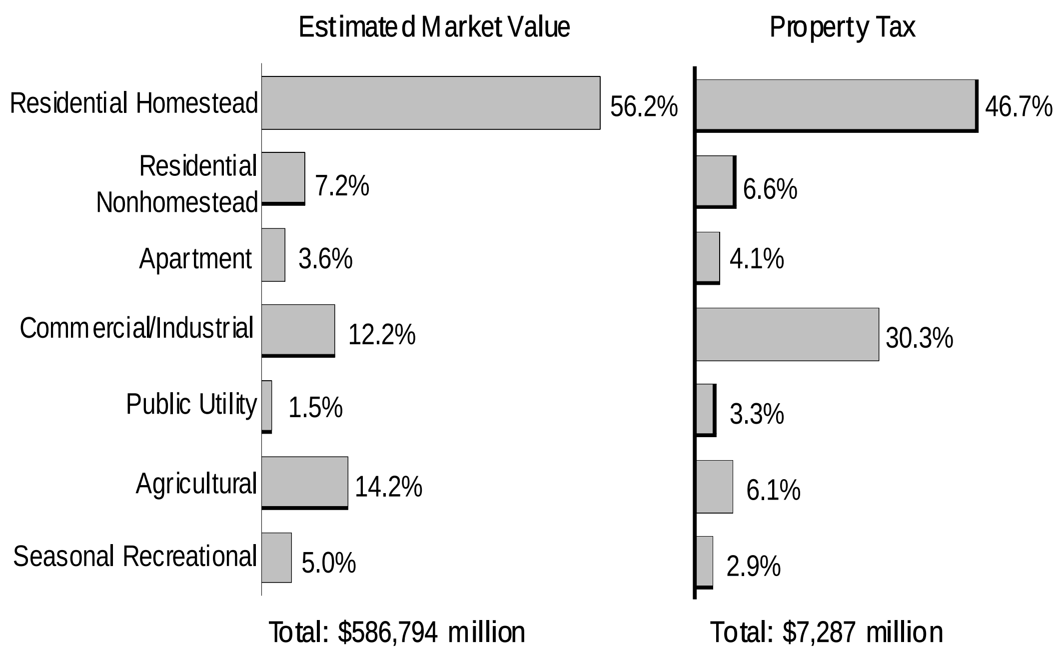
*** This property has a market value of $2,000,000 to show a typical effective tax rate on a larger commercial/industrial property.

Who Pays Property Taxes and Who Receives Them

Where property taxes come from

Total property taxes statewide were $7,287 million for calendar year 2008. The total amount of property value (excluding the value of exempt property) was $586,794 million. The graphs below show the breakdown of the state's total property tax base by market value and by taxes paid in 2008.

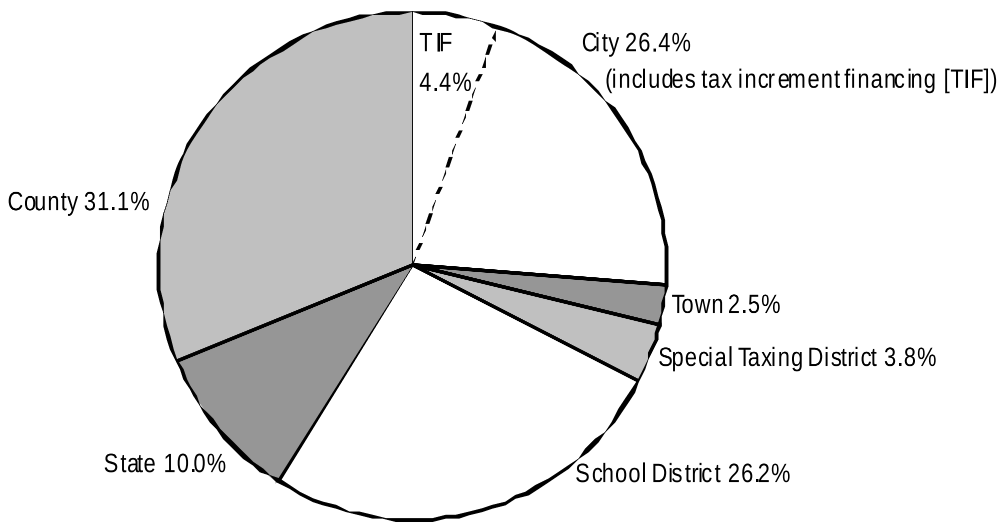
Statewide Shares of Market Value and Property Tax by Property Type (Taxes Payable 2008)



Where property taxes go

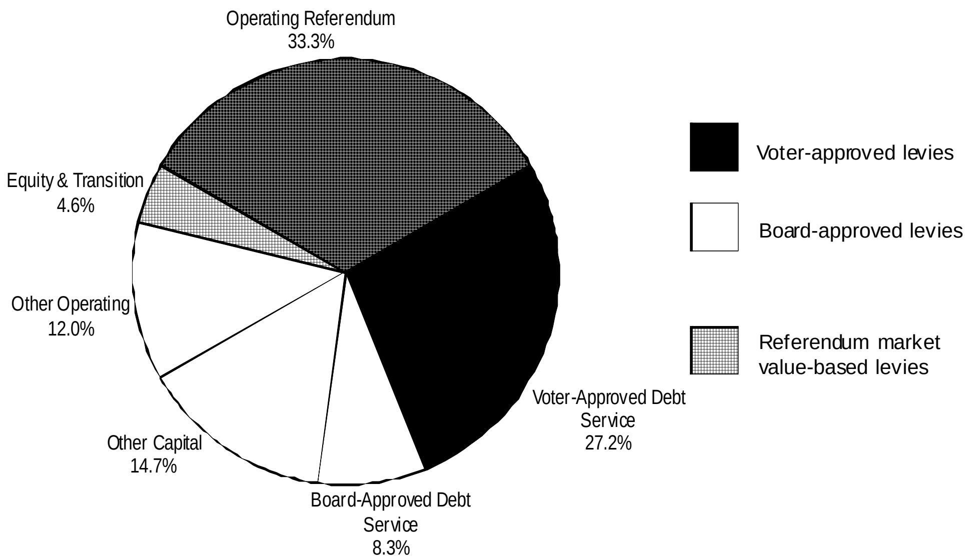
The total property tax burden in Minnesota was $7,287 million for calendar year 2008. The pie chart below shows the distribution of the tax among the various types of taxing jurisdictions.

Property Tax by Type of Government,*
Taxes Payable 2008
(Total: $7,287 million)



*Amounts shown are after allocation of property tax credits.

School District Levies
$2.14 Billion for Pay 2009



School District Levies

	Preliminary Pay 2009 Amount ($ millions)	Tax Base*	Equalized?	No. Districts Affected
Voter-Approved				
Net Debt Service Levy	585	NTC	Yes, 2-Tier	272
Operating Referendum	715	RMV	Yes, 2-Tier	307
Not Voter-Approved				
Debt Service (w/o voter approval)	178	NTC	Yes, 2-Tier	112
Operating Capital	123	NTC	Yes	337
Equity	74	RMV	Yes	338
Transition	25	RMV	Yes	200
Health & Safety	67	NTC	Yes	318
OPEB Bonds	27	NTC	No	32
Alternative Facilities	55	NTC	Yes	24
Building Lease / Lease Purchase	48	NTC	No	211
Deferred Maintenance	23	NTC	Yes	310
Basic Community Education	38	NTC	Yes	337
Integration	27	NTC	No, some aid	110
Safe Schools	27	NTC	No	317
Early Childhood Family Education	22	NTC	Yes	337
Alternative Compensation (Qcomp)	18	NTC	Yes	36
All other levies	98	NTC	Yes/No	1 - 337
Total	**2,140**			

* RMV = Referendum Market Value
NTC = Net Tax Capacity

State General Tax

- The state general tax was instituted in 2001 as part of a major overhaul of the property tax system

- The state levy was initially set at $592 million for taxes payable in 2002. The law provides for the levy to increase each year by the percentage increase in the implicit price deflator for government consumption expenditures and gross investment for state and local governments, as prepared by the U.S. Dept. of Commerce. For taxes payable in 2008, the state levy is $734.5 million.

- Beginning with taxes payable in 2006, the state levy is apportioned into separate pools so that 95% is borne by commercial-industrial property (including public utility), and 5% is borne by seasonal recreational property (both commercial and non-commercial). Separate tax rates are determined for each pool. Before 2006, the same tax rate was applied to all properties subject to the state levy. Each property's tax is determined by multiplying its net tax capacity by the applicable state tax rate, except that for noncommercial seasonal-recreational property up to $76,000 in value, the state tax is levied at only forty percent of the full rate. The portion of public utility property consisting of attached machinery used in the generation of electricity is not subject to the state general tax.

- Revenues from the state general tax are deposited in the state general fund. The initial 2001 legislation provided that the amount levied each year over and above the FY 2003 amount would be dedicated to education funding, but that dedication was eliminated in 2003.

- The table below lists the state levy and the state tax rate(s) for each year since the state levy was initiated:

		Tax Rates	
Payable Year	State Levy (millions)	Commercial-industrial rate	Seasonal-recreational rate
2002	$592.0	57.933%	57.933%
2003	594.9	54.447	54.447
2004	624.5	54.109	54.109
2005	629.3	51.121	51.121
2006	658.7	50.827	28.385
2007	696.3	48.032	24.225
2008	734.5	45.949	20.385
2009	776.6	45.535	18.214

Property Tax Relief Programs

CY '08/FY '09 (millions)	Program	Recipients
	Aids	
$484	Local government aid	Cities
206	County program aid	Counties
90	Referendum equalization aid	School districts
9	Debt service equalization aid	School districts
20	Disparity reduction aid	Counties, towns, and school districts
	Credits	
268	Homestead market value credit	All taxing jurisdictions
25	Agricultural market value credit	All taxing jurisdictions
	Refunds	
256	Property tax refund–homeowners	Individuals
173	Property tax refund–renters	Individuals
7	Special property tax refund–targeting	Individuals

Local Government Aids

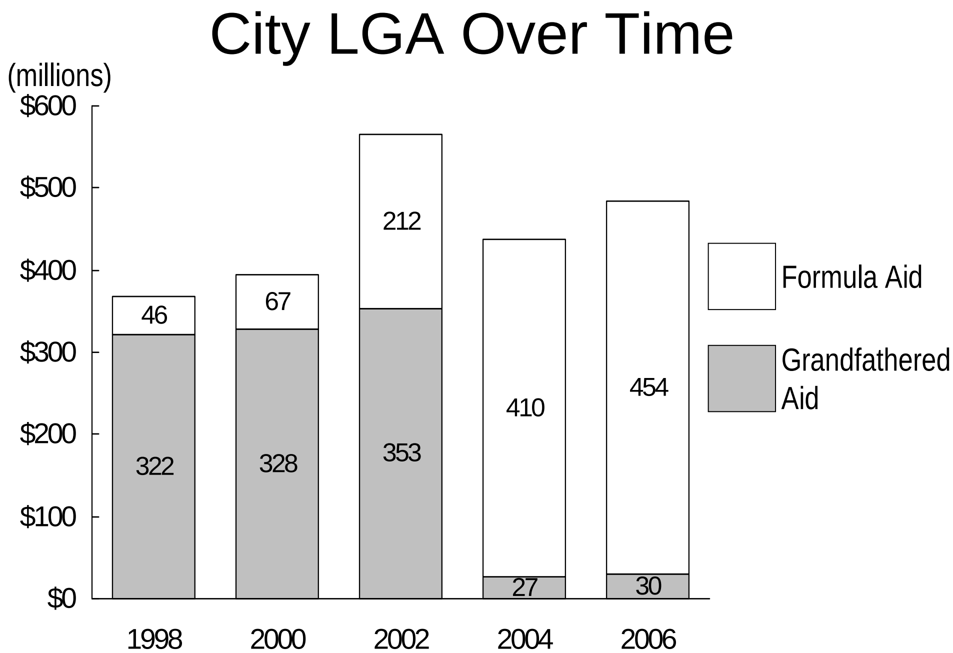
City LGA underwent major changes in 2003	The city local government aid (LGA) program underwent major changes in 2003, including the elimination of most of the old city aid base (grandfathered aid) and an increase in the amount distributed via a formula based on "need" and "ability to raise local revenues." New need measures were developed and taconite aid was added to the measure of ability to raise local revenues.
Changes were made in 2008 in response to criticisms of the new program	The 2003 program was criticized for being too volatile and not recognizing need of certain cities such as established suburbs. The appropriation was also lower than in previous levels. The LGA program was modified in 2008 to address all three criticisms—volatility, distribution, and the appropriation level.
Volatility was reduced by using earlier data and averaging it across years	Small changes in certain factors used to determine "need" often caused large fluctuations in a city's aid. In addition, the actual certified aid amounts were different than the end of session estimates because some of the data used to calculate aid wasn't available until July. Beginning with 2010, data used to calculate need is the data available as of January 1 of the year in which the aid is certified. Also the average of two years of "unmet need" (need minus ability to raise revenue) is used in calculating aid each year.
Maximum annual reductions to individual cities were also lowered to limit volatility	Decreases had been limited to 10 percent of the city's levy in the previous year for large cities and to 5 percent of the city's *certified* 2003 LGA amount (before 2003 aid reductions) for small cities. Beginning with 2009, the limit on decreases for each type of city is the <u>lesser</u> of (1) $10 per capita or (2) its old limit for decreases. For 2009 only, no small city's aid could be less than its aid in 2008, unless its only 2008 aid was due to previously grandfathered small city aid, in which case its aid could decrease to zero.
New special aids and other changes were made to the formula to change the distribution	Previously, cities under 5,000 population received a small city aid amount of $6 per capita as part of their city aid base. Beginning in 2009, this amount was increased to $8.50 per capita but moved from the city aid base and included in the LGA formula. A new aid for cities with 5,000 or more population was added to the formula, based on a city's jobs per capita. The city jobs aid is reduced by 36% of "regional center aid" which is grandfathered aid paid to large Greater Minnesota cities. Both the small city aid and city jobs aid increase proportionately to increases in the LGA appropriation. A city's small city aid or city jobs aid is reduced if their "need" exceeds their "ability to pay" measure. Taconite aid was removed from the "ability to pay" measure. These changes increased aid to established inner ring suburbs and mid-size cities in Greater Minnesota.
The appropriation was increased for the next three years	Prior to the 2008 change, the LGA appropriation was frozen at $484 million annually. It was increased to $526 million for 2009, and will increase by an additional 2 percent in 2010, and another 4 percent in 2011.

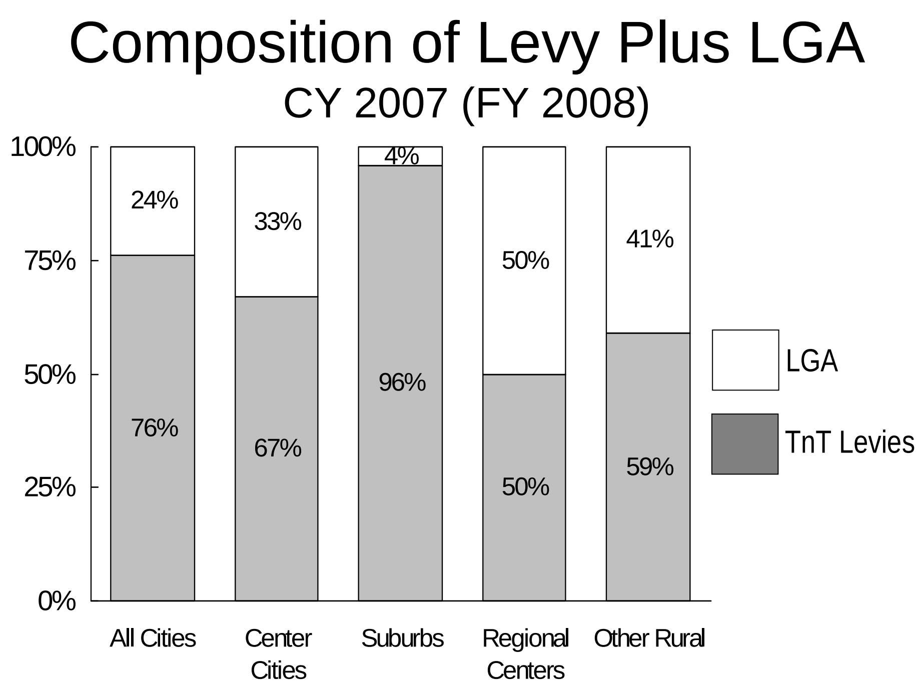
City LGA Formula – Old Law vs. Changes Enacted in 2008

Characteristic	Old Law (in effect in CY 2002)	Changes made effective CY 2009
Funding	$484.5 million per year with no inflation adjustment*	$526.1 million in CY 2009 Additional 2 % increase in CY 2011 Additional 4 % increase in CY 2012
City aid base (grandfathered aid)	$30.4 million to certain cities based on specific criteria	$26.1 million because small city aid is moved to the formula
City formula aid	$454.1 million distributed based on a percentage of 'unmet need" which is equal to "need" minus "ability to raise revenue"	A city's distribution is now equal to small city aid, plus city job aid (new), plus a percentage of its average "unmet need" for last two years
Large city need per capita measure	Based on (1) pre-1940 housing %, (2) pop. decline %, (3) road accident factor, (4) household size, and (5) if it is in the metro area	Data used is most recent data available as of January 1 of the year in which the aid is certified. May not be less than $285 per capita
Small city need per capita measure	Based on (1) pre-1940 housing %, (2) comm'l/industrial, (3) pop. decline %, and (4) transformed pop	Data used is most recent data available as of January 1 of the year in which the aid is certified.
Ability to raise revenue measure	= Average city tax rate x adjusted city tax capacity (tax base) – 100% of taconite for most taconite cities**	Taconite aid offset eliminated
Small city aid	$6 per capita as part of grandfathered aid	$8.50 per capita, increasing at same rate as the appropriation, now part of formula aid
City jobs aid (New)	-----	For city over 5,000 population - equal to $25.20 x number of jobs per capita in the city up to $4.725 million, adjusted for regional center aid and increases in the LGA appropriation
Limits on increases and decreases	No city's aid can increase by more than 10% of its levy from the previous year No large city's aid loss can exceed 10% of its levy in the previous year and no small city's loss in any year can exceed 5% of its certified 2003 LGA	Beginning with CY 2009 aids, the maximum aid loss for large cities is the lesser of 10% of previous year levy or $10 per capita For CY 2009 small cities' aid cannot decrease unless due to the small city base change. For CY 2010 and later, the decrease is limited to the lesser of $10 per capita or 5% of certified 2003 LGA

* In CY 2008 only, $430.1 million of the $484.5 million aid was paid. $53.5 million of the December payment was unalloted by the governor.

** The taconite aid paid to the cities of Babbitt, Eveleth, Hibbing, Keewatin, Mountain Iron, Silver Bay, and Virginia are not included in calculating their ability to raise revenue measure.


City LGA Over Time
(millions)
$600
$500
$400
$300
$200
$100
$0
46
322
67
328
212
353
410
27
454
30
1998
2000
2002
2004
2006
Formula Aid
Grandfathered Aid


Composition of Levy Plus LGA
CY 2007 (FY 2008)
100%
75%
50%
25%
0%
24%
76%
33%
67%
4%
96%
50%
50%
41%
59%
All Cities
Center Cities
Suburbs
Regional Centers
Other Rural
LGA
TnT Levies

County Program Aids

County program aid replaced several county aid programs

Prior to calendar year 2004, counties received property tax aid under a number of different programs. Beginning in 2004, the aid programs were consolidated into one general aid program, called county program aid (CPA). The county aid programs that were consolidated include the following:

- attached machinery aid (Minn. Stat. § 273.138)
- homestead and agricultural credit aid (HACA) (Minn. Stat. § 273.1398, subd. 2)
- manufactured home homestead and agricultural credit aid (Minn. Stat. § 273.166)
- county criminal justice aid (CCJA) (Minn. Stat. § 477A.0121)
- family preservation aid (FPA) (Minn. Stat. § 477A.0122)

County program aid consists of "need aid" and "tax-base equalization aid"

From calendar year 2005 to calendar year 2008, CPA has been allocated by two formulas, need aid and tax-base equalization aid, with approximately $100 million being distributed through the need aid formula and $105 million being distributed through the tax base equalization aid formula. The table on the next page shows the calculation of a county's aid under each formula.

The appropriation is increased in 2009

The appropriation for CPA increases beginning in calendar year 2009 by $22 million, with $11 million going to each of the two parts. For aids payable in 2010 and 2011 the appropriation is scheduled to further increase by 2 percent per year. For aid paid in calendar year 2011 and thereafter, about $116 million will be distributed under the need aid portion and about $121 million under the tax base equalization aid portion of CPA.

Counties receiving less aid under the post-2004 formula receive transition aid

Seven counties whose relative *share* of the total CPA formula allocation in calendar year 2005 was significantly less than their share of 2004 program aid qualify for "transition aid." Each county's transition aid amount is permanently fixed at one-third of the amount it received in 2005. The total amount of transition aid for calendar year 2009 is $464,000.

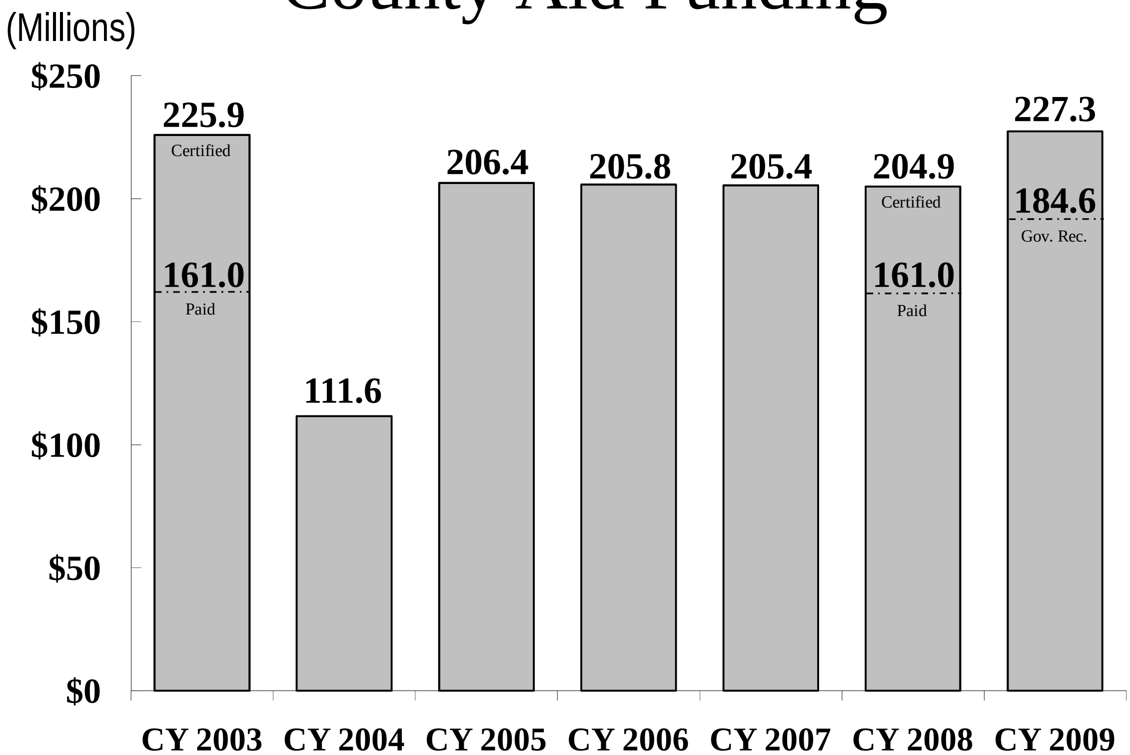
Additional aid granted to counties with special circumstances

The 2008 tax bill granted supplemental payments of $500,000 to Beltrami County and $100,000 to Pine County for special circumstances in 2009 only.

Calculation of County Program Aid

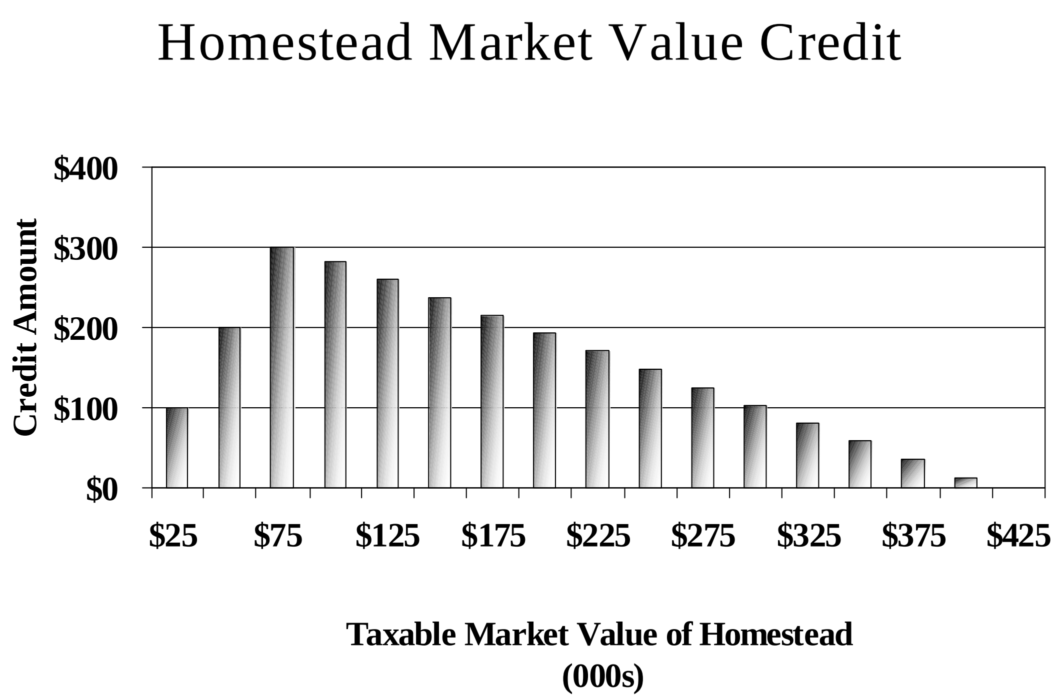
Need Aid	Tax-base Equalization Aid
Share of Appropriation: $100.5 million (CY 2005-2008) $111.5 million (CY 2009) $113.7 million (CY 2010) $116 million (CY 2011 and thereafter)	**Share of Appropriation:** $105 million (CY 2005-2008) $116.1 million (CY 2009) $118.5 million (CY 2010) $120.8 million (CY 2011 and thereafter)
Reductions from the appropriation: $500,000 annually for court-ordered counsel and public defense costs	**Reduction from the appropriation:** up to $312,000 annually to pay for the preparation of local impact notes
Factors used in the formula: • **age-adjusted population,** which ranges from 80% to 180% of the county's actual population based on the percentage of the county's population over 65 years, compared to the statewide average • **average monthly number of households receiving food stamps** in the county over the last three years • **average number of Part I crimes** reported in the county over the last three years. These are the most serious crimes	**Tax-base equalization factor used in the formula:** **Factor = N** times ($185 x population - 9.45% of the county adjusted net tax capacity) **where N equals:** • 3 if the county population is less than 10,000; • 2 if the county's population is at least 10,000 but less than 12,500; • 1 if the county's population is at least 12,500 but less than 500,000; and • 0.25 if the county's population is 500,000 or more
The formula: • 40% of the appropriation is distributed to each county based on its relative share of the total age adjusted population in the state • 40% of the appropriation is distributed to each county based on its relative share of the total average monthly number of households receiving food stamps in the state • 20% of the appropriation is distributed to each county based on its relative share of the average number of Part I crimes reported in the state	**The formula:** • 100% of the appropriation is distributed based on each county's relative share of the sum of the tax-base equalization factors for all the counties in the state

County Aid Funding



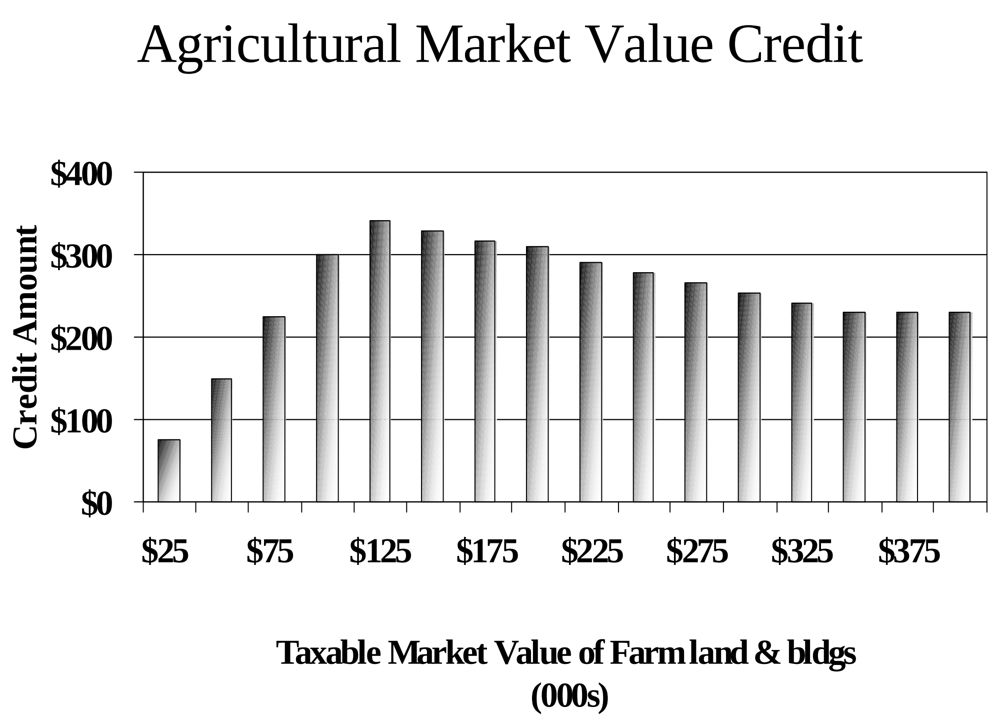
Homestead Market Value Credit

- The credit amount is based only on the taxable market value of the property, not on the tax itself
- The maximum credit is $304; homes valued over $414,000 receive no credit
- The credit amount is shown on the tax statement as a subtraction after the gross tax has been computed
- The credit is deducted from each local government's tax on the homestead in proportion to its share of the gross tax (excluding school referendums)
- For agricultural homesteads, the credit is computed on the value of the house, garage and one acre of land only
- For homes valued at $76,000 or less, the credit is 0.4% times the taxable market value; for homes valued over $76,000, the credit is $304 minus 0.0009 times the taxable value of the home in excess of $76,000, as shown in the chart below
- The cost of the credit for taxes payable in 2008 (FY 2009) is $265.8 million (before unallotment)



Agricultural Market Value Credit

- The credit applies to agricultural homesteads only
- The credit amount is based on the taxable value of the agricultural portion of the property, *excluding the value of the house, garage and surrounding one acre of land*
- The credit amount is shown on the tax statement as a subtraction after the gross tax has been computed
- The credit is deducted from each local government's tax on the homestead in proportion to its share of the gross tax (excluding school referendums)
- The maximum credit amount is $345; all farms valued over $345,000 receive a credit of $230
- For farms with a market value less than $115,000, the credit is 0.3% of the market value; for farms valued between $115,000 and $345,000, the credit is $345 minus 0.0005 times the value in excess of $115,000; for farms valued over $345,000, the credit is $230; as shown in the chart below
- The state cost of the credit for taxes payable in 2008 (FY 2009) is $25.1 million



Homeowner's Property Tax Refund Program

What is the property tax refund program?

The homeowner's property tax refund program (sometimes called the "circuit breaker" or the PTR) is a state-paid refund that provides tax relief to homeowners whose property taxes are high relative to their incomes. If property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

What are recent changes to the program?

The 2008 tax law expanded the homeowner's property tax refund program, effective for refunds based on property taxes payable in 2009. The changes lowered the maximum threshold percentage for determining eligibility from 4.0 percent of income to 3.5 percent of income, and increased the maximum refund allowed from $1,800 to $2,310.

What are the maximums?

For refund claims filed in 2009, based on property taxes payable in 2009 and 2008 household income, the maximum refund is $2,310. Homeowners whose income exceeds $96,939 are not eligible for a refund.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2009, will be paid beginning in late September 2009. The deadline for filing claims based on taxes payable in 2009 is August 15, 2010; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions" (www.taxes.state.mn.us).

What is the average refund and total amount paid?

Statewide Homeowner Property Tax Refunds
Filed in 2007
(based on 2006 incomes and payable 2007 taxes, most recent data available)

	Number of returns	Total refund amount	Average per return
Under 65 years old	198,206	$132.0 million	$667
Senior/disabled	120,691	$80.9 million	$670
Total: all homeowners	318,897	$212.9 million	$668

How do refunds vary depending upon the filer's income and property tax?

The following table shows the refund amount for two example families with different incomes—one family in the metro area and one in greater Minnesota. Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average residential homestead property tax in the metro area is higher than in greater Minnesota. The metro area family has payable 2009 property taxes of $3,125, a typical amount for the metro. The family in greater Minnesota has payable 2009 property taxes of $1,580, a typical amount for greater Minnesota. Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple, both under age 65, two dependents
Example refunds for claims to be filed in 2009,
based on taxes payable in 2009 and 2008 income

		Metro area		**Greater Minnesota**	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #3**	**Taxpayer #4**
1	Estimated average market value of home	$280,000	$280,000	$165,000	$165,000
2	Gross income	$25,000	$50,000	$25,000	$50,000
3	Deduction for dependents	$9,450	$9,450	$9,450	$9,450
4	Household income (2 – 3 = 4)	$15,550	$40,550	$15,550	$40,550
5	Property tax	$3,125	$3,125	$1,580	$1,580
6	Statutory threshold percentage	1.9%	2.7%	1.9%	2.7%
7	Threshold % x income (4 x 6 = 7)	$295	$1,095	$295	$1,095
8	Property tax over threshold (5 – 7 = 8)	$2,830	$2,030	$1,285	$485
9	Statutory copay percentage	30%	40%	30%	40%
10	Taxpayer copay amount (8 x 9 = 10)	$849	$812	$385	$194
11	Remaining tax over threshold (8 – 10 = 11)	$1,981	$1,218	$899	$291
12	Maximum refund allowed	$2,010	$1,700	$2,010	$1,700
13	Net property tax refund	$1,981	$1,218	$899	$291

Renter's Property Tax Refund Program

What is the renter's property tax refund program?

The renter's property tax refund program (sometimes called the "renters' credit") is a state-paid refund that provides tax relief to renters whose rent and "implicit property taxes" are high relative to their incomes. "Rent constituting property taxes" is assumed to equal 19 percent of rent paid. If that rent constituting property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

What are the maximums?

For refund claims filed in 2009, based on rent paid in 2008 and 2008 household income, the maximum refund is $1,490. Renters whose income exceeds $52,299 are not eligible for refunds.

How are claims filed?

Refund claims are filed using Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2009, will be paid beginning in August 2009. The deadline for filing claims based on rent paid in 2008 is August 15, 2010; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions" (www.taxes.state.mn.us).

What is the average refund and total amount paid?

Statewide Renter Property Tax Refunds
Filed in 2007
(based on 2006 incomes and rent paid in 2006, most recent data available)

	Number of returns	Total amount	Average per return
Under 65 years old	196,738	$104.3 million	$530
Senior/disabled	77,051	$46.3 million	$601
Total: all renters	273,789	$150.6 million	$550

How do refunds vary depending on income and property taxes?

The following table shows the refund amount for two example families with different incomes—a married couple without dependents in the metro area, and a married couple without dependents in greater Minnesota (a single person living alone would qualify for the same refund amounts). Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average rent is higher in the metro area than in greater Minnesota. The metro area family paid monthly rent in 2008 of $699, the fair market rent for a one-bedroom apartment in the metro area. (19% of $707 x 12 = $1,594, which is their rent constituting property tax.) The family in greater Minnesota paid monthly rent in 2008 of $444, the fair market rent for a one-bedroom apartment in many greater Minnesota counties. (19% of $433 x 12 = $1,012, which is their rent constituting property tax.) Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple, both under age 65, no dependents
Example refunds for claims to be filed in 2009,
based on rent paid in 2008 and 2008 income

		Metro area		**Greater Minnesota**	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #3**	**Taxpayer #4**
1	Gross income	$15,000	$30,000	$15,000	$30,000
2	Deduction for dependents	0	0	0	0
3	Household income (1 – 2 = 3)	$15,000	$30,000	$15,000	$30,000
4	Rent constituting property tax	$1,594	$1,594	$1,012	$1,012
5	Statutory threshold percentage	1.4%	2.4%	1.4%	2.4%
6	Threshold % x income (3 x 5 = 6)	$210	$720	$210	$720
7	Property tax over threshold (4 – 6 = 7)	$1,384	$874	$802	$292
8	Copay percentage	20%	30%	20%	30%
9	Taxpayer copay amount (7 x 8 = 9)	$277	$262	$160	$88
10	Remaining tax over threshold (7 – 9 = 10)	$1,107	$612	$642	$205
11	Maximum refund allowed	$1,490	$1,490	$1,490	$1,490
12	Net property tax refund	$1,107	$612	$642	$205

Targeting Property Tax Refund

What is targeting? The "additional" or "special" property tax refund, generally referred to as "targeting," directs property tax relief to homeowners who have large property tax increases from one year to the next.

Who qualifies? A homeowner qualifies if the property tax on the home has increased by more than 12 percent over the previous year's tax and if the increase is over $100.

The homeowner must have owned and lived in the same home for both years. If any improvements were made to the home, that portion of the tax increase resulting from the improvements must be subtracted when determining the refund.

How does targeting work? The refund equals 60 percent of the increase over the greater of (1) 12 percent of the previous year's tax or (2) $100. The maximum refund is $1,000. The following example shows how the refund is calculated.

Payable 2008 Property Tax Payable 2009 Property Tax	$1,400 2,000
2009 tax increase (over 2008) Taxpayer pays first 12% of increase compared to previous year's tax, which must be at least $100 (12% x 1,400)	$600 168
Remaining increase eligible for relief ($600 - $168 = $432)	$432
State pays 60% of excess over 12% increase up to a $1,000 maximum (60% x $432 = $259)	$259
Amount of 2009 increase paid by taxpayer ($600 - $259)	$341

The taxpayer's $600-increase (i.e., 42.9 percent) is reduced to an out-of-pocket property tax increase of $341 (i.e., 24.4 percent) as a result of the $259 refund.

The taxpayer pays the full $2,000 amount of the 2009 property tax to the county, the first half in May and the second half in October. The taxpayer applies to the state for a targeting refund, which is paid at the same time the regular homeowner property tax refund ("circuit breaker") is paid.

Does targeting have any other restrictions? No, unlike the regular property tax refund, the targeting refund is not tied to the taxpayer's household income. Under the regular homeowner property tax refund, the taxpayer's household income may not exceed a specified maximum and the amount of household income affects the amount of the refund.

However, the targeting refund does not use income as a factor, nor is there any limitation on the taxpayer's household income. Therefore, many higher income taxpayers who do not qualify for the regular property tax refund due to income restrictions are eligible for the targeting refund.

Is targeting a new program? No, the first targeting program was enacted in 1980. With the exception of a few years in the 1980s, the program has been in effect for about 25 years, although miscellaneous changes have been made to the program during that time.

What are statewide amounts?

The amounts paid out for the targeting program decreased substantially from $13.6 million in 2006 to $7.6 million in 2007, with much of the decrease occurring in the metro area.

The table below shows the statewide amount, with a breakdown for the metro and the 80 nonmetro counties, for the past four years.

Targeting Refunds, Filed 2004 – 2007 (dollars in thousands)

	Filed 2004	Filed 2005	Filed 2006	Filed 2007
Total Metro	$2,463	$2,636	$10,224	$4,940
Total Nonmetro	$1,241	$1,663	$3,390	$2,655
State	$3,704	$4,300	$13,614	$7,595

Some taxpayers (e.g., those who typically don’t qualify for the regular property tax refund) may not be aware of the targeting program, resulting in lower total refunds statewide than would be the case if the program were more widely known.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR, the property tax refund form. There is a separate schedule on the back of the M1PR (“Schedule 1 – Special Refund”) for the targeting program. The taxpayer files for this refund after receiving his or her property tax statement in February or March. Claims filed before August 15, 2009, will be paid beginning in late September 2009. The deadline for filing claims based on taxes payable in 2009 is August 15, 2010; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR’s web site, under “Forms and Instructions” (www.taxes.state.mn.us).

Senior Citizens Property Tax Deferral Program

What is the Senior Citizens Property Tax Deferral Program?

The Senior Citizens Property Tax Deferral Program allows property taxpayers who are 65 years or older, and whose total household income is $60,000 or less, to defer a portion of their homestead property taxes until some later time. It allows senior citizens whose property taxes are high relative to their incomes, but who wish to stay in their homes, an option for paying their property taxes.

How does it work?

Regardless of how high the tax is on the homestead, the taxpayer initially pays an amount equal to only 3 percent of the total preceding year's household income. The state pays any amount over 3 percent, called the "deferred tax," to the county in which the home is located. A lien attaches to the property. The deferred tax is a loan. Interest on the loan is calculated at the same rate as unpaid state taxes (a floating rate), but cannot exceed 5 percent. Before the owner can transfer the title of the property, the deferred tax plus interest must be repaid.

For example, John and Mary Jones own a home; its total property tax is $1,400. They have a total household income of $30,000. Under this program, they must pay $900 in tax (3 percent of $30,000); the remaining $500 ($1,400 minus $900) is deferred.

Who qualifies?

In order to qualify for the program, **all** of the following criteria must be met:

- The property must be owned and occupied as a homestead by a person 65 years of age or older (If married, both must be 65 years old)
- Total household income must be $60,000 or less for the calendar year preceding the year of the initial application
- The home must have been owned and occupied as the homestead of at least one of the homeowners for at least 15 years before the initial application
- There must be no state or federal tax liens or judgment liens on the property
- The total unpaid balances of debts secured by mortgages and other liens on the property, including deferred tax and interest amounts under the program, unpaid and delinquent special assessments and property taxes, penalties and interest (but excluding the current year's property taxes), do not exceed 75 percent of the assessor's estimated market value for the current year

Does the taxpayer need to annually reapply?

No, once a taxpayer is enrolled in the program, annual applications are not required. However, if household income exceeds $60,000 in any calendar year, the owner must notify the Department of Revenue. No *further* property taxes may be deferred until income falls below the $60,000 threshold. However, the owners will remain enrolled in the program until their income falls below the $60,000 threshold, at which point they must notify the state and request that the deferral be resumed.

Can the taxpayer still file for refunds?

Yes, a taxpayer is still allowed to file for the property tax refund and any other property rebates that the state may offer. However, no direct cash payments will be made to the taxpayer. Rather, the amount of the refund will be applied to the total amount of the deferred property tax on the taxpayer's home. The property tax refund is calculated on the full tax amount.

When does it terminate?

The deferral terminates when **any one** of the following events occurs:

- the property is sold or transferred
- all qualifying homeowners die
- the homeowner notifies the Commissioner of Revenue, in writing, of intent to withdraw from the program
- the property no longer qualifies as a homestead

How does this program differ from a reverse mortgage?

A reverse mortgage loan is a loan arrangement with a lender, secured by a mortgage (lien), where the homeowner **receives** a monthly payment from the lender. The total dollar amount is established at the beginning of the arrangement. The full amount, plus interest, is due when the home is sold. The lender charges closing costs, which can be substantial.

The senior citizen deferral program also constitutes a lien on the property, but the homeowner does not need to guess "up-front" how many dollars are needed. Rather any tax amount over 3 percent of income is automatically deferred. Interest, not to exceed 5 percent, is charged on the deferred tax as it is accumulated.

How many taxpayers are participating in the program?

For property taxes payable in 2005, qualifying taxpayers are using the program to defer taxes on about 100 homes. The Department of Revenue reimbursed the counties about $182,000 for the deferred tax in 2004.

Where does a taxpayer apply for the program?

Applications are available in the county auditor's office or may be obtained from the Department of Revenue's web site at www.taxes.state.mn.us/taxes/property/forms/crscd.pdf.

Distribution of the Property Tax Burden

The *Minnesota Tax Incidence Study* estimates how the property tax burden is distributed across Minnesota households. (See http://www.taxes.state.mn.us/taxes/legal_policy/other_supporting_content/07_incidence_report_links.pdf.) It shows both the direct incidence of the gross tax on homestead and cabins, and the indirect incidence of business and residential rental property taxes. It also shows the effect of the property tax refund program on the incidence of the tax.

Net property tax as a percent of income declines from 3.9% of total income for the poorest fifth of Minnesota households to 2.3% of income for the richest fifth of Minnesota households, making the overall effect moderately regressive.

The richest fifth of Minnesota households (with 55.4% of total income) are estimated to pay 45.9% of the total property tax.

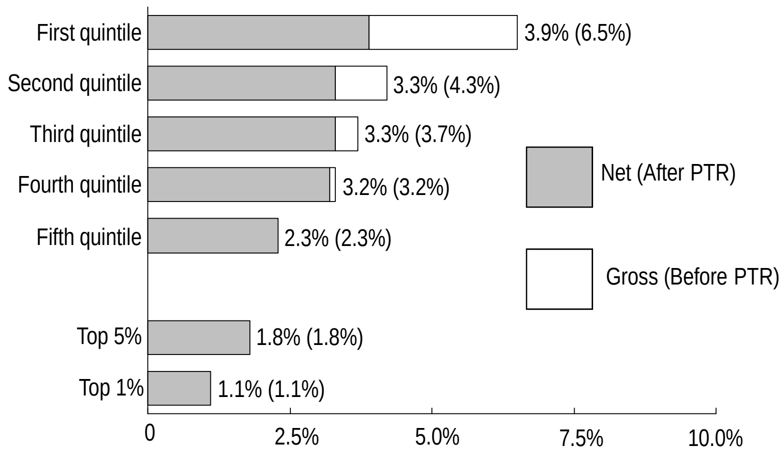
Distribution of Property Tax Burden by Population Quintiles (2004)

Quintile	Income Range	Percent of Total Income	Gross Property Tax (000s)	Property Tax Refunds (000s)	Percent of Total Net Property Tax (000s)	Effective Tax Rate
First	$16,816 or less	3.3%	$299,532	$121,014	4.7%	3.9%
Second	$16,817 – 29,766	7.9%	465,597	101,216	9.6%	3.3%
Third	$27,767 – 47,192	12.9%	665,041	65,950	15.8%	3.3%
Fourth	$47,193 – 76,437	20.6%	940,807	28,118	24.0%	3.2%
Fifth	Over $76,437	55.4%	1,744,392	2,762	45.9%	2.3%
Total	All incomes	100%	$4,115,369	$319,060	100%	2.7%
Top 5%	Over $146,809	29.8%	725,858	251	19.1%	1.8%
Top 1%	Over $3547580	15.6%	238,955	46	6.3%	1.1%

Source: MN Dept. of Revenue, 2007 Tax Incidence Study

Property Tax Burden

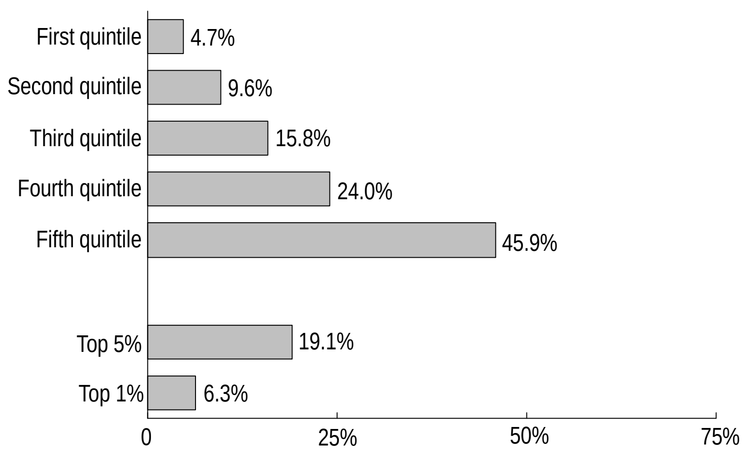
Effective Tax Rates by Population Quintiles (2004)



Source: Department of Revenue, 2007 *Tax Incidence Study*

Net Property Tax Burden*

Distribution by Population Quintiles (2004)



*After property tax refund.
Source: Department of Revenue, 2007 *Tax Incidence Study*

Mining Taxes

Mines and facilities used in the production of taconite are exempt from the property tax. In lieu of the property tax, the iron mining industry pays a production tax based on the tons of taconite produced. The industry is also exempt from the corporate income tax, and pays an occupation tax in lieu of it. The structure of the occupation tax is quite similar to that of the corporate income tax.

The mining industry paid about $112.6 million in taxes in 2007. The taconite production tax constitutes about 83.7 percent ($94.2 million) of the total taxes. The remaining 16.3 percent ($18.4 million) includes the occupation tax, the sales tax, and some miscellaneous taxes. This overview focuses on the production tax, since it is so large relative to the other mining taxes.

Because it is in lieu of the property tax, the taconite production tax is paid to local governments and is a major revenue source for qualifying taxing jurisdictions—counties, cities, towns, and school districts, located in the taconite assistance area. The "taconite assistance area" includes all or a portion of Cook, Lake, St. Louis, Itasca, Koochiching, Aitkin and Crow Wing Counties.

The production tax collected and distributed in 2008:

- was based on the production of the mining companies in calendar year 2007;
- was based on a tax rate of $2.258 per taxable ton (the tax rate is established by the legislature);
- was based on the three-year average tonnage produced in 2005, 2006, and 2007, which was 38.8 million taxable tons. (A three-year average is used to keep the tax base more stable.);
- was required to be paid in two equal installments on or before February 24th, and on or before August 24th; and
- was paid to the respective counties in the taconite assistance area and to the Iron Range Resources and Rehabilitation Agency (often referred to simply as Iron Range Resources, or IRR). The counties then make payments to the cities, towns, and school districts.

The formula for distributing production tax revenues is a complex one that has evolved over many years. It is specified in statute and is generally defined on a cents per taxable ton (CPT) distribution. The 2008 tax was distributed as follows:

Distribution	**Amount**	**Cents per taxable ton (CPT)***
Cities and townships	$11,059,423	28.5
School districts	16,495,306	42.5
Counties	13,342,766	34.4
Property tax relief and misc.	14,959,194	38.5
Iron Range Resource (IRR) includes distribution to the Taconite Environmental. Protection Fund and the Douglas Johnson Economic Protection Trust Fund	25,730,951	66.3
Other	12,598,034	32.4
Total	**$94,185,674**	**$2.426**

* This is "net" cents per taxable ton distributed (i.e., after deducting the tax credits, but including the state general fund appropriation).

Levy Limits

General levy limits are imposed for taxes payable in 2009–2011

The general levy limits under Minnesota Statutes, sections 275.70 to 275.74, restrict the amount of property taxes cities with a population of 2,500 or more and all counties may impose for general fund expenditures. Levy limits were reenacted during the 2008 legislative session and are in effect for taxes payable in 2009 through 2011.

Levy limits are intended to ensure that state aid reduces property taxes and limits the growth rate of property taxes

Levy limits are adopted to keep the growth in property taxes low and to help ensure that cities and counties use increased state aid payments to reduce property taxes and not for higher local spending. Because of this, general purpose state aids are included in calculating the limit. When a local government's state aid increases, its maximum allowed levy decreases. Conversely, if a local government's aid decreases, its allowed levy increases. If a local government receives no state aid, the limit applies only to its property tax levy.

Although the purpose of levy limits is to limit growth in property taxes, some opponents argue that they may actually increase taxes by encouraging cities and counties to levy up to the maximum allowed.

Levy limits have expired several times and been reenacted

In recent years, the legislature has generally imposed levy limits as part of property tax reforms, or when state aid reductions may have led to higher property taxes. They were re-imposed for Pay 2009–2011 to limit rising property taxes and ensure that aid increases are passed on as property tax reductions. The table shows the years in which levy limits were imposed.

Chronology of Levy Limits

Taxes payable years	**Limits Apply?**	**Instigating Event**
1972–1992	Yes	Enactment of 1971 property tax reform
1993–1997	No	Enactment of Truth-in-Taxation notices as a replacement
1998–2000	Yes	"Compression" of class rates
2001	No	Allowed to expire
2002–2003	Yes	2001 property tax reform
2004	Yes	2003 and 2004 aid reductions
2005–2008	No	Allowed to expire
2009–2011	Yes	Previous county and city levy increases

State aids are used to calculate limits

As noted above, state general-purpose aids are used to calculate levy limits. The aids included in the levy limit base are (1) taconite aid; (2) county program aid, for counties only; and (3) local government aid (LGA), for cities only. The combination of levy plus aid is known as the levy limit base.

The allowed growth in the levy limit base for Pay 2009–2011 is less than usual

In recent history, the levy limit base has usually been adjusted for inflation, new households, and new commercial and industrial property. For Pay 2009–2011, stricter limits were imposed. A local government's levy limit base (levy plus aids) is increased for growth for the three factors but limited as follows:

- The rate of inflation, as measured by the implicit price deflator (IPD) for state and local government purchases, *but only to a maximum of 3.9 percent*
- *Only one-half* of the percent growth number of households in the local jurisdiction, as estimated by the state demographer or the Metropolitan Council, rather than the usual 100 percent of the growth rate
- One-half of the increase in the total market value in the jurisdiction due to new commercial/industrial development

Local governments may levy "outside of limits" for certain purposes

The levy limits do not apply to "special levies." Special levies can be imposed for whatever amount the city or county needs outside of levy limits for specified purposes. For taxes payable in 2009 these purposes include:

- debt for capital purchases and projects;
- state and federal required matching grants;
- preparation for and recovery from natural disasters;
- certain abatements;
- increases in public employee retirement association (PERA) rates after June 30, 2001;
- required jail operation costs;
- operation of lake improvement districts;
- repayment of a state or federal loan related to highway or capital projects; and
- for an animal humane society.

For Pay 2009–2011 the special levy for pension plan rates was expanded to all local government pension plans and five new special levies were added, which include:

- to cover increased costs related to reductions in federal health and human service program grants;
- to cover city costs in cities with high foreclosure rates;
- for Minneapolis to cover unreimbursed costs related to the I-35W bridge collapse;
- for salaries and benefits for police, fire, and sheriff personnel; and
- to recoup any LGA or county program aid losses *if* the governor unallots moneys from these programs due to a future budget crisis.

Local governments may go to voters for authority to exceed limits

When levy limits are in effect, a local government may certify a levy higher than its levy limit *if* approved by the voters at a referendum. A vote to exceed the limit may be for any amount, and the tax is spread on tax capacity. Unless approved by a referendum, the final levy may not exceed the limited amount plus the amounts levied for authorized special levies.

The Fiscal Disparities Program

What is the fiscal disparities program?

The fiscal disparities program is a system for the partial sharing of commercial-industrial (C/I) property tax base among all jurisdictions within a geographic area. In Minnesota, two programs are used: the primary one was created in 1971 and operates in the seven counties of the Twin Cities metropolitan area; a smaller scaled version was created in 1995 for the Iron Range in northern Minnesota.

Why share commercial/ industrial tax base?

The main purposes and goals of the program are to:

- *Support a regional approach to development*. Tax-base sharing spreads the fiscal benefit of business development spawned by regional facilities, such as shopping centers, airports, freeway interchanges, and sports stadiums. It also may make communities more willing to accept low-tax-yield regional facilities, such as parks.

- *Equalize the distribution of fiscal resources*. Communities with low tax bases must impose higher tax rates to deliver the same services as communities with higher tax bases. These high tax rates make poor communities less attractive places for businesses to locate or expand in, exacerbating the problem. Sharing C/I tax base can reduce this effect.

- *Reduce competition for commercial-industrial development*. Communities generally believe that some kinds of C/I properties pay more in taxes than it costs to provide services to them. This encourages communities to compete for these properties by providing tax concessions or extra services, which can weaken their fiscal condition. Tax-base sharing reduces the incentive for this competition, thereby discouraging urban sprawl and reducing the cost of providing regional services such as sewage and transportation.

How does the fiscal disparities program work?

Contributions to the areawide tax base. Each taxing jurisdiction annually contributes 40 percent of the growth in its C/I tax base since the year of enactment to an abstract entity called the “areawide tax base.” This contribution value is not available for taxation by the jurisdictions where the property is located.

Distributions from the areawide tax base. Each municipality receives a share of the areawide tax base through a formula based on its share of the area’s population and its relative property tax wealth (tax base per capita). The municipality is allowed to tax this distribution value at the same rate as the tax rate paid by its residents. All taxing jurisdictions whose boundaries encompass the municipality are also allowed to tax the municipality’s distribution value (i.e., counties, school districts, and special taxing districts).

Calculating the property tax for each commercial-industrial property. The property tax statement for each C/I property has a local portion and an areawide portion, based on the relative amount of the tax base that is contributed (areawide portion) versus the relative amount that is retained (local portion) for the municipality where the property is located.

How has the metropolitan area program grown?

In the first year of implementation (1975), the areawide tax base included 6.7 percent of the total metro C/I tax base and 2.1 percent of the total metro tax base. For 2004, the areawide tax base was 32.3 percent of the total metro C/I base and 9.8 percent of the total metro tax base.

How much do fiscal disparities affect tax burdens?

A House Research study based on taxes payable in 2004 found that the average homestead tax in St. Paul, which is one of the largest net beneficiaries of the program, was 8.8 percent lower because of fiscal disparities. The study also found that the average homestead tax in Bloomington, which is one of the largest net contributors, was 5.5 percent higher. Homestead effects throughout the area generally varied between these extremes.

For commercial-industrial properties, average taxes were 2.7 percent lower in St. Paul due to fiscal disparities and 9.7 percent higher in Plymouth, another suburban city that is a large net contributor. Commercial-industrial properties elsewhere in the metro area fall in line between these extremes.

The study looked only at the direct effect of fiscal disparities, i.e., the redistribution of tax base, and made no attempt to factor in alternative development patterns that might have occurred without fiscal disparities.

How did the 2001 property tax reform affect fiscal disparities?

The elimination of the general education levy, imposition of a state property tax levy, and reduction in commercial-industrial class rates caused the nominal amount of money redistributed by the fiscal disparities program to decrease. However, based on the aforementioned House Research study, the net effect of fiscal disparities on tax burdens is similar to what it was before the reform.

What about the Iron Range program?

Tax effects of the Iron Range fiscal disparities program are much smaller in magnitude since the percentage of tax base being contributed is so low due to the relative infancy of the program.