MINNESOTA'S TAX STRUCTURE

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REPORT OF THE

MINNESOTA TAX STUDY COMMISSION

DECEMBER, 1954

ACKNOWLEDGEMENT

In the preparation of this report, the Minnesota Tax Study Commission has received invaluable aid, assistance, and information from numerous sources. To attempt to list the many individuals, organizations and institutions to whom this Commission is indebted might leave some unnamed whose contribution did not come to the direct attention of the Commission.

Many individuals came to the regional meetings of this Commission at their own expense in time and money to express their convictions and present detailed information about Minnesota's taxes. Various public and private institutions compiled data for the Commission's benefit. This Commission is deeply grateful to all who in one form or another helped to make possible a more adequate portrayal of the tax structure of the State of Minnesota.

In here recording the sincere appreciation of this Commission for the assistance rendered by others it is not intended to imply that those who did so, share any responsibility for the material herein contained. The Minnesota Tax Study Commission accepts full responsibility for the analysis, interpretations, conclusions and recommendations in this report.

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Scope, Method and Philosophy

The duties of the Interim Tax Study Commission as prescribed in the law which created it are broad and inclusive.[1] Basically this Commission is charged with making a study of the "present tax structure of the state." The term structure means "a combination of related parts." The tax structure is made up of a combination of all of the taxes levied by the state, including all of its subdivisions, namely, counties, cities, villages, towns and school districts. The Commission's assignment was to study the combined effect of these taxes.

It is sometimes helpful in defining a composite to call attention to what it is not. For example, the three following areas were considered by this Commission as not coming within the scope of its assignment.

In the first place this Commission was not charged with the duty of passing upon the merits of expenditures of the state, as to whether such expenditures are wise or unwise.

Given the expenditures of the state and its subdivisions, it became the responsibility of the Commission, as the members saw it, to determine if the combined effect of the taxes levied to meet these expenditures is just, equitable and not unduly burdensome to the people of lower incomes, and if a friendly tax climate obtains for industries.

Secondly, since this Commission was concerned with the over-all tax structure, it did not feel that inequities of individual taxes came within its province. Any given tax law could, and ought to, be re-examined from time to time to ascertain whether it should be rewritten to eliminate individual inequities which have developed through usage, interpretation and amendments. It became apparent to the Commission, however, that the recodification and rewriting of the present tax laws of the state to eliminate inequities in the laws are long overdue.

[1] See Appendix for: *Minnesota Session Laws of 1953*, Chapter 736.

Thirdly, this Commission has not made tax collection a part of its study, and consequently has considered a state withholding tax outside the scope of its investigation. To change the payments of the state income tax from an annual basis to a withholding system would be changing the tax collection procedure, and would not materially affect the tax structure as such. To hold that more revenue could be collected by a withholding tax is to emphasize the obvious fact that better enforcement of tax collection in any field would produce more revenue.

It became obvious at the outset of the study that the Minnesota tax structure was not the result of systematic, long-range planning. Rather, most of the changes and additions to our revenue laws seem to be the result of moving from one crisis to another. To meet temporary emergencies, taxes have been piled upon taxes, and few of them have been repealed.

To rearrange the tax burden so as to make it more equitable for the people, and at the same time preserve a tax climate favorable for industrial progress is not a simple task. Suggesting a desirable tax structure—even in theory—is difficult enough, but to shape it into law and achieve it in practice is a task of formidable complexity.

Because of the magnitude of this task of studying the entire tax structure of the state of Minnesota, this Commission could not give sufficient attention to all of the detailed aspects of the tax problems which were presented to it. The Commission interpreted its main assignment, therefore, to study the impact of the *over-all tax structure* of the state.

Emphasis was, therefore, placed on the following quotations from the law: to recommend an "over-all tax structure" which will "produce the necessary income" with a minimum of duplication and hardship on "particularly those in lower-income brackets" and "which will create a friendly, healthy atmosphere for present and future industries."

Three other commissions dealing in part with taxes were established by the 1953 Legislature to make special studies in their respective areas. These commissions were "The Highway Study Commission," "The Iron Ore Tax Commission" and "The Forestry Study Commission." Because of the special assignment of these commissions, and to avoid duplication, it was early decided by this Commission to concentrate its efforts on the other forms of taxation. However, as each of the taxes in these special areas is a part of the total tax structure of the state, their relationship clearly fell within the jurisdiction of this Commission. Letters to this effect were addressed to the three above-mentioned commissions.

This Commission approached its study of the tax structure from several angles: special hearings were conducted at the State Capitol to acquaint the Commission with the fiscal problems of the state; the Commission called upon such officers of the state as the Commissioner of Taxation, Commissioner of Administration, Treasurer, Auditor, Public Examiner, Commissioner of Education and Attorney General to present facts and figures regarding the tax problems. It invited representatives of labor, industry, agriculture, taxpayers groups, assessors and the public to present their positions and recommendations on tax issues.

In order to obtain grass roots opinions directly from the people, invitations were sent to interested groups in all of the 87 counties of the state, and a total of eight regional meetings, covering the entire state, was held. A total of over 1,000 people attended these meetings and every person who wished to be heard was given time to make his statement orally to the Commission and to make extended arguments in writing if he so desired.

During the last four months of 1954 this Commission had 11 all-day sessions compiling, sifting, writing and rewriting the report, in order to make it one which could be truly called a full Commission report in which all the members had a part in compiling.

No attempt was made to get complete unanimity of opinion, for that might lead to a watered-down report. Any individual member of the Commission who wished to disagree with the majority opinion was urged to write his dissent, which is noted throughout the report.

The Commission gave serious consideration to obtaining an outside firm to make an objective analysis of the Minnesota tax structure. At one time it investigated the employment of a tax analyst to study the incidence of Minnesota taxes upon individuals and upon income groups. On what individuals or income groups does the burden of Minnesota taxes lie? A person who pays a tax to the government does not necessarily bear the burden of that tax. He may shift all or part of the burden to others—even to people outside of the state.

The Commission undertook a general study of the tax burden of the 48 states, believing that the tax burden of a single state ought not to be too different from that of other states, especially neighboring and competing ones. This study consists of more than 50 typewritten pages, and though not included in this final report, it is available in the State Capitol for interested persons. It became evident from this survey that one cannot evaluate a single tax as being generally good or bad. A tax is good or bad depending on how well it fits into the entire tax pattern of a state. For example, a gross receipts tax, which is generally considered a regressive tax, may be just the tax which is needed if most of the other state taxes are heavily progressive, but it would be very undesirable should the other state taxes bear heavily on the low-income group.

The report of this Commission is not intended to be a scientific, theoretical analysis such as might be expected from a specialized group of tax engineers. Rather, it is a report made by a group of open-minded citizens and lawmakers who have made a contribution to the state by putting in many days of faithful study of the Minnesota tax structure. The individual members of this Commission, though they represent different walks of life, are all vitally interested in Minnesota taxes and are all genuinely concerned with the economic welfare of the people of the state and the state as a whole. Although this report has been prepared by the members of this Commission, it nevertheless reflects the opinions of many interested citizens of this state.

In addition to the printed report itself, and to the comparative state study referred to above, hundreds of pages of testimony, together with the data, statistics and analyses, are compiled in typewritten form and placed on file, and are available at the Capitol for anyone wishing the information. A virtual library of tax material obtained from this study and from other state studies, together with private studies and original investigation, is likewise available.

The members of this Commission, in giving consideration to a desirable tax structure for the state, tried to keep constantly in mind the basic accepted principle of our form of government, namely, separation of powers and responsibilities of the various units of government.

This Commission supports the philosophy that each unit of government should levy, as far as possible, the taxes for the expenditures it elects to make. There seems to be a tendency for the smaller unit of government to seek aids and support from the larger units of which it is a part. Although the Commission recognizes the growing need for grants and aids because of the limited sources of revenue on the part of some local units, every opportunity should be taken to place responsibility on each unit of government.

This Commission is cognizant of recent reports indicating that in population increase and economic development the state of Minnesota is falling well behind the national averages. It is assumed that these conditions were responsible, at least in part, for the Legislature's action in creating the Commission. No effort has been put forth by the members of this Commission or its staff to further analyze the economic conditions within the state except only as they are reflected in the findings in respect to the tax structure. The special charge made to the Commission by the Legislature in respect to taxes on the manufacturing industry indicates an awareness on the part of that body that the only way in which this state can increase employment within its borders is by making more industrial jobs available to Minnesota citizens. By this means, employment is not only increased in the industries themselves, but the added workers in the factories likewise require more employment in the service industries, merchandising and the professions, and furnish a broader market for the products of agriculture. The Commission has taken all of these factors into consideration in making its recommendations in respect to changes in the tax structure.

As this study progressed, the members of the Commission became increasingly aware of the fact that they were asked to evaluate the tax structure, for which there is no generally accepted measuring rod. To ask the question: "Does Minnesota have an equitable tax structure?" assumes that all are agreed on what an equitable tax structure ought to be. Such an assumption, however, does not follow.

Taxes are a subject upon which people have strong convictions. A reason why individuals hold so tenaciously to differing ideas as to what is good or bad about taxes stems from the fact that they have adopted one or two measuring rods to the exclusion of all others. For example, some believe that the only fair measurement of a tax is how well it relates to their concept of "ability to pay." They may differ as to how this ability should be measured. Those who say ability is best measured by one's income consider a progressive income tax as the only acceptable tax, but those who say it is best measured by one's wealth find the property tax as the appropriate tax.

Then there are those who contend that the only worth-while measuring rod is one which measures how well a tax is related to the general benefit the individual receives from government, such as the right to receive an education and to own and accumulate property.

As distinguished from the benefits received, others would want a tax system so constructed that they would pay taxes in proportion to the cost of government services received as individuals—as a gasoline tax is related to one's use of highways. Those who hold to this view have their answer as to how much one ought to be taxed, but fail to indicate how or to what the tax should be applied.

Then there are those who take the more extreme position that to tax for revenue is of least importance in taxation. They would use the instrument of taxation for social and economic purposes, such as control of cyclical fluctuations, redistribution of wealth and regulation. The power to tax is the power to destroy.

Citizens are always vitally and intensely interested in the subject of taxation. If any single factor contributed to the birth of our nation, it was the issue of taxation without representation. In a representative government like ours people have an opportunity to become articulate and to make their feelings known. We would not have it otherwise.

However, it is unfortunate when taxation becomes a partisan issue. To be for, or against, a tax because of what it will do for a political party, rather than what it will do for the state, is indeed unfortunate. Whether a tax should, or should not, be adopted depends entirely upon the place it occupies in the tax structure when considered together with the other taxes—in other words, how it contributes to improving the over-all tax structure.

So long as citizens of Minnesota want various units of government to perform services for them which they either cannot do for themselves or feel that governmental units can do better, they accept a moral responsibility to pay taxes to enable government to perform these services. It is clear that no one or two of the afore-stated measuring devices, nor others not stated, can be, or are, used alone to determine what constitutes a good tax structure or how much the individual should pay.

The members of this Commission, who are individuals with differing attitudes and opinions, hope that all the conflicting ideas and philosophies have been weighed in proper balance, and that their conclusions and recommendations reflect all of the various concepts as to what constitutes a fair and equitable tax structure.

State and Local Relationships

This Commission has recognized in analyzing the Minnesota tax structure that it is fundamental to investigate the combined total of the taxes of the state and its variety of local governments and also the fiscal relationships existing between the various units of government. In the early history of the United States, local government levied the taxes necessary to maintain local functions. However, today local government is becoming more and more dependent upon the state, just as the states themselves are becoming more dependent upon the federal government.

There is a wide variation among the 48 states in the proportion of local fiscal requirements supplied by the state, as shown by the fact that Minnesota ranks fourteenth in per capita state taxes and eleventh in per capita local taxes, while in combined state and local taxes Minnesota ranks tenth. Because of Minnesota's below-average per capita income, the state ranks fifth in measuring the economic burden of combined state and local taxes on the average citizen.[1]

Of the total general revenue of all local government in Minnesota during the fiscal year of 1953, approximately 70 per cent of the funds was raised locally and 30 per cent came from distributions made by other levels of government.[1] On the other hand, in the same fiscal year the state of Minnesota retained only 63 per cent of its revenues, and 37 per cent was redistributed to other levels of government.

The relationships between the state and local governments cover a wider area than the distribution of revenues. Other factors are apparent in appraising the tax structure, and probably of prime importance to the local community is the fact that the state legislature controls the base on which the local taxes are levied. While it is possible that the legislature could increase the size of this base, it does not appear that this has been done. On the other hand, on numerous occasions the size of the tax base has been reduced. This subject is covered in the section of this report entitled, "The Property Tax Base." That section also sets forth the fact that, on some occasions, the property-tax base has been reduced and the state has imposed in lieu taxes which are paid into the state treasury without redistribution to the local units of government.

In addition to controlling the tax base, the state has the authority to limit the taxes levied by local government. In respect to certain expenditures, notably schools, these limits are fixed dollar amounts per capita of population in the taxing district, while in other cases a ceiling is placed on the number of mills that can be levied. These restrictions are intended as a protection to property owners, and in the recent period of rising costs they have effectively limited expenditures in a number of local units of government. With the present irregularities in assessment standards, which have been set forth in the section of this report entitled, "Assessment Procedure," these limits are neither as effective nor as equitable as they would be if all property were assessed according to law.

Of increasing importance in the affairs of local government is the tendency for local revenue to be raised at the state level. Perhaps the best illustration of this tax procedure is the Minnesota income tax, only a very small portion of which is expended at the state level, the balance being distributed to local government. As the property tax tends to become too burdensome, there is a tendency to look to the other methods of taxation, and some of these are unsuitable for local application. It would be impracticable to have some communities levying an income tax while others are not using this form of raising revenue.

On the other hand, the raising of local revenue at the state level is complicated by

[1] *State and Local Government in 1953;* U. S. Department of Commerce, Bureau of the Census, October 27, 1954.

the procedure followed in redistributing it to the local units of government. Again, the income-tax revenue is a good illustration, but more particularly the portion of it which is distributed as equalization aids to distressed school districts. Some of the problems involved in this procedure, especially in respect to the study being made by the Equalization Aid Review Committee, have been discussed in the "Assessment Procedure" section of this report. Similarly, the present controversy over the distribution of the highway user revenues shows the problems inherent in state-collected taxes for the benefit of local government.

Of a somewhat similar nature are the problems created by the distribution of state and federal funds as aids and grants to local government. Unlike those mentioned above, they are not levied for a special purpose, but, in making the allocations to the local units, it is specifically designated how the funds shall be spent. These funds would include aids for health and welfare, school lunches and airports.

The welfare distributions originated during the stress of the depression of the nineteen thirties when local governments were hard pressed to meet their requirements. In spite of this fact, welfare distributions have continued to increase, and the grants now made are shared jointly by the state and federal governments, and serve to augment any revenue which may be raised at the local level. These aids and grants all tend to lessen the revenue that would have to be raised locally to provide the same standard of services, but usually they lead to a higher and more uniform standard of functions than would be the case if the funds were all raised locally.

The Minnesota legislature is authorized by the Constitution to provide for the method of distribution of the income from the Permanent School Fund and the Swamp Land Fund.

There is another phase of state and local relationships which needs special mention in this report, and that is the tendency for the state to take over local functions. Perhaps the clearest illustration of this procedure occurred when the trunk highway system was created. As is only too well understood by the citizens of Minnesota, this has led to many controversies concerning the roads to be included in the trunk highways, the requirements for improving the existing mileage, and, at the present time, the distribution of the user revenues between state and local government. In this case the state has taken over in toto the function of maintaining and improving certain specific mileage of the highway system, but the principle of transferring functions from local to state government is inherent when the citizens demand state financing for these functions. Thus the aid programs of caring for the aged, dependent children and the disabled, are being financed primarily by federal and state funds, and there is increasing control of these functions at the upper levels of government. Furthermore, the tendency for the state to finance an increasing proportion of the cost of education undoubtedly will continue to bring increased regulation of our educational system by the state. Attempts have been made recently to have the federal government make certain contributions to the states for educational purposes.

In spite of the dangers inherent in the partial transfer of functions to the state, the legislature, in a number of instances, has shown its intention to have local units of government administer their own affairs. The sharing of the highway user revenues is a deliberate effort by the legislature to provide supplemental finances for roads without usurping the local responsibility for streets and roads other than the trunk highway system. The sharing of liquor and cigarette tax revenues places no restriction by the state on local use.

The strength of the American form of government stems in a large measure from the vitality of the local unit. Unless these subdivisions of the states and nation are ultimately to become wards of the federal government, they must be permitted and required to assume the responsibility for their local functions. To accomplish this there must be a satisfactory balance in the financial relationships between the state and the local units of government.

This Commission Concludes That:

Local units should not appeal to the state to furnish the funds for purely local responsibilities. On the other hand, the state, in its exercise of control of the local units, must provide them with sufficient and satisfactory means to levy the necessary taxes to raise the needed revenues.

Assessment Procedure

In earlier and simpler forms of taxation tangible property was considered one of the fair measures of an individual's duty to support government because many, if not most, of the more elementary services rendered by government in those days attached to tangible property, such as roads and protection against fire and theft.

Various methods have been employed in the taxation of tangible property but today practically all such levies are calculated by applying a specified rate of tax to each dollar of property value and hence are known as ad valorem taxes—"according to the value."

If all taxpayers are to be treated on an impartial basis, this system of taxation is entirely dependent upon fairness and equity in valuing the taxed property. In recognition of this principle, the Minnesota statutes provide that the full and true value of property for the purposes of levying taxes "means the usual selling price at the place where the property to which the term is applied shall be at the time of assessment; being the price which could be obtained at private sale and not at forced or auction sale." (Section 272.03.)

In actual practice it has been the custom of the assessors in Minnesota and other states to value property for taxation at a figure below its actual sale price, and so long as no injustice to taxpayers resulted from this practice, it was equitable. Thus if all property was assigned a full and true value that was one third of its market price, there was no discrimination between taxpayers, and the only result was to require a higher rate of taxes per dollar of value to raise a given total revenue than would be required if the actual market price was used.

To avoid confusion it may be desirable to define the different "values" that may be applied to the same property in this report:

Fair Market Value—The selling price of the property in accordance with the above quotation from the Minnesota statutes.

Assessors' Full and True Value—This is a nonlegal term because the statute provides that this value shall be identical with the "Fair Market Value." However, as stated in the foregoing paragraph, assessors seldom use the market value but determine a lower figure presumed to be a certain percentage of the market value; this value is termed "assessors' full and true value" in this report.

Assessed Value—The value against which the tax rate is applied. It is the fraction of the assessors' full and true value that remains subject to taxes according to the provisions of the Minnesota classified property tax law.

Before the turn of the century, certain differences and difficulties developed in the assessment procedure, and successive sessions of the Minnesota legislature struggled with the problem of trying to obtain valuations of property on a basis that would be equitable to all taxpayers. Finally, in 1913 the legislature passed the classified property tax law which provided that all property would have a full and true value equal to its market price and that the assessed value against which the tax rates should be applied would be a certain fraction of the full and true value depending upon its classification. That law classified all property in the state as follows, and fixed the percentages to be applied to the full and true value as indicated:

Class	Per Cent
1. Iron ore	50
2. Household goods	25
3. Livestock, manufacturers' equipment and unplatted real estate	33⅓
4. All other property	40

While this provision places differing tax burdens on the citizens of Minnesota depending upon the class or classes of property they own, it complies with the provision of the state's constitution that "taxes shall be uniform upon the same class of subjects."

Since the enactment of the classified property tax law there have been numerous attempts to revise its provisions, some of which have been successful and often with the result that one class of property is benefited at the expense of some or all other classes. As compared with the above four classes, the law now provides for 13 classes of property, and a summary of what is included in each class is shown in the Appendix to this report. As of today only seven of the 48 states classify property for taxation and Minnesota has the most complex provisions of any of these seven states.

The first assessment under the new classification law was in 1914 and the new assessed values derived under the law were actually greater than those that prevailed before the law. Further substantial increases in the assessed value of all real and personal property occurred with the inflation of prices which accompanied World War I. Between 1910 and 1920 the taxable value of all property rose by approximately 75 per cent. With the advent of the agricultural difficulties in 1920 the total began to decline. Aided and abetted by the depression in the nineteen thirties, together with the changes in the classification law including the homestead exemptions and some new statutes, this decline was not reversed until 1942, and at the low point in 1941 the total property tax base was less than $100,000 above the 1910 figure.

The period of the depression of the nineteen thirties had the combined effects of lowering total assessed values, increasing demands for local revenues, and causing extensive delinquency of ad valorem tax payments. The legislature in 1935 embarked on the use of the assessed values in relating them along with other factors as a basis for granting various state aids for welfare purposes. The particular statutes have been continuously revised, but for the applicable counties their total assessed value continues to be one of the bases for receiving welfare aid.

Reference to new statutes in a foregoing paragraph is particularly directed to the provisions for the distribution of equalization aid to school districts from the income tax fund. The statute provides that, in addition to the basic aid which is calculated on the average number of pupils in daily attendance, special aid will be paid to school districts which have low assessed property values per average pupil in attendance. While this provision was originally intended to aid a limited number of the poorer school districts in the state, consciously or otherwise, the assessed values in many districts are low enough so that at least one district in 84 of the 87 counties in the state qualified in 1952-53 for equalization aid and about four of every 10 pupils in this state are receiving their education in school districts obtaining equalization aid.

This situation came to the attention of the Little Hoover Commission and in its report, submitted in 1950, it recommended that an examination of the facts be conducted. The 1951 Legislature created the Equalization Aid Review Committee composed of the Commissioners of Education, Taxation and Administration. That Committee submitted a pilot study to the 1953 Legislature which clearly showed widespread variations between the assessors' full and true value and the estimated fair market value for real estate in nine counties studied. As a consequence the legislature appropriated funds to study the conditions in every school district in Minnesota receiving equalization aid.

A considerable portion of the testimony presented at the several hearings conducted throughout the state by this Commission dealt with differences in assessment valuations. It would be impractical and repetitious for this Commission to conduct a separate valuation study.

It might be well to point out that a limited number of cases of inequalities in assessment standards will exist under the most exacting procedure and do not necessarily prove that there is a fundamental defect in the entire system. Therefore this Commission sought factual information on which a conclusion could be reached as to the equality of taxation of tangible property.

The text of the report of the Equalization Aid Review Committee has not been made available to this Commission. However, on November 19, 1953, G. Howard Spaeth, Commissioner of Taxation, appeared before this Commission and presented complete data covering 33 counties, and on July 12, 1954, he again appeared and stated that the survey had been completed to include 62 counties, with a substantially unchanged result.

The following comments are based on the statistics for 33 counties and are presumed to be accurate and reliable.

Looking first at the extreme examples, farms in Becker County have a full and true value fixed by the assessors which averages 63.91 per cent of the fair market value while lakeshore property in Aitkin County averages only 8.29 per cent of its fair market value. These variations are extremely important in the distribution to the various counties of school equalization aids and relief aids, inasmuch as assessed valuation is a factor in such distribution, and constitute a disparity between various counties in meeting their obligations to pay for the cost of state government. It is worthy of note that the owner of a non-homestead farm in Becker County pays on the average about eight times as much in state taxes as the owner of rural lakeshore property in Aitkin County pays on the average on property of equal market value, although the statute intends that both should pay the same amount.

If the area being considered is narrowed to a single county, a better illustration of the effect of the deviation between the assessors' full and true value and the fair market price can be presented. For example, in Scott County the study has arrived at the following ratios of the assessors' full and true value to the estimated fair market value for the respective classes of real estate:

Class	Per Cent
Residential	25.09
Commercial	24.28
Industrial	30.55
Public utility	51.97
Lakeshore	15.37
Farm	51.14
County-wide ratio	37.37
Average ratio for 33 counties	36.97

To show the disparity created by these variations in assessment standards, it is assumed that a non-homestead farm and a non-homestead residence are both located in the same taxing district and therefore subject to the same tax rate. Each has a fair market value of $10,000.00. The residence would be given a full and true value by the assessor of $2,509.00 and the assessed value according to the classification law would be 40 per cent of that figure, or $1,003.60. The assessors' full and true value for the farm would be $5,114.00 and the assessed value for tax purposes would be 33⅓ per cent of that figure, or $1,704.67. If the same tax rate is applied to the residence assessed at $1,003.60 and the farm assessed at $1,704.67, it is clear that the farm is paying approximately 70 per cent more in taxes than the residence. But according to the provisions of the law the residence should have an assessed value of $4,000.00 and the farm $3,333.33, and hence the residence should pay 20 per cent more in taxes than the farm.

Actually in the above hypothetical case the farm is subjected to more than twice as much tax in relation to the residence as is intended by law. Of course, if the taxes were equalized to conform with the statutes, the amount levied on the residence would be increased approximately 47 per cent and the farm levy would be reduced about 28 per cent.

Admittedly, the figures for Scott County were selected for this illustration because they showed a somewhat greater discrepancy between farm and residential property than is indicated in the average for all of the 33 counties included in the figures presented by the Commissioner of Taxation. The ratio of the assessors' full and true value to the estimated fair market value as indicated by the averages for 33 counties is as follows:

Class	Per Cent
Residential	30.55
Commercial	32.25
Industrial	29.21
Public utility	46.83
Lakeshore	19.47
Farm	46.63
33 county over-all average	36.97

The effect of the variations in these percentages is much greater than mere examination of the figures indicates. Farm and public utility standards are more than 50 per cent above residential and industrial, and nearly that much above commercial. Too much weight should not be given to the industrial figures included in this average as none of the important industrial areas are included in these totals.

It must be realized that all these figures are averages, and do not disclose the variations in assessment standards in the same class of property and within the same county. For example, in Becker County where, as previously mentioned, the assessors' full and true value of farms averages 63.91 per cent of the estimated fair market value, it is a reasonable assumption that the assessors' full and true value of some individual farms was in excess of the fair market value, and the value of some farms may have been as low as 40 per cent of the estimated fair market price. Under such circumstances injustices are done to "subjects of the same class."

Furthermore, it should be noted that the Minnesota statutes do not classify property for the purposes of valuation—the classification is stated to be "for purposes of taxation." Regarding valuation the law says "*All property* shall be assessed at its true and full value in money." (Section 273.11.) Hence variations in assessment standards between classes of property contravene the intention of the legislature in classifying property.

No similar study has as yet been made in respect to personal property. However, some of the testimony presented at this Commission's hearings indicated wide variations between the assessors' full and true value and the fair market price for this class of property. Merchants who disclosed the actual cost of their inventories to the assessor paid taxes on that basis and complained that those who refused to do so paid lower taxes, and manufacturers objected vigorously to what they termed unduly oppressive taxes on their inventories and tools of production, which placed them at a competitive disadvantage in interstate trade.

Farmers were more vocal in their opposition to real estate taxes than to personal property levies. A study published in the November 1953 *Agricultural Finance Review*, issued by the U. S. Department of Agriculture, shows by states the ratio of assessors' full and true value to market value of classes of farm property. According to this survey Minnesota farm real estate in 1950 had an assessors' full and true value equal to 50 per cent of its market value—a figure not too far from the average presented by the Commissioner of Taxation, especially when consideration is given to the downward trend in assessors' full and true values which the Bureau of Agricultural Economics states was in evidence during that period. However, the *Agricultural Finance Review* study shows livestock was assessed at 39 per cent of its market value and farm machinery at 34 per cent.

One segment of personal property requires special mention and that is the levy against household goods. A number of witnesses appearing before this Commission suggested that this tax be entirely eliminated. They pointed to the fact that the total revenue received from this source was less than three million dollars and that the tax was in the nature of a nuisance tax. On the other hand this Commission received a copy of a resolution adopted by eight county assessors or supervisors of assessment recommending that there should be no reduction in the tax base and that household goods should continue to be assessed and taxed. They further recommended the elimination of the $100 exemption on this class of property and suggested that if necessary the classification rate be lowered from the present 25 per cent.

According to the assessors' reports the full and true value of all household goods in Minnesota on May 1, 1953, was $310 million after equalization. Under the provisions of the classification law, household goods have an assessed value equal to 25 per cent of their full and true value. Hence the assessed value of all household goods in Minnesota on May 1, 1953, was approximately $77.5 million and the Department of Taxation estimates that the taxes collected in 1954 against this assessment will approximate $2.7 million.

The full and true value of household goods reported at $310 million is less than the 1953 retail sales in Minnesota of merchandise that should have been included in this class of property by the assessors. It is reported to this Commission that the assessors do not, at least in all instances, include in the total full and true value the assessments which are so small that after deduction of the $100 exemption there would be nothing left to tax. To what extent the inclusion of these small items would increase the total is not known but, based on a rough estimate, it might add something in the vicinity of 10 per cent to the reported full and true value.

Admittedly, the problem of assessing household goods is a difficult one and very few of the assessors have the necessary background to do more than make a rough estimate, usually well on the conservative side. The assessors are confronted with many other irksome tasks in performing their required duties but this hardly appears to be a valid reason for exempting any portion of a class of property from taxation.

Perhaps a better argument is the relatively small yield from this tax and this stems from two principal factors: (1) the apparent discrepancy between the market value of household goods and the assessors' full and true value, and (2) the $100 exemption applied to the assessed value of personal property of each household. This latter point is discussed in the section of this report entitled, "The Property Tax Base."

This Commission is satisfied that assessors' full and true values of personal property in this state vary sufficiently from the same standard within the same taxing district and between taxing districts so that they not only create injustices between taxpayers but also are not in conformity with the provisions of the Minnesota statutes.

Attempts have been made during recent years to improve the assessment procedure in this state. Legislative action as well as administrative procedure has been aimed in that direction. The commissioner of taxation is charged with general supervision of assessments throughout the state and in furtherance of that charge has, since 1940, conducted annually an assessors' school in conjunction with the University of Minnesota.

The Department of Taxation biennially prepares and distributes a comprehensive *Assessors' Manual* which includes all applicable statutes with appropriate explanations. To further provide for uniformity, the Department of Taxation prescribes forms and records for the assessors' use, and the commissioner requires that the forms for the listing of personal property be prepared according to his instructions. The 1947 Legislature made it mandatory for every county to have either a supervisor of assessments or a county assessor. These individuals are to be selected because of their knowledge of property taxation and their appointment shall be subject to the approval of the commissioner of taxation.

The local assessor, however, still functions in the assessment procedure even though the county assessor may have authority to adjust his valuations. Town, city and village assessors are either elected or appointed by the county commissioners or city or village councils, and there are no qualifications provided by law governing the persons who fill these positions. The Minnesota statutes provide in some instances that these assessors shall be employed for only a limited period of time in any year and may receive compensation as low as $6.00 a day. These officers should know the current market value of farm and city real estate, livestock, farm machinery, household goods, stocks of merchandise, manufacturers' equipment and a host of other items.

The commissioner of taxation is directly responsible for the original assessments of all commercial pipelines, airflight property of commercial airlines and of rural transmission and distribution lines that are subject to ad valorem and not in lieu taxes. Iron ore is assessed legally by the local assessors, but because of the local assessors' inability to acquire the necessary information as to its extent and value, the valuation for practical purposes is made by the commissioner of taxation after receiving the factual data certified by the School of Mines of the University of Minnesota. This procedure is probably responsible for the better-than-average assessment standard shown for public utility property in the table on page 16. In addition, the services of the Department of Taxation are available to county and local assessors when special help is desirable. However, the extent of this help is limited by the personnel available, and is restricted so that the local responsibility for assessments will not be abrogated nor that the expense of that function will not be charged to the state rather than to the local taxing district. Except as herein set forth, neither the commissioner of taxation nor the board of county commissioners have any statutory power to make an original assessment.

While there is no doubt that these efforts to improve the assessment procedure have produced desirable results, the evidence submitted clearly shows that a large segment of the property taxes is not being levied in accordance with the provisions of the statutes. Probably iron ore and some business inventories are the only classes of property that have a full and true value which approximates their fair market value. For the balance of the property in this state, the full and true value assigned to it by the assessors varies widely from the fair market value depending largely upon the assessors' knowledge, judgment, wisdom, wishes or desires.

There is no doubt that this procedure is responsible for a large number of the complaints presented to this Commission in the course of its several hearings. The farmers of this state might be less anxious to change the method of taxing their real estate if their assessments were in proper balance with other property. The businessmen who complained bitterly about the taxes on their personal property might get a fair measure of relief if all property were valued according to the statutes. And these statements naturally raise the question of: Why don't these taxpayers take action to get relief? That necessitates consideration of the equalization procedure as now operated in this state under the existing statutes as interpreted by the Minnesota courts.

Under the Minnesota statutes an action to correct inequality of an assessment is difficult and expensive, and is neither a speedy nor an adequate remedy.[1] Insofar as the process is used to correct inequities arising under the present assessment system, it emphasizes the need to correct the assessment procedures. The procedure starts with the town board, village or city council sitting as a board of review. If the action of the board of review does not satisfy the taxpayer, he may appear before the county board of commissioners sitting as a board of equalization and plead his case. It should be noted that the county

[1] Although this Commission is aware of the procedures provided for the abatement of taxes levied, the procedure is not discussed in this report.

boards of equalization (except in Ramsey County where a special statute governs—Ch. 391) cannot reduce the total value of the property in their jurisdictions below the amount of the assessed value certified to them by the assessors, and the same is true of local boards of review in the 47 counties operating under the county assessor system.

Local boards in counties under a supervisor of assessment system have the power to lower an assessment without raising other assessments. Thus, if one or more parcels of property are found to be overvalued by the county board of equalization in 86 counties and by many local boards of review, some other property must be raised in value to offset any reductions.

Prior to 1939 a state board (three members) was empowered to equalize assessments. The Reorganization Act of 1939 abolished this board and its powers were transferred to the then created office of commissioner of taxation, and from time to time thereafter additional powers were given to the commissioner of taxation. At the same time a Board of Tax Appeals was created to review the orders of the commissioner of taxation.

The commissioner of taxation is provided by statute with "the power to raise or lower the assessed valuation of the real or personal property of any individual, co-partnership, company, association, or corporation. . ." (Section 270.11, subd. 6) without limits, and also the commissioner of taxation now constitutes the state board of equalization where by statute the aggregate valuations of real or personal property may be increased or decreased for entire counties or local taxing districts within a county (Section 270.12).

The effect of the actions of the commissioner, sitting as the state board of equalization, cannot result in a statewide decrease in assessed values of more than one per cent. The statutes giving powers to the commissioner of taxation as such and the commissioner of taxation as the state board of equalization are ambiguous and their interpretation by the court has left this Commission in doubt as to what are the real powers of the commissioner of taxation acting in either capacity.

The Board of Tax Appeals, an administrative tribunal which is independent of the commissioner of taxation, is provided so that the taxpayer may appeal from the decisions of the commissioner of taxation.

There is an additional procedure whereby the taxpayer, after he receives the statement of the taxes levied on his property, may file a petition or answer in the state courts of Minnesota. Nevertheless, there is a rule of law, evolved by the courts of some states and followed by the Minnesota Supreme Court, which is that no property owner can complain if, in assessing his property, the taxing authorities have not valued it in excess of its fair market value, even though the comparable property of other taxpayers in the taxing district is valued at a standard of market value less than his.[2] Although in some other state courts and in the federal courts there are some decisions contrary to the Minnesota rule,[3] these early decisions have not been overruled or reversed by the Minnesota Supreme Court. However, in dealing with taxpayers' remedies against excessive valuations of property, the legislature in recent years has indicated that relief should be given if property has been partially, unfairly or unequally assessed.

[2] In the case of *State v. Cudahy Packing Co.*, 103 Minn. 419 (1908), the Minnesota Supreme Court stated: "The statutes of this state distinctly provide that 'all property shall be assessed at its true and full value in money.' (Section 810, R. L. 1905). Neither the state auditor nor the courts have the power to repeal or amend this clear and positive requirement."

[3] In the case of *Willsborough v. Cromwell*, 326 U. S. 620 (1946), the Supreme Court of the United States said in part: "The equal protection clause of the Fourteenth Amendment protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class."

The May First Assessment Date

According to law, all property in Minnesota is assessed as of May first. During the course of the hearings conducted by this Commission numerous objections were raised against the use of this date for the assessment of personal property. The farm implement dealers presented a strong case showing that the peak of their inventory usually occurred about that time and that the farmers were opposed to taking delivery of large items until after May first in order to avoid paying the current year's tax. As mentioned elsewhere in this report, cold storage operators stated that their business declined drastically around May first because owners of perishable products withdrew their goods to avoid the tax.

Several witnesses suggested other dates, principally January first, and some recommended that monthly averages be substituted for any fixed date. It has not been possible to make an exhaustive analysis of the effects of changing the assessment date. However, some observations brought to the attention of the Commission members are worthy of comment.

Prior to 1878 the Minnesota Statutes required averaging of monthly inventories of the stocks of goods of merchants and the raw materials of manufacturers. Other personal property was assessed as of any date between June first and July first at the assessor's option. This Commission is not aware of the reason for changing the law from the average of monthly inventories to the May first date, but it is assumed that at that time small merchants did not have the data available for such a procedure and the same is true today.

When consideration is given to selecting another date for the assessing of personal property, a number of other factors should be considered. From the standpoint of the farmers, May first is probably the least objectionable date, even though some objections to that date were voiced by cattle feeders. But, changing the date of assessment to January first would find the cattle feeder in possession of his feed as well as his cattle. Furthermore, farmers who sell their grain and feed crops would be compelled to do so before January first or be liable for the tax.

While merchants contend that January first is the logical date for assessing their inventories because so many of them end their fiscal year at that time, it is nevertheless true that they are in some measure influenced by the fact that the year-end marks the low point in the inventories of many merchants. Just as May first is an unsatisfactory date to the farm implement dealer, January first, or for that matter any other date, will be found to be objectionable to merchants handling other lines of goods.

It must be realized that the farmers and other businessmen of this state have adjusted their operations as far as they can do so to the May first date, and unless, and until, considerably more time can be devoted to a study of the effects of any change than this Commission has found possible, it seems best that the May first date remain as the effective date for the assessment of all personal property as well as of real estate.

Homestead Exemption

With local government hard pressed for additional tax revenues, special significance attaches to the homestead exemption granted by the Minnesota Statutes. This was a depression-born form of relief intended to lighten the tax burden on home owners and more particularly on those in the lower-income groups. While the undervaluation of property in Minnesota as compared to the statutory requirements of current market price is unquestionably responsible for the greatest minimizing factor in the tax base, the homestead exemption caused one of the largest reductions of the base authorized by law.

The classification section of the Minnesota Statutes defines a homestead as real property including lands and buildings occupied and used by the owner on May first of the assessment year for the purposes of a homestead. For assessment purposes there is no limitation as to the size of the homestead so long as the tracts of land which are being used for the purpose of a homestead are contiguous. In those areas which are rural in character, such properties shall be valued and assessed at 33⅓ per cent of the full and true value except that the first $4,000 of property which is used for the purposes of a homestead shall be valued and assessed at 20 per cent of the full and true value. Other real estate (except that owned by certain disabled veterans) shall be valued and assessed at 40 per cent of its full and true value except that where it qualifies as a homestead the first $4,000 of full and true value shall be valued and assessed at 25 per cent of its full and true value.

This law no doubt eased the lot of many taxpayers during the dark period of the nineteen thirties. However, there is considerable difference of opinion as to its relative merits in today's tax structure. While it is argued that it is primarily intended to give relief to those urban and farm home owners in the lower-income brackets, and to promote good citizenship through home ownership, it must be realized that the segment of the low-income group most in need of relief are those who are financially unable to own their homes and consequently have their real estate taxes included in their rent.

To illustrate this point it is assumed that the owner of a duplex lives in one apartment and rents the other. The assessor's full and true value of the property is assumed to be $8,000 and the owner receives the benefit of the homestead exemption on the first $4,000, which in this case is one half. The tax saving to the owner, and indirectly to the tenant, is added to the tax burden of both non-homestead housing and commercial and industrial real property, as well as to all personal property. A homestead having a full and true value of $4,000 in the city of St. Paul would be subject to taxes at current rates of $133.81. Non-homestead real property in the same city having a full and true value of $4,000 would currently be subject to taxes of $220.64. Hence, non-homestead real property in this example is subject to 65 per cent higher taxes than homestead property. Other values and differing rates of tax in other taxing districts will result in varying percentages of disparity between homestead and non-homestead property.

Historically, Minnesota adopted this form of credit in 1933 and was one of the first states to make such a provision in its laws. Twelve more states have some form of homestead exemption included in their tax structure but Florida alone provides a more generous exemption than Minnesota. The legislature of the state of Iowa in granting the homestead exemption in that state foresaw the fact that this would reduce local tax revenues, and created a homestead credit fund from other state revenue (retail sales tax) from which fund it reimbursed the local government for its loss in revenue created by this exemption. Similarly, Louisiana, Mississippi and Wyoming make restitution to the local government for a substantial part or all of the loss created by the exemption. On the other hand, four states—Alabama, Arkansas, South Dakota and Texas—have granted the exemption only insofar as it applies to state taxes on property. Thus, in those states there is no reduction of local taxes by reason of the homestead exemption. This Commission does not have any reliable estimate of the loss in revenue to local government created by the homestead exemption provisions of the Minnesota Statutes. However, it is reasonable to assume that it is very substantial and that it contributes to the high property tax rates.

The Property Tax Base

According to figures compiled by the state auditor, during the year 1954 the citizens of Minnesota will be expected to pay $261 million in property taxes which constitutes more than 50 per cent of all state and local taxes levied in Minnesota during the current year. As only about $16 million of these tax collections are for state purposes, the remaining $245 million constitute a very high percentage of the total tax revenue of local governments. The figures necessary to compute this percentage for 1954 are not available but in 1953 property taxes represented 96 per cent of all *local* tax revenue. Consequently any increase in the cost of local government or any additional services found necessary impose higher levies against property.

The assessed value of property against which these taxes are levied is commonly called the "tax base." The state auditor's records show that the total assessed value of all property in Minnesota was $2,084 million in 1920; that it declined to $1,293 million in 1941; and that it totaled $1,811 million as of May 1, 1953. The first and rather obvious comment on these figures is that the value of all property in the state must be greater in 1954 than it was in 1920, so why doesn't the tax base reflect this? In answering that question it should first be pointed out that there is no fixed relationship between the assessors' full and true value of property and its full and true value in money as defined in the Minnesota Statutes. To the extent that the average assessment standard may have declined since 1920 it will have a direct bearing on the total assessed value of all property in the state. This subject is covered more completely in this report in the section entitled, "Assessment Procedure." Along with this, it must be remembered that there was a drastic decline in the market value of all property between 1920 and 1932. However, average prices are now higher than those prevailing in 1920.

But there are other factors that have caused the tax base to shrink. The transfer of the property of telephone, telegraph, insurance, freight line and express companies from property taxation to a gross-earnings levy has not only lowered the property tax base but has diverted substantial revenue from the local units of government to the state treasury. The enactment of the mortgage registry tax and the grain bushel tax, together with the removal of property taxes on automobiles, air flight property, and taxes on money and credits (although for good and sufficient reasons) have nevertheless contracted the tax base. The trend toward municipal ownership of utilities and other governmental use of land has contributed to some extent. But probably the most important element in contracting the tax base has been the downward adjustments of the percentages in the classified property tax law that are applied to the assessors' full and true value, which started in 1923 and has since occurred intermittently. The merits of these reductions are not given consideration here. Obviously the lowering of the rates on oil refineries, in order to obtain some property to tax that would otherwise have gone to another state, was a wise move.

The point here stressed is that all of these reductions have lowered the base on which the great bulk of the local taxes is raised. In 1953 less than 6 per cent of the property taxes collected went to the state and over 94 per cent went to the local units of government. It is estimated that nearly $130 million was taken out of the tax base in 1934 by the homestead exemption provision alone. The loss to the tax base from this provision has increased substantially since 1934 because of the greater amount of property eligible for the lower classification.

Additionally, the exemption of $100 of assessed value of personal property granted to each household should be evaluated in the light of the present needs of local government for a broader tax base. If the average property tax rate for the state in 1953 of

143.52 mills be applied to 25 per cent of the assessors' full and true value for household goods, the resulting tax revenue would be $11,140,420. To provide an exemption that eliminates more than three quarters of the taxes that would otherwise be due seems rather high and difficult to justify. According to recent estimates about 35 per cent of the families of this state are renting their homes, and the only direct taxes levied on them are the personal property tax and the income tax.

This Commission Concludes and Recommends That:

1. There is ample evidence of wide variations between the provisions of the laws of Minnesota in respect to assessment procedure and the administration of those laws at the local level. Lax enforcement of laws leads to contempt and contempt leads to evasion. The assessment provisions provided in the Minnesota statutes should be enforced.

2. A satisfactory system of uniform original assessments and a workable system of state supervision can best be achieved by a substantial reduction in the number of administrative units involved. That is to say that many of the local assessors are competent and honestly striving to perform their tasks but the system presently bars the way to satisfactory performance. An improved system would be one with the governmental units capable of employing the best of the present assessors on a basis of full-time work with adequate pay.

   In the situations where the commissioner of taxation is the direct and original assessor of property (for example, commercial pipelines, airflight property of commercial airlines and rural transmission and distribution lines), the valuation for assessment more nearly approximates the statutory requirement than does the assessment made by local assessors. This results in an inequitable assessment in the taxing district where such property is located and an inequitable burden upon the users of the products ensues. All of which leads this Commission to conclude that the tax commissioner should have more direct and effective control over all original valuations for assessment purposes.

   The wide variation in the present assessment standards throughout the state is contributed to by the incompetence of some of the assessors, is fostered by lack of effective centralized control of the assessing procedure, and, under the present system, could in some measure result from local needs or pressures. Minnesota has an important interest in uniform valuations because it levies direct taxes on property throughout the state, distributes school aids, welfare aids and other aids on the basis of assessed valuations, and provides for supplemental loans to school districts from state funds as measured by local assessed valuations.

   Every county should have a county assessor (as distinguished from a supervisor of assessments), appointed by the board of county commissioners, qualified according to standards fixed by the commissioner of taxation, and subject to his confirmation. The commissioner of taxation should prescribe a proper salary range and be empowered to compel the boards of county commissioners to provide the county assessor with the necessary assistants and clerical help and suitable office space and equipment at the county seat. In counties containing a city of the first class where its charter requires the services of a city assessor, that office should be continued. The appointment should be made as required by the charter, subject, however, to the approval of the commissioner of taxation, and the assessor so appointed should be subject to his supervision.

3. The Minnesota statutes should be amended to clearly give relief from taxation based on property values when it appears that the owner has been discriminated against by having his property valued at a higher standard of market value than other property in the taxing district. This is not intended to mean that the statute requiring assessment at full and true value should be relaxed. Provision should be made by the legislature to reimburse the taxpayer, for his costs either in whole or in part, when he is successful in his proceeding.

4. The taxpayer often is unaware of changes made by the assessor in the full and true value or the assessed value of his property until after they have been certified to the county auditor. The assessor should be required to send notice to the taxpayer whenever a *change* is made in either value.

5.[4] For many of the citizens of this state the tax on household goods is the only direct property tax they pay and is also the only levy made directly upon them for the support of local government. The tax on household goods should be continued unless the personal property tax is to be dispensed with in its entirety. The recommendations to improve the assessment procedure should make this tax produce significant revenue, particularly at the local level where it is most needed.

6. In order for the Department of Taxation to meet its present and any future responsiblity in the relationships and responsiblities of the commissioner of taxation and those of the commissioner acting as the state board of equalization, it is essential not only that the type of sales ratio assessment survey be continued but also that the working relationships between the state and the local assessment officials be strengthened so that the statutory requirements governing assessments will be practiced uniformly throughout the state.

7. In order to formulate corrective steps to be taken, and to determine the extent of the deviation from statutory standards for the assessment of property which has resulted in inequities in the assessment system as presently administered, the 1955 Legislature should call on the Department of Taxation not only for the averages by counties, but more especially for an analysis of the deviation from the statutory standard in the assessment of individual properties by classes above and below the average for the class as a whole.

8. This Commission deplores the present deviation from statutory standards for the assessment of property practiced throughout this state and recognizes that it has inadvertently created nonlegal and unintentional vast differences in the actual property tax to be paid the state from its mill rate levied on property throughout the state. The legislature, when it has reviewed the results of the statewide survey of assessments, should then evaluate the need of an immediate change in the practice of spreading a uniform mill rate for state purposes on the unequally valued property throughout the state.

9. The legislature, as the assessment standard is brought into conformity with the statutory standards of valuation, should review and make suitable adjustments in the relevant statutes governing local financial affairs in terms of their assessed values.

[4] Sen. M. H. Anderson dissents from Recommendation No. 5.

10. The statutes providing for the powers of the commissioner of taxation and his powers when acting as the state board of equalization should be examined, and the statutes should be changed to clarify the apparent ambiguity.

11. Testimony offered and information received by this Commission justifies the belief that the present Commissioner of Taxation is bending every effort to require a standard of assessment procedure on the local level consistent with the statutory requirements, and that he has in all matters cooperated with this Commission.

Trust Funds

Various proposals to change the present provisions of the Minnesota Constitution providing for the payment of certain revenues to the permanent trust funds of the state were submitted to this Commission during the course of its hearings. Some of these proposals suggested that there should be no further accumulation of principal of these funds and that the revenues that are now directed to that purpose be diverted to some other use.

Before reaching any conclusion as to the desirability of such a move, it is essential that careful consideration be given to the history, present status and use of the income from these funds.

National Picture

A study[1] of state-owned trust funds was completed in 1952. This study defined a permanent trust fund as one which kept the principal inviolate, with only the income used for specified purposes. In general such funds originated from natural resources, including the sale of land grants, oil, minerals and forestry.

According to this survey, 35 of the 48 states had permanent trust funds in 1952, which totaled over one billion dollars. Two states held more than half of this total, Texas leading with $351 million and Minnesota ranking second with $217 million. The top ten states possessed considerably more than 90 per cent of the national aggregate.

History of the Minnesota Funds

The groundwork for the establishment of permanent trust funds was laid in the original Constitution of Minnesota which became effective when Minnesota was admitted to the Union, May 11, 1858. Minnesota, in becoming a state, would receive free land grants from the federal government under the provisions of the famous ordinance of May 20, 1785, which provided for the disposal of government land to the states. By congressional act the 16th and 36th sections in every township were designated for the support of schools.

Considerable discussion and debate preceded the adoption of Article VIII, Section 2, of the constitution. Although some delegates contended that the revenues from the sale of these federal lands should be divided so that each township had its own fund, others proposed that the school fund be used to establish a statewide school system without regard to the limitations of the townships or school districts. The following compromise was finally reached:

> The proceeds of such lands as are or hereafter may be granted by the United States for the use of schools within each township of this state shall remain a perpetual school fund to the state. . . . The principal of [these] funds . . . shall forever be preserved inviolate and undiminished; . . . . (Art. VIII, Sec. 2.)

The constitution also called for the selection of 72 sections of land, the sale of which should go to the University of Minnesota, and an act of 1870 secured an additional 72 sections with the provision that the revenues from the sale of these lands should constitute a Permanent University Trust Fund. The University in its early years did not receive support from state revenues and during this period used its income from sales of timber, hay and some land.

Other funds were subsequently established. The act of Congress known as the first Morrill Act (1862) provided for a fund to establish an agricultural college. This fund was transferred to the University in 1868.

Minnesotans did not originally realize that, as a result of the congressional act of 1841, the state was entitled to the lands which formed the basis for the Internal Improve-

[1] This study was conducted by the Honorable Val Bjornson, State Treasurer of Minnesota, and was the basis of a report by him to the National Association of State Treasurers.

ment Fund. A constitutional amendment establishing a permanent trust fund from the proceeds of the sale of these lands was adopted in 1872. It provided for the accumulation of the income until the electorate should approve its disposition. By an act approved by the electorate in 1884, the principal of the fund was to be used to pay off the 1857 defaulted railroad bonds. After these bonds were retired, an amendment adopted in 1897 dedicated the income of this fund to the State Road and Bridge Fund.

The Swamp Land Fund arose by reason of a congressional act of 1860 extending the provision of an act of 1850 donating swamp lands to the state. The permanent trust fund, however, was not established until 1881 when a constitutional amendment was adopted dedicating the proceeds from the sale of the remaining swamp lands to that fund. As presently provided by the constitution, one half of the income of this fund is dedicated to the same purpose as the Permanent School Fund and one half is appropriated by the legislature to state institutions.

Minnesota received a salt springs land grant and a grant of land for state buildings, in the Enabling Act of 1857. The grants for state buildings were used to pay for developing the present Capitol. The 10 sections of land granted in 1857 were not authorized for sale until 1901, after which they were sold and the state, in turn, received the highest average value per acre for these lands because of this delay. The salt springs lands were partially used to attempt to develop in Minnesota an early salt company. The remaining lands were transferred to the University of Minnesota in 1873.

A careful review of the lands granted Minnesota clearly indicates that considerable lands and proceeds from the sale of lands granted were disposed of in various ways other than being placed in the permanent trust funds. Among the uses, business development was of major importance and the largest grants for this purpose were made by the legislature to aid the early railroads—these grants were in addition to national grants for this purpose. Proceeds were also used by the University for geological and natural history surveys of the state.

The only grants actually originating when Minnesota became a state, and remaining undisturbed as a permanent trust, are the revenues from the school lands.

Some school and other public lands were better adapted for timber production than for agriculture. In 1914 the constitution was amended to provide that such lands be set apart as school forests of the state, and that the net revenue from public sale of the timber be directed into the respective trust funds.

The phenomenal growth of the funds has been partially due to the fact that iron ore has been mined on some of the lands, and the royalties from these mines have been paid into the funds. But more importantly, the increase in the funds resulted from a constitutional amendment, adopted in 1922, which permitted the levy of the occupation tax on iron ore. This amendment directed 50 per cent of the tax to the permanent trust funds as follows: 40 per cent to the Permanent School Fund and 10 per cent to the Permanent University Trust Fund. Since 1922 this single source has increased these two trust funds by over 109 millions of dollars.

At the present time the state of Minnesota has four permanent trust funds. In the following table no value has been included in the principal for the approximately 2,650,000 acres of unsold lands dedicated to these trust funds.

Status of Trust Funds Year Ended June 30, 1954

(1) Permanent School Fund

Present principal ---------- $192,597,325.16

Source: Mainly from proceeds of 40 per cent of the occupation tax on iron ore, royalty on iron ore mined from the trust fund lands,[1] and the sale or lease of school lands

Earnings ---------- 4,771,202.12

Distribution: To school districts according to the number of pupils between the ages of 5 and 21 in average attendance during the preceding year

Unsold land: 1,004,912.63 acres

(2) Permanent University Fund

Present principal ---------- 37,390,531.95

Source: Chiefly from the 10 per cent occupation tax on iron ore, royalty on iron ore mined from the trust fund lands,[1] and sale or lease of university land

Earnings ---------- 913,389.10

Distribution: To the State University

Unsold land: 26,040.56 acres

(3) Swamp Land Fund

Present principal ---------- 22,871,026.92

Source: Mostly from sale of state swamp lands and royalty on iron ore mined from trust fund lands[1]

Earnings ---------- 595,976.76

Distribution: One half to be distributed as provided for the Permanent School Fund. One half to be appropriated by the legislature for the educational and charitable institutions of the state

Unsold land: 1,612,570.91 acres

(4) Internal Improvement Fund

Present principal ---------- 402,323.50

Source: Mostly from sales of land and leases

Earnings ---------- 11,077.39

Distribution: Fund earnings go to the State Road and Bridge Fund

Unsold land: 7,004.35 acres

[1] These royalties received from the mining of iron ore under leases to the mining companies must not be confused with the taxes which are collected by the state on royalties paid by the mining companies to other owners.

Increases in Permanent Trust Funds, Fiscal 1954

	Internal Improvement Land Fund	Swamp Land Fund	Permanent School Fund	Permanent University Fund	Total
Sales of land, right of way, leases, etc.	$ 863.93	$ 62,559.92	$ 110,112.85	$ (335.90)	$ 173,200.80
Sales of timber, etc.	293.50	112,288.02	103,703.90	129.00	216,414.42
Interest on land contracts	604.00	----------	----------	----------	604.00
Penalties on land contracts	.26	----------	----------	----------	.26
Mineral permits and leases	--------	250.00	1,250.00	150.00	1,650.00
Royalty on mined ore[1]	--------	606,826.60	2,198,422.05	1,179,760.60	3,985,009.25
Occupation tax	--------	----------	11,032,760.38	2,758,190.04	13,790,950.42
TOTAL	$1,761.69	$781,924.54	$13,446,249.18	$3,937,893.74	$18,167,829.15

[1] These royalties received from the mining of iron ore under leases to the mining companies must not be confused with the taxes which are collected by the state on royalties paid by the mining companies to other owners.

Percentage Various Sources of Increase Are of Total Increase, Fiscal 1954

	Internal Improvement Land Fund	Swamp Land Fund	Permanent School Fund	Permanent University Fund	Total
Sales of land, right of way, leases, etc.	49.0	8.0	.8	.00	1.0
Sales of timber, etc.	16.7	14.4	.8	.00	1.2
Interest on land contracts	34.3	-----	-----	-----	.0
Penalties on land contracts	.00	-----	-----	-----	.0
Mineral permits and leases	-----	.03	.0	.00	.0
Royalty on mined ore[1]	-----	77.06	16.3	30.0	21.9
Occupation tax	-----	-----	82.1	70.0	75.9
	100.0	100.0	100.0	100.0	100.0

[1] These royalties received from the mining of iron ore under leases to the mining companies must not be confused with the taxes which are collected by the state on royalties paid by the mining companies to other owners.

Sources of the Total Accumulations of All Permanent Trust Funds from the Date of Their Establishment as of June 30, 1954 and Per Cent of Each Source to the Total

		Per Cent
Sales of land, right of way, leases	$ 20,779,807.48	8.1
State land contracts receivable	920,579.31	.4
Sales of timber, etc.	22,319,696.10	8.7
Mineral permits and leases	554,356.46	.2
Interest on land contracts	6,505.43	.0
Penalties on land contracts	6.84	.0
Profit on purchase or sale of bonds	3,423,813.33	1.3
Royalty on iron ore[1]	98,363,106.98	38.5
Occupation tax on iron ore	109,521,335.60	42.8
Total accumulations	$255,889,207.53	100.0
Less: Principal used to purchase Minnesota railroad adjustment bonds and Minnesota state funding bonds, then later cancelled and destroyed. This principal came from the proceeds realized from the sale of internal improvement trust fund lands as authorized by the constitutional amendment passed in 1884	2,628,000.00	
Remaining accumulations	$253,261,207.53	

[1] These royalties received from the mining of iron ore under leases to the mining companies must not be confused with the taxes which are collected by the state on royalties paid by the mining companies to other owners.

Investment of Permanent Trust Funds

The statutes of 1866 provided that the governor, the auditor and the treasurer serve as the commission for investing the permanent trust funds. The board was expanded by statute in 1873 by adding the chief justice of the Supreme Court and the president of the University Board of Regents. The constitution was amended in 1875 to provide, for the first time, for the control of the type of investment of these funds. It required that the funds be invested in U. S. bonds, Minnesota bonds except those issued before 1860 (to prevent purchase of the defaulted railroad bonds) and bonds of other states, although this last type of investment has never been permitted for the Internal Improvement Fund.

Loans to local governments were first permitted by the amendment adopted in 1886 authorizing loans from the Permanent School Fund for county and school buildings. Any loan could not exceed 3 per cent of the assessed value of the real estate of the county or district, and the interest rate minimum was 5 per cent. This 1886 amendment specified that the governor, the treasurer and the auditor should constitute the investment board for these loans. Subsequent amendments have extended these loans as investments for all the trust funds except the Internal Improvement Fund, increased the maximum loan permitted to 15 per cent of the assessed value, set the minimum length of loans at one year and the maximum at 30 years, and reduced the minimum interest rate on loans to 2 per cent (statutes permit a minimum of 1 per cent for bonds of other states for the three funds permitting this type of investment).

By statute in 1917 the administration of investments was entrusted to a secretary of the investment board, aided by a clerk. By statute, the composition of the board is now the governor, the auditor, the treasurer, the attorney general, and a member of the Board of Regents of the University of Minnesota. The size and composition of the staff has not been changed.

The limitation (provided in 1904) on loans to local governments to a maximum of 15 per cent of their assessed value has progressively restricted these investments. This is the result of the combined application of the classification law, which provides that assessed value is legally the assessed taxable value, and also the assessment practice of setting the assessors' full and true values at substantially less than current market values.

The combined income derived from all permanent trust funds of this state is presented in the following table. The purchasing power of this income is shown in the right-hand column. It is to be noted that the investments permitted are such that they do not vary materially in asset value with changes in general economic conditions.

Trust Fund Income in Dollars, 1930 to 1954 And in Purchasing Power, 1930 = 100

Year Ended June 30	Total Principal of Trust Funds	Total Income of Trust Funds	Per Cent Earned on Principal[1]	Index of Consumer Purchasing Power of Dollar 1930 = 100[2]	Effective Purchasing Power of Trust Fund Income in 1930 Dollars
1930	$ 74,964,084	$2,918,611	3.89	100.0	$2,918,611
1932	80,742,463	3,094,596	3.83	122.2	3,781,596
1934	82,669,655	2,978,828	3.60	124.8	3,717,577
1936	86,452,348	3,574,077	4.13	120.3	4,299,614
1938	97,967,030	3,531,517	3.61	118.3	4,177,784
1940	102,322,702	3,207,756	3.14	119.1	3,820,437
1942	117,573,590	3,713,745	3.16	102.4	3,802,784
1944	134,354,880	3,713,351	2.76	94.9	3,523,970
1946	151,350,585	4,446,428	2.94	85.6	3,806,142
1948	169,378,023	4,573,079	2.70	69.5	3,178,289
1950	192,693,846	4,741,454	2.46	69.5	3,295,310
1952	221,517,246	5,280,609	2.38	62.9	3,321,503
1953	235,093,378	5,581,215	2.37	62.4	3,482,678
1954	253,261,208	6,291,645	2.48	62.1 est.	3,907,111 est.

[1] Variations in accounting procedure are responsible for some of the fluctuations shown in the earlier years in this column.

[2] Based on Consumer Prices as received from Department of Commerce.

Reference to the fourth column in the foregoing table, headed "Per Cent Earned on Principal" demonstrates the effect of the general decline in interest rates that has occurred during the last quarter century. Under the existing constitutional limitations on the investment of these funds, not much improvement in the yield can be expected unless there is a general increase in all interest rates.

Philosophy of Permanent Trust Funds

There should be no criticism of the wisdom, judgment and high ideals of the framers of the Minnesota Constitution for the establishment of the Permanent School Fund, nor of the citizens of this state who subsequently amended that document in order to create other permanent trust funds. However, almost a century has passed since the original idea was written into the fundamental law of this state and it is proper that the principle of establishing state trust funds and the results and benefits derived from them should be carefully reappraised in the light of present and future conditions.

Thrift is a common attribute and was probably more nearly responsible for the creation of these funds than any other motive. In the light of the historical review already presented, the rather generally accepted idea, prevalent today, that these funds were established to preserve the benefits of depleting natural resources for future generations can hardly be substantiated. Although a moderate amount of revenue was paid into these funds from the sale of timber, they had all been created prior to the shipment of any iron ore from Minnesota and even before the discovery of the Mesabi iron range. The large revenues that have accrued to three of these funds from royalties on the mining of ore located on trust-fund lands could not have been foreseen when the funds were established. The amendment diverting tax revenue from mining to two of these funds was adopted only 32 years ago.

Perhaps it would be well to digress for a moment and examine the basic principle of a state establishing this type of trust fund. To the citizen who saves some of his income, such savings represent a bulwark against a time of adversity, or possibly a provision for his old age, and the same individual probably views the state trust funds as a protection for the state in time of adversity. On the contrary, Minnesota's state funds cannot be used in such an emergency unless the Constitution is amended, which requires that two thirds of the members of both houses of the legislature agree to submit the proposal to the electorate, and a majority of those voting at the next general election must vote favorably on such a proposal. To the extent that the funds produce income, they do relieve the burden of taxation that would otherwise have to be levied.

Then there is the broader question of whether a sovereign state, without restrictions on its powers of taxation, has any occasion to build up large funds, especially insofar as current revenues raised by taxes are diverted into such funds. The real effect of this diversion of tax revenues is to deprive today's citizens of some of their means of livelihood in order that future generations may have more to spend.

It may be recalled that 35 of the 48 states have permanent trust funds; 34 of these states derive these permanent funds, in part, from sales of lands. Only five states have permanent funds which exceed 50 million dollars. It is clear that the states with unsold lands having exceptional natural resources have been benefited and that in these states, substantial proceeds for their permanent trust funds have been derived from leases and royalties. Minnesota, however, is unique among the states in providing additional trust-fund revenue derived from severance taxes; Louisiana is an example of the other extreme in that it has no permanent trust fund, and uses the proceeds of its leases, royalties and severance taxes for current revenue needs.

However, the history of the Minnesota trust funds shows that about 60 per cent of their principal has been derived from lands that were given to the state by the Federal Government. This is obviously in the nature of a windfall, and very strong arguments can be put forth in support of the position taken by those who believe that these monies should be retained as a permanent trust fund. Perhaps the strongest argument against such a procedure is that many of the other states did not do so.

This Commission Concludes and Recommends That:

1.[2] No maximum limitation should be established upon any of the state's permanent trust funds.

2.[2] No expenditure of the principal of any of the state's permanent trust funds should be approved.

3.[2] All funds received from the remaining lands contributed to the state by the United States Government and dedicated to the permanent trust funds of the state should continue to be added to the principal.

4.[2,3] If the legislature deems it wise to submit to the voters a constitutional amendment to appropriate any of the funds now directed into the trust funds for other purposes, such a diversion should be confined to a portion of the revenue to be received from the occupation tax on the mining of iron ore.

5. The legislature should consider the advisability of submitting a constitutional amendment for the purpose of increasing the yield upon the principal of the state's permanent trust funds from

   (a) the fixed income securities now authorized but which cannot be purchased because of the narrow limitations now prescribed in the constitution,

   (b)[4] investing a limited portion of all permanent trust funds of the state in other than fixed income securities, providing for proper and adequate safeguards including a competent investment board whose members shall all have had adequate experience in this field of investment.

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[2] Senator M. H. Anderson dissents in part from the recommendations numbered 1 through 4 inclusive, and would recommend that the growth of the permanent trust funds should be slowed down by diverting a portion of incoming revenues (not interest income) to the state's general revenue fund where it would then be available for appropriation to meet current expenditure needs.

[3] Senator G. T. Mullin concurs in the recommendations except a reservation to further consider the desirability of recommending that none of the iron ore occupation taxes should be dedicated to the permanent trust funds.

[4] Senator A. R. Johanson dissents from approving recommendation numbered 5(b) and opposes any changing of the investments permitted so as to include the purchasing of securities issued by private corporations for the permanent trust funds.

Restricted Revenues

By provisions of the Minnesota Constitution or through legislative enactment a large portion of the state's revenue is restricted as to use. In the fiscal year ended June 30, 1953, 79 per cent of the total income of the state was subject to some form of restriction and only 21 per cent was unrestricted.

In order to avoid confusion the following terms have been adopted for use in this report in accordance with the designations set opposite them:

Dedicated Revenues—Those limited by constitutional provision.

Earmarked Revenues—Those limited by legislative action.

Restricted Revenues—An inclusive term covering both dedicated and earmarked revenues.

From the foregoing definitions it is obvious that to effect a change in **dedicated revenues** will require an amendment to the Constitution while a change in **earmarked revenues** requires only legislative action.

Because Minnesota has apparently restricted so large a portion of its state income, considerable interest has been expressed as to the desirability of this procedure. Some states apparently operate with little or no restriction on their funds, and the question which has been discussed by numerous witnesses appearing before this Commission is whether or not Minnesota's restrictions provide this state with a more efficient fiscal operation. To show the extent to which this state has restricted the use of its funds, the following table covers the principal items of revenue and indicates the restrictions applicable to the fiscal year 1952-1953. (See table on next page.)

Because of the fact that it was mentioned in the act creating this Commission, the members feel that this report should include some discussion of the principle of dedicating and earmarking revenues. However, the Legislature's charge is limited to studying the tax structure of the state, and consequently the only approach to restricted revenues given consideration here is whether or not the tax structure of the state and local governments would be improved by more or less restriction on revenues.

At the outset let it be clearly understood that these restrictions apply only to the use of the funds derived from a given source and not to the rate or amount of the tax to be levied. This is true of those revenues dedicated by constitutional provision as well as those earmarked by legislative action as demonstrated by the fact that there have been several changes in the applicable rates of taxation in both categories.

Although another commission is currently studying the use and rate of the highway revenue, the taxes on gasoline and the motor vehicle fees together constitute 25 per cent of the state revenue, and it is fair and proper to raise the question: Would the state's tax structure be improved if this dedication were removed? Those who feel that some portion of this revenue should be used for other purposes will answer in the affirmative, but they might ask themselves the question: Were it not for this dedication would the constitutional amendment creating the highway system ever have been approved by the voters?

When consideration is given to legislative earmarking of revenues there is perhaps more room for argument. For example, the question of restricting the income tax to education cannot be substantiated on the user principle, so often applied to the highway revenues. The income tax accounts for 20 per cent of the state revenue, and there are many citizens who believe that part of this revenue should be used for other than primary and secondary educational purposes. This is a special situation among the state's revenues and it is well to go back to the time the law was first enacted to see why it was restricted. It was

Per Cent of Taxes and Other Revenue Restricted, 1952-1953 Showing Each Source as a Per Cent of the Total Revenue

Per Cent of Total State Revenue	Revenue Source	Per Cent Restricted	Source of Restriction	Function Supported By Restricted Revenue
	Taxes:			
20	Income	100	L[3]	Elementary and secondary education, university, soldiers' home, soldiers' bonus
16	Gasoline[1]	100	C[3]	Highways
9	Motor vehicle[1]	100	C	Highways
4	Property[2]	99	L	State debt and retirement funds
6	Iron ore occupation[1]	59	C & L	Trust funds (university and elementary and secondary education), Iron Range Resources Commission, soldiers' bonus
2	Other:	40	L	States' share:
	Mortgage registration			State office and specific cities
	Fire marshals' tax, firemen's relief, etc.			State for specific debts
	Airflight properties and license			20 per cent to counties
	Inheritance and gift			Soldiers' bonus and local units
	Bank excise			General revenue, etc.
	Oleo and miscellaneous			
5	Liquor	31	L	Local government, soldiers' bonus
4	Cigarette	25	L	Local government
1	Iron ore royalty	8	L	Soldiers' bonus
7	Gross earnings		L	
74	Total taxes	75		
	Other Revenues:			
17	U. S. grants—aid	100	F[3]	Functions for which grants made
3	Interest earned[1]	85	C & L	To fund from which earned (mainly educational, state institutions, trunk highway and retirement)
	Other Fines, etc.[4]	85	L	
6	Department earnings:	58	L	To respective departments
	Service and inspection fees			
	Sales of products			
	Hunting and fishing licenses			
	Hospital charges			
26	Total other revenues	90		
100	Total all revenues	79		

SOURCE: Department of Administration

[1] Gasoline and motor vehicle taxes are dedicated to highway use by constitutional provision. Also by constitutional provision 50 per cent of the 11 of the 12 per cent occupation tax on iron ore is dedicated to the permanent trust funds and all of the income from these trust funds is dedicated to specific uses, mainly education.

[2] By action of 1953 legislation, Minnesota will, for 1954-1955 and 1955-1956, levy a property tax for general revenue purposes.

[3] C—Minnesota Constitution; L—Legislature by statute; F—National government.

[4] Less than ½ of 1 per cent.

passed at the 1933 session of the legislature —the same one that enacted the mortgage moratorium law, when many people were unable to pay the taxes, much less the mortgages, on their homes. In the judgment of the members of the legislature at that time, restricting the revenue from the income tax to the cost of education, would lessen the property taxes that would have to be levied for school purposes.

Although there have been times since the law was originally enacted when a surplus has accumulated in this fund, the legislature has always been in control of all disbursements and the only question for this Commission to consider is whether or not the tax structure of the state would have been improved if the revenue from the income tax had not been earmarked. Here is a case where it is easy to imagine the demands that would have been made for expenditure of state funds if the surplus from the income tax had been unrestricted. And this leads to the question of where would the schools now be obtaining the funds they need for increased enrollment and salaries? The answer is that the already burdensome taxes on property might be higher than they now are if this revenue had not been restricted.

The other restrictions of tax revenue created by legislative action are mainly caused by the levying of special taxes for a specific purpose such as the soldiers' bonus and provisions for sharing revenue from certain taxes with local government.

The only other tax revenue restricted by constitutional provision is half of the receipts from the occupation tax on the mining of iron ore which is to be added to the principal of the school and university trust funds. This, together with the constitutional restriction on the use of the income from the trust funds, is discussed in the section of this report entitled, "Trust Funds."

Minnesota receives 17 per cent of its total revenue in grants and shared revenues from the national government. These monies are classed as restricted revenues and have a variety of influences in the study of the state's finances. In all cases, the monies are received by the state subject to specific restrictions imposed by Congress and the national administrative agencies. For some of the funds, the state acts only as an administering agency in receiving the money and, in turn, transmitting it to the local units of government entitled to receive the payments. The majority of the funds are, however, highway and welfare aids which, in large part, represent authorized reimbursement to the state for part of the money spent on federal-state matching programs. These are mainly dependent on legislative action in establishing the programs and in providing for the necessary state financing and administration. It should be noted that Minnesota does not restrict its state activities in these areas to the extent of the federal-state joint contribution.

Referring back to the table on page 35 it will be noted that the constitutional dedication of funds to the highways, the constitutional transfer of 50 per cent of the occupation tax to the trust funds, and the constitutional provision for distribution of the income from the trust funds, are the only expenditures in this entire list over which the legislature does not exercise full control. Of these only the occupation tax trust fund portion is exempt from some control by the legislature.

This Commission Concludes That:

It is not generally considered good fiscal policy for a state to operate with such a high proportion of restricted revenues, but it is the considered judgment of this Commission that, aside from its conclusions regarding the trust funds set forth elsewhere, there would be no material improvement in the Minnesota tax structure by the elimination of any of these restrictions and the expenditures of the state might be greater than they are if there were no such restrictions.

Taxes on Agriculture

According to the 1950 census, 14.5 per cent of the labor force in Minnesota was engaged in farming, and during that year about 15 per cent[1] of the income received by individuals in this state was derived from agriculture. These percentages are approximately twice the national average[1] and indicate that farming is still important in this state in spite of a greater than average decline in our farm population between 1940 and 1950.[2] In addition, Minnesota ranks fourth highest in the percentage of manufacturing employees engaged in the food and kindred products industry,[3] showing the dependence of a substantial portion of our factory workers on our agriculture. Furthermore, some transportation and marketing workers are engaged in activities related to our agriculture.

In the general theory of taxation, it is the ultimate consumer who pays the taxes, but taxes on agriculture, like many of those in industry, can only be passed on insofar as competitive conditions permit. The great bulk of Minnesota's agricultural products are sold by the producers at prices which are fixed at the national level or are on a competitive basis. Therefore the farmer has no opportunity to adjust his prices upward because of any above-average taxes imposed by state and local government.

That his taxes are above average is indicated by the following table showing the average state and local taxes per acre and per $100 of value on farm property in the Midwest region.

While Minnesota's high rate of taxation on farm real estate no doubt stems in part from an above-average reliance on property taxes, it is nevertheless accentuated by the fact that the average of the assessors' full and true value is nearer to its market value than is true of urban property. This is shown by the testimony presented by the Commissioner of Taxation, which did not include the consideration of values in cities of the first class, and is dealt with elsewhere in this report.

Taxes Levied on Farm Real Estate in 1953[4]

	Per Acre	Per $100 of Value
East North Central		
Illinois	$2.61	$1.22
Indiana	1.57	.91
Michigan	.92	.77
Ohio	1.41	.81
Wisconsin	1.81	1.82
Average	1.78	1.10
West North Central		
Iowa	2.27	1.23
Kansas	.85	1.10
Minnesota	1.56	1.59
Missouri	.60	.83
Nebraska	.80	1.12
North Dakota	.44	1.18
South Dakota	.54	1.26
Average	.97	1.20
United States average	.81	1.00

Several times during the hearings conducted by this Commission arguments were presented in favor of exempting from taxation farm improvements, other than homestead. In the main the proponents of this change in the taxation of farm real estate were of the opinion that the levy on these improvements tended to discourage the erection and repair of farm buildings. This argument, carried to its logical conclusion, can be used with equal force to additions to urban residences, modernization of commercial properties and the installation of labor-saving machinery in factories. In the interest of general tax equity it does not appear reasonable that any one of these should be singled out for preferential treatment nor that all of them should be exempted from taxation.

[1] Adams, John F. *The Economy of Minnesota*, 1952, Minnesota Division of Employment and Security, p. 155, and 1954 *Statistical Abstract of the United States*, p. 198.

[2] Adams, p. 240.

[3] *Ibid.*, p. 265.

[4] *Taxes Levied on Farm Real Estate in 1953*, August 1954, U. S. Dept. of Agriculture.

A more pertinent argument in favor of exempting farm improvements stems from the present economic trend toward larger farms. To illustrate this point, years ago a section of land was divided into four 160-acre farms, each with its own residence and farm buildings. Three of the owners have moved out of the state and the fourth is leasing and operating the entire section. The owners of the leased property want the buildings removed or destroyed so as to lower the tax burden and at the same time increase the productive area and consequently their share of the crop. Those who favor the elimination of taxes on farm buildings point out that the operator's buildings will be serving all four quarter sections and that the taxes should be equalized by only taxing the land on the basis of its productivity. This would lower the value and taxes on the operator's quarter section and increase those of the lessors.

In spite of the apparent logic and equity in these arguments there are parallel situations in our urban centers and it is unreasonable to conclude that one should be relieved unless relief is granted to the others. For example, in our larger cities the automobile has created many problems, not the least of which is parking. Some of the owners of older properties have had the buildings removed or destroyed so the land can be used as parking lots. This has resulted in substantial tax savings to the owners. Should the taxes on the adjacent store and office buildings be lowered and additional taxes be placed on these parking lots? Or should the downtown area of our cities be taxed on the land only, regardless of the size and value of the structures? These farm and city problems are both the result of modern progress and, while every effort should be made to keep the tax system adjusted to new developments, the proposed solution places a penalty on progress.[5]

Another proposal submitted to this Commission would place a progressive tax on farm lands—the greater the acreage owned, the higher the rate per acre. Here again, with the trend toward larger farms, is an attempt to tax modern progress. Why should one section of land divided into four farms make a smaller contribution to government than an adjoining section operated as one farm? The section with four farms will make a much heavier demand for government services such as schools and roads. Why then should the taxes on it be lowered? What will prevent the owner of the full section from selling three fourths of his land and operating it under lease? What is the size of the tract to which the minimum tax will apply and how is the progression to be calculated?

Although real estate taxes appear to be the primary concern of the farmers, personal property taxes place unequal burdens on their operations. While the May first assessment date is treated more broadly in another sec-

[5] Senator A. R. Johanson is not in accord with the views expressed in the preceding three paragraphs of this report and makes the following statement setting forth his objections:

"The report fails to take into consideration the distinction between agricultural lands which are actually occupied by the owner, or by a tenant of the owner, as distinguished from unimproved farm lands where the operator lives at a distant point. The effect of the present taxing system on farm improvements is derogatory and tends towards a definite discouraging of either building farm homes and appurtenances, or improving or maintaining farm homes and buildings which are already in existence.

"I would urge the abolition of taxes on farm homes and buildings when they are occupied by a bona fide farmer or by his tenant who operates the land as a bona fide farmer.

"The derogatory effect that I have in mind is the tendency now to either move farm buildings which do not continue to be farm homes into adjoining urban centers to create dwellings and for additional income; or the failure to maintain or repair existing buildings allowing them to fall into a dilapidated condition and their becoming unuseable for living occupancy.

"We must face the fact that most of the lands in Minnesota which are rented to tenant operators are upon leases providing for shares of the crops produced. Therefore, there is just as much income for the owner of a bare piece of land as there is from a piece of land improved with expensive buildings, constituting a home. At the present time there is an urge on the part of landowners who do not live thereon to allow the buildings to be moved away or allow them to depreciate into obsolescence for the simple reason the maintenance of the buildings does not increase the percentage of crop share under leasing arrangements. Throughout the state of Minnesota this has visibly brought about the abandonment of farm buildings or yards and the allowing of farm buildings to become dilapidated. This situation is startling and discouraging and the facts support the conclusion that the reason for this situation is excessive taxes and the burden created by the present tax structure on farm improvements."

tion of this report, it is pointed out here that it tends to unbalance a number of farm operations, causing the marketing of livestock and crops before they might otherwise be sold and delaying the purchase of tractors and other equipment. Some witnesses have stated that this date tends to penalize the livestock raiser more than the grain grower and, while this statement may be open to debate, this Commission has not received any proposals from the agricultural industry that seem to be an improvement over the May first date.

Personal property taxes as applied to agriculture are partially a tax on the tools of production (farm implements) and partially a tax on the annual products of the farm. When agriculture was distressed, the legislature in 1923 lowered the assessed value of both agricultural products in the hands of producers and agricultural tools, implements and machinery used by the owner in an agricultural pursuit, to 10 per cent of their full and true value, and the legislature in 1933 lowered the assessed value of livestock to 10 per cent. With the return of more favorable agricultural conditions, the legislature in 1941 raised agricultural tools, implements, machinery and livestock to an assessed value of 20 per cent. These lower assessed values are compared with the 33⅓ per cent for tools, machinery, raw materials and finished goods in manufacturing. The legislature has also provided that farm real estate shall be assessed at a lower per cent of full and true value than is applied to urban real estate but, as discussed elsewhere in this report, the present assessing procedure has circumvented that provision in many instances.

This Commission Concludes That:

The general recommendations with relation to this portion of the report are contained in the section entitled, "Assessment Procedure."

Taxes on Commercial Enterprise

The term "commercial enterprise" has been used in this report to include all forms of business activity except manufacturing, farming, the professions and businesses subject to special taxes, which are covered in other sections.

When a businessman buys and sells commodities or renders a service, his obvious purpose is to make a profit. It is also clear that his profits will result from any margin he can obtain over and above the cost of his goods or services and the expenses of conducting his business. Under such conditions, any taxes imposed upon him are part of his expense of doing business, just as much as the labor he may hire or the rent he may pay. If he is to continue to operate his business profitably, all taxes he pays must be passed on to the ultimate consumer in the price of the goods or services. Otherwise his business is unprofitable and will very likely have to be discontinued.

If all of the business in Minnesota were conducted within the state's borders and if all taxing districts within the state levied equitable taxes on competing businesses, the extent to which taxes are imposed on commercial enterprise, within reasonable limits, would not be subject to justifiable criticism. But the two foregoing conditions are not met in Minnesota; all business is not conducted within the state's borders, and taxes are not levied on an equitable basis between competing businesses. Insofar as the latter point stems from the assessment procedure in this state, it is dealt with in the section of this report devoted to that subject. Where it is caused by differing rates of taxation applied to those assessed values, it is the result of varying requirements for revenue among the local units of government and the multiplicity of overlapping taxing units within this state.

To the extent that commercial enterprise in Minnesota is in competition with business concerns in other states which impose lower taxes on competing firms, the profits of Minnesota businessmen are adversely affected. The wholesaler who distributes his merchandise in a number of states and the local merchant subject to mail-order competition are obvious examples of this type of competition.

During the course of the eight regional hearings conducted by this Commission, many representatives of commercial enterprise presented evidence showing where, in their opinion, their taxes were burdensome or inequitable. Several of these witnesses went only so far as to demonstrate that on some comparable basis the taxes imposed on them were too high. Insofar as they made no competitive comparisons, they joined the general complaint that taxes on all forms of business, including farming, are unduly burdensome. Many, if not most of those who indicated they were operating under a competitive disadvantage, presented cases which clearly stemmed from the inequalities in our assessment system or the May first assessment date.

Very little testimony regarding competition with business concerns in other states was presented by those engaged in commercial enterprise. However, some evidence indicated the possibility of a competitive advantage in Minnesota cities which border on states that impose a sales tax.

Some cases merit special mention. Cheese merchants who age their product are penalized by the imposition of the personal property tax on May first, while similar aging of cheese in Wisconsin is not subject to any tax.

A somewhat different difficulty arises in connection with the warehousing of perishable goods in Minnesota. These goods move in and out of cold storage plants and public warehouses during the course of any year but the owner who is unsuccessful in removing his wares before May first has to pay personal property tax on them. As these products are usually handled on narrow margins, the tax may be in excess of the entire profit. It is contended that the storage of these goods in

Minnesota is materially lessened by reason of this tax.

Complaint was made on behalf of local government against the present method of taxing trailer camps. The evidence pointed out that these camps had been presumed to be for the accommodation of transients but, to the contrary it was shown that some owners occupy the camps for long periods of time, sending children to the local schools and making an insignificant payment toward the cost of their education. Education is not free but on the contrary is very expensive.

The commercial enterprise group made many pleas to this Commission for the complete elimination of the personal property tax, and some suggested substitute taxes, principally a retail sales tax. The basic argument for most of these proposals was the inequality of assessments between competitive businesses, again demonstrating the fact that many of the tax problems in this state are caused by the assessment procedure.

Some witnesses showed that the amount of the taxes levied, particularly on personal property, was a much higher proportion of their profit than was the case in other lines of business. This, of course, raises the question of why don't the merchants with narrow margins of profit increase their sales price? And the obvious answer is that competition will not permit them to do so. From a standpoint of tax equity it is only important that competing forms of enterprise be taxed on the same basis. That one type of business may have a wider margin of profit than another is an inherent element in our competitive free enterprise system, an element which obviously must be weighed by those who invest their capital in any venture.

This Commission Concludes and Recommends That:

1. The evidence before this Commission justifies the belief that storage of goods in public and private warehouses is discouraged by taxing such stored goods as personal property on May first. This Commission recommends that legislative investigation of this problem should be undertaken which would consider the factors of the perishable nature of goods, the storage in original packages, and the ownership of the stored goods, for the purpose of enacting a more equitable tax on personal property stored in public or private warehouses.

2. This Commission recommends that the legislature re-examine the tax contribution of occupants of trailers with a view to increasing their contribution to education.

Taxes on Manufacturing

A dictionary definition of manufacturing is "the making of wares or other products by hand, by machinery or any other agency." However, for the purpose of this report a more technical definition is needed, and the following is quoted from the Iowa revenue statutes: "Manufacturer defined—Any person, firm or corporation who purchases, receives or holds personal property of any description for the purpose of adding to the value thereof by any process of manufacturing, refining, purifying, combining of different materials or by the packing of meats with a view to selling the same for gain or profit shall be deemed a manufacturer . . ." (Section 428.20.)

During several of the hearings conducted by this Commission, many representatives of manufacturing concerns stated their objections to the state and local taxes imposed upon them, and illustrated the points they presented with factual data. Their primary criticism was directed toward the personal property tax, although some of the material submitted indicated that real estate levies, as well as the over-all tax burden on manufacturing, were excessive.

Before discussing these claims, it appears desirable to examine briefly the effect of state and local taxes on the manufacturer, and the reasons for the location of his plant in a given place. As to the latter point, the greatest single factor in determining the city or town in which a new manufacturing plant will be situated is the residences of its principal owners. As these small business concerns grow to greater size, some of them do migrate but it has been estimated that approximately 90 per cent of all manufacturing concerns are still located in the same community in which they commenced business. This applies to most of the older industrial plants in Minnesota.

Of course, some locations are determined by the sources of their raw material, such as the taconite plants, and there are other contributing factors including marketing area, power and transportation, but, once established, there is a strong tendency to remain. It is highly improbable that any company has moved from Minnesota or any other state solely because of high taxes. Although taxes may have been an important contributing factor—and even the determining one—it is safe to assume that there were other contributing causes.

A state is not likely to obtain new industries via low taxation alone. Some states have come a long way in reducing the direct taxes on manufacturing operations yet find it difficult to attract new plants, and conversely there are states which are highly industrialized in spite of heavy direct taxes. It is safe to assume that some factors are singularly more important than taxes in determining the location of a new plant or branch. Some recent independent studies rank taxation in the lower half rather than the upper half of the list of reasons why industries generally locate where they do.

However, this is not to say that therefore taxes are inconsequential. Industry, to exist and provide jobs, must make a reasonable profit, and must treat taxes as part of its cost of production. To quote from the 1953 study made by Dr. Arthur M. Borak of the University of Minnesota:[1]

> Finally, industrial management is now giving more attention to the tax load than formerly. A couple of decades ago taxes were not as large an item in the cost of doing business as today. Certainly interstate tax differences, whether or not designed as competitive bait by the low taxers or no taxers, constitute one of the factors in the location of industry. Placing tax bargains or favored treatment aside as economically unsound in the long run, nevertheless, it can be said that a single state treads on dangerous ground in placing comparatively high taxes on business, no matter how meritorious the tax or the services it finances may be from the point of view of popular support or general social interest.

If a tax can be safely shifted to the consumers in higher prices, it will have little

[1] *Business News Notes*, University of Minnesota, June 1953.

effect on the location of an industry. An industry which cannot shift the taxes because of competition from outstate firms with lower taxes would at least give other states consideration in expanding its facilities. Recent studies indicate that, though taxes are not of first importance, they are becoming increasingly more important to industry in determining its location. Minnesota must meet this fact squarely in any program it chooses to adopt to encourage industrial expansion within its borders.

There has been a noticeable increase in the number of branch plants which have been opened since the end of World War II. Before the managers of the concerns opening these branches select their locations they examine a number of factors to determine the most advantageous site. These factors will include proximity to markets for their products and cost of transporting raw materials to the plant, in respect to which Minnesota is generally at a disadvantage except for the processing of agricultural products and the treating of natural resources found within the state. These managers will also examine the supply and efficiency of labor, and here Minnesota has an above average rating. Some industries may find the climate in this state unsuited to their requirements, while it may be advantageous for others. Those requiring substantial quantities of cheap power will possibly be attracted to states having large hydroelectric installations. However, the abundant supply of water provided by Minnesota's 10,000 lakes and subterranean water resources should prove attractive to many industries. Among other considerations the taxes to which the plant and its contents will be subjected will doubtless be investigated. Individuals who contend that taxes are the first or prime consideration of those who locate branch plants can hardly support their position in the light of the usual procedure followed. However, as mentioned above, Minnesota's geographic location places it in an unfavorable position for some industries because of excessive transportation costs, and if the state and local taxes are also unfavorable, they can be the determining factor. This is especially true when all other conditions are substantially the same and the taxes are lower in a neighboring state.

Turning now to the effect of state and local taxes on the manufacturer, it is rather obvious from the above statement that in this respect there is important competition among the states. To illustrate this point, if a manufacturer is considering locating a branch plant in one of the southern Minnesota cities, he will very likely compare the state and local taxes he will have to pay with those imposed by Iowa, Illinois and probably Missouri. According to data submitted to this Commission, Minnesota would have to offer some other rather important advantage to offset the higher taxes required in this state under the existing tax structure.

This Commission is also aware of the fact that during its study of this subject certain Minnesota manufacturing concerns announced the opening of branch plants in other states, and in so doing stated that their primary reason was because of the lower taxes imposed on these branches than would have been imposed had they been erected in Minnesota. This Commission is also aware of the offers made by certain states to finance new plants at low cost for new industries and to exempt or lower the taxes on such plants for a period of time. This Commission is of the opinion that this is an undesirable procedure, and furthermore it believes that well-managed American industrial corporations do not object to paying taxes on their property which they consider fair and equitable and competitive with those in other states.

Of course, the obvious question raised by this discussion is in what category are Minnesota taxes higher than in other states? The answer, from the data submitted, indicates that in this state higher state and local taxes are applied to manufacturing operations in all categories than is the case in some competing state. However, the outstanding example in practically all data submitted shows the personal property tax to be the most oppressive tax on manufacturing. It taxes the tools of production and places a penalty on the industry that has a high inventory on the assessment date.

The numerous complaints by representatives of manufacturing concerns against high personal property taxes raise the question of the assessment standards used by the assessors. The data submitted to this Commission by the Commissioner of Taxation does not deal with personal property, and very little information was supplied by the industrial representatives dealing with this subject. There is some indication, however, that in the larger manufacturing centers a higher assessment standard is applied to industrial plants and inventories than is true of most other property. This probably accounts for the observation that in cities in Minnesota ranging upward from 10,000 population objections of manufacturers to the personal property tax increase somewhat in line with the industrialization of the community.

If the citizens of Minnesota desire to increase employment within the state sufficiently to stop the present exodus of population from the state, the only opportunity afforded them is to create more jobs in manufacturing industry. As to certain industries, Minnesota is disadvantageously located geographically and, in the opinion of this Commission, the state and local taxes imposed upon manufacturing are well above those in competing states. The citizens of Minnesota can do nothing to alter the geographic location of the state nor change its climate but, if they so choose, they can, through their legislature, lighten the burden of taxation on manufacturing industry.

A rough estimate of the total personal property taxes to be collected from manufacturers during this year is somewhere in the vicinity of 15 million dollars. Some fraction of that tax must be shifted if Minnesota is going to place these levies on a basis competitive with other states. As all but a small portion of this tax revenue accrues to local government, this Commission is reluctant to recommend any reduction in these taxes. However, if additional industry were to locate in the state, the loss in revenue could be offset over a period of time.

Historically, the classification law passed in 1913 provided for the taxing of livestock on 33⅓ per cent of its full and true value and all other farm personal property, except household goods, at 40 per cent of full and true value. When it became evident that agricultural taxes were too burdensome, these percentages were lowered, and today livestock, tools and machinery used by the owner in any agricultural pursuit are taxed on 20 per cent of their full and true value and agricultural products in the hands of the producer are taxed on 10 per cent of their full and true value.

When it became apparent that this state might lose a projected oil refinery to a neighboring state, the legislature reduced the classification rate to be applied to the full and true value from 40 per cent to 27 per cent in respect to real estate occupied by refineries, and from 33⅓ per cent to 17 per cent for their personal property. As a consequence, oil companies have erected and projected refineries costing several million dollars in Minnesota, which will add to employment as well as serve to increase the tax base.

Favorable low rate taxes have been devised to assure reasonable taxation of taconite, and thus encourage the now apparent development of this important industry in Minnesota.

This Commission Concludes and Recommends That:

1. To encourage and promote the growth and expansion of present industries and to promote the influx of new industry into the state, the present classification rate on manufacturers' personal property be changed to conform with those on agricultural personal property; i. e., that the rate on manufacturers' equipment, including attached machinery, be lowered to 20 per cent and the rate on inventories be lowered to 10 per cent. This Commission believes that this will be of long range benefit to all of the people of the state, and that this will encourage the expansion of industry in the state, will increase the tax base, will create more jobs for people throughout the state and will enhance our economic welfare. This Commission recognizes that the loss in revenue to the local taxing units will have to be replaced by some new method of raising revenue. A new revenue method should be spread fairly and equitably over all the people of the state.

2. The present lack of uniformity in assessment procedure results in taxing some manufacturers' personal property as real estate to the extent that manufacturers are paying on a considerable portion of their property at excessive classification valuations. This Commission recommends that the laws of this state be amended to establish a clear, workable definition of the distinction between real and personal property, to be followed by subsequent administrative procedures to insure, in practice, conformance with the law.

Taxes on Individuals

The legislature charged this Commission to recommend an over-all tax structure that, among other things, would "produce the necessary income with a minimum of duplication and hardship on individuals, particularly those in lower income brackets . . ." This Commission is not charged with any responsibility to investigate the level of expenditures by the state of Minnesota or its subdivisions. However, it is necessarily true that the burden of taxation on individuals is determined in the final analysis by the amount of their income in relation to the taxes they must pay.

One of the fundamental principles of taxation is that only individuals pay taxes. Any taxes imposed on business enterprise are added to the cost of doing business insofar as possible, and are passed on to the ultimate consumer in the price he pays for his goods and services—usually at a profit to the business concerns. They are in effect hidden sales taxes, and hence the real burden rests on the individual.

Under these circumstances if a comparison be made between the per capita total of all state and local taxes in a state with the per capita income, the average burden of the taxes within the state can be determined. A study recently released by the U. S. Department of Commerce has computed the burden of state and local taxes on individuals in this manner for the 48 states, and it ranks Minnesota fifth highest. Thus it can be seen that the burden of state and local taxes in Minnesota will take a relatively greater proportion of the average individual's income than will be true in 43 other states.

Some will contend that this is not a correct statement because of the taxes on iron ore, only a small portion of which is paid by the citizens of this state. While this is true, it must not be overlooked that other states are likewise ingenious in exporting some of their taxes beyond their borders. How much of the state and local taxes imposed in Michigan are paid by Minnesota citizens when they purchase automobiles? And how much of the taxes in Texas are transferred to this state through the purchase of gasoline and oil?

It is an inescapable fact that the citizens of Minnesota bear an above average tax burden in relation to their income. And that emphasizes another principle of taxation that is important—all taxes imposed on the individual are taxes on his income. The yardsticks by which they are imposed may be used to measure his income, his property, or the goods and services he purchases, but, unless he is living off his capital, these taxes will all be paid from his income.

And that statement is only another way of expressing a third principle of taxation—that there are only three ways known of taxing the individual and those are on his income, on his property and on what he spends. It is unlikely there will ever be substantial agreement as to which method is the fairest to the individual.

In direct taxation of individuals Minnesota employs all three methods. Statistical data disclosing the portion of property taxes levied directly on individuals are not available, but as taxation of property provides the largest portion of all state and local taxes in this state, it can be assumed to constitute a fairly heavy burden on individuals. Comparison of the taxes on homes in the class one cities of Minnesota with the national average for large cities indicates that the burden of these taxes is somewhat above the general level. On the other hand sales and gross receipts taxes (other than those imposed on public utilities and railroads) which in Minnesota consist largely of taxes on gasoline, liquor and tobacco, place the state below the national average in this category. According to a publication of the U. S. Department of Commerce,[1] this state collected sales taxes averaging $24.08 per capita in 1953 compared with the national average for that year of $38.47 per capita. In neighboring states Iowa collected $39.99, North Dakota $46.74, South Dakota $45.28, Wisconsin $18.90, Illinois $43.96 and Michigan $60.53.

Another publication of the U. S. Census Bureau[2] shows the per capita national median of income taxes levied directly on individuals by state and local governments in 1953 to be $6.25. Minnesota collected $15.60 per capita and ranked fifth highest among all the states. In the neighboring states the per capita collections were as follows: Iowa $6.89, North Dakota $5.93, South Dakota none, Wisconsin $18.09, Illinois none and Michigan none.

These figures indicate that among the states listed above, direct taxes imposed upon individuals in Minnesota may be above average in respect to property and are below average on sales, but are very high on incomes. The total of these direct levies supports the contention that Minnesota collects a below-average proportion of its governmental revenue by primary imposts on the individual and more of it by indirect taxes on business. Whether this results in greater or less burden on the low-income group is difficult to ascertain and would require special study which this Commission did not have the opportunity to make.

However, this Commission did examine the relative burden of the Minnesota income tax on the low-income group. The following table has been prepared from information contained in Table XI of the report of the Department of Taxation for the fiscal year ended June 30, 1953:[3]

Tax Burden on Selected Income Groups

(Normal tax only—does not include surtax for soldiers' bonus)[4]

Gross Income Group	Average Gross Income	Average Federal Tax Deduction	Average Minnesota Normal Tax	Per Cent Minnesota Tax of Gross Income	Per Cent Minnesota Tax of Federal Tax
$ 0- 999	$ 604.37	$ 51.09	$ .86	0.14	1.68
1,000-1,999	1,474.15	125.99	2.34	0.16	1.86
2,000-2,999	2,451.96	240.03	8.00	0.33	3.33
3,000-3,999	3,449.45	353.38	16.85	0.49	4.77
4,000-4,999	4,402.12	470.20	31.66	0.72	6.73

Just where the line of demarcation should be drawn between the low-income group and the so-called middle-income group may vary in the minds of the citizens of Minnesota. However, by including all income taxpayers whose gross income was less than $5,000, this table includes 70.37 per cent of all individuals who paid income tax in this state, and collectively they paid 29.63 per cent of all normal individual income taxes. Stating the other side of this picture, approximately 30 per cent of the taxpayers had gross incomes in excess of $5,000, and they paid over 70 per cent of all normal individual income taxes. This fact alone shows a light burden on the low-income group.

Applying another test, the column in the above table entitled "Per Cent Minnesota Tax of Gross Income" shows that the tax is only 0.14 per cent of average income in the lowest group and rises to 0.72 per cent in the $4,000 to $4,999 group. It is not until

1 *Compendium of State Government Finances in 1953*, U. S. Department of Commerce, Bureau of the Census. These figures for all states include taxes on motor fuel consumed by commercial vehicles, and to that extent are overstated. However, only as the per capita amount of these taxes vary from state to state will there be any change in their relative positions.

2 *State and Local Government Revenue in 1953* (Special Study No. 37), Department of Commerce, Bureau of the Census.

3 *Tax Research Bulletin No. 18.*

4 As the adjusted compensation surtax is a temporary increase in the income tax, it has not been included in this analysis.

the gross income exceeds $6,000 that on the average the normal income tax exceeds one per cent of the gross income. Here again it can be concluded that the income tax places a light burden on the low-income group.

Still another measure of the burden of the income tax on the low-income group is shown in the right-hand column in the above table, entitled "Per Cent Minnesota Tax of Federal Tax." If the Minnesota income tax increased proportionately from group to group at the same rate as the federal income tax, these percentages would all be the same. The fact that the Minnesota income tax is a much smaller percentage of the federal income tax in the lowest bracket than it is in the $4,000 to $4,999 bracket clearly shows that Minnesota has been much more considerate of the low-income group than the federal government.

The progressively increasing burden of the Minnesota income tax as compared with the federal income tax continues, beyond the levels shown in the table, to about 15 per cent of the federal tax on a $10,000 gross income. On incomes above that point the Minnesota tax increases approximately in line with the federal tax. If this ratio of 15 per cent of the federal tax had been maintained at all income levels, the Minnesota income tax on the $1,000 to $1,999 group would have been $18.90 instead of the $2.34 shown in the table.

This Commission Concludes That:

The Minnesota income tax places a very light burden on the low-income group.

Inheritance, Estate and Gift Taxes

Minnesota imposes an inheritance tax on the share of property received by transfer from the estate of a deceased person. Minnesota also imposes a tax upon the entire estate of a decedent in order to obtain for the state the full amount of the deduction for state taxes permitted by the United States Revenue Act of 1926. In other words, if the state did not impose the estate tax, the federal government would receive these funds. A gift tax, companion to the inheritance tax, is imposed upon the transfer of property by gift. Exemptions are provided in all these laws.

The proceeds of the inheritance, estate and gift taxes are shared 20 per cent to the county and 80 per cent to the state general revenue fund.

Special Business Taxes

The Minnesota Statutes provide for the imposition of special taxes on certain types of business. Most of these taxes are in lieu of other forms of taxation. The occupational tax on iron mining is one of these taxes, and as such is not discussed in this report because another commission is studying the problems of iron ore taxation. It is discussed, however, in the "Trust Fund" section of this report in respect to the dedication of part of the occupation tax revenue.

Railroads

Probably the most generally known special tax is the 5 per cent levy on the gross earnings of the railroads. This tax relieves the railroads of all other Minnesota taxes except special assessments, and ad valorem taxes on property not used for railroad purposes, and income tax on income derived from non-railroad property.

Many citizens are of the opinion that there is a provision in the Minnesota Constitution for the imposition of this form of gross earnings tax on the railroads, but such is not the case. The early legislatures, including the territorial legislatures, in granting the charters for all railroads organized in Minnesota, required provision for this form of taxation and, by legislative act, it was later extended to all railroads operating in this state. The rate of the tax is fixed by the legislature but, under a constitutional provision, before any change in the rate can become effective it must be approved by a majority of the voters at the next state election.

The revenue from this tax is placed in the general fund of the state but under certain conditions a small portion of it is allocated to local government. This point is discussed in the section of this report entitled "Property Tax Base," and that section also deals with the fact that all gross earnings taxes deprive local governments of revenues they would receive if these taxes were not imposed by the state as in lieu taxes.

The problems here to be considered are whether some other form of taxation should be applied to the railroads, and whether the present rate of 5 per cent should be changed.

In requiring that the railroad corporations which were chartered by the state make provision for taxing their gross earnings, the Minnesota legislature has, in effect, entered into a contract with those companies, and it is doubtful if that contract can be legally changed unless both the legislature and the railroads agree. Under such circumstances, it appears likely that this form of taxation will remain until, and unless, the railroads themselves request a change. It is within the scope of possibility that the legislature could change the method of taxing the non-chartered railroads, but even if such a procedure were permitted by law, it would not be desirable to apply different methods of taxation to competing railroads.

A few of the witnesses who appeared before this Commission recommended that the 5 per cent rate of the tax on the gross earnings of the railroads, which has been in effect since 1913, should be increased so as to produce more income for the general fund of the state. While the problem of finding additional sources of revenue is not strictly within this Commission's assignment, the members feel that this recommendation should be considered from the point of equity in the tax structure.

Very few states employ the gross earnings method in taxing any of the railroads and Minnesota is the only state that provides for the exclusive use of this tax in lieu of all other taxes on the railroads (except the income tax and special assessments, as noted earlier). All state and local taxes paid by the class one railroads in the United States last year were equal to 3.36[1] per cent of

[1] *Statistics of Railways, No. 38,* Association of American Railways, August, 1954.

their gross earnings as compared with 5 per cent in Minnesota. However, in fairness, it should be pointed out that in periods of economic depression, such as 1932, the decline in gross earnings lowers the total tax to be paid to a greater extent than would be true if the railroads were taxed on an ad valorem basis.

The economics of the transportation industry must be considered in judging the desirability of increasing the rate of the gross earnings tax on the railroads. Except possibly during World War II, the railroads for a long period of years have not earned what could truly be called a fair return on their invested capital. The Interstate Commerce Commission fixes the rates charged for transportation services on a regional basis so that higher taxes imposed by any one state cannot be passed on in higher rates to the users of the services rendered in that state. The application of a tax on gross earnings of the railroads tends to increase the revenue from that tax as the cost of performing the service, and consequently the rates charged, automatically rise. This factor, together with increased use of railroad services, has increased the revenue produced by the gross earnings tax on the railroads in Minnesota from $5,578,474 in fiscal 1940 to an all-time record of $14,080,047 in fiscal 1954. The decline in iron ore shipments during the calendar year 1954 will reduce the yield of this tax in the current fiscal year.

If a tax structure is to be fair and equitable, it should impose comparable taxes on competing forms of business. The railroads are now subject to rather intense competition from trucks, buses, barges and airplanes. This Commission has not been supplied with any data which satisfactorily demonstrate that these competing forms of transportation are paying for all costs of the services they render, including the provision of public facilities, and, in addition, paying for the support of general government in Minnesota to an extent comparable to the proceeds of the gross earnings tax on the railroads.

Telephone

A gross earnings tax is also imposed on telephone companies operating in Minnesota. The current rates are 7 per cent on the gross earnings from cities having a population of 10,000 or more, and 4 per cent on all other gross earnings. This tax, like the railroad gross earnings tax, is in lieu of all other taxes except the income tax and special assessments, and the proceeds are credited to the general fund of the state.

The telephone gross earnings tax is included in the telephone companies' cost of doing business and hence, in fact, is paid by the telephone users in charges for the services furnished. The Minnesota Railroad and Warehouse Commission fixes, on a state basis, the rates the telephone companies can charge their customers for services, and in so doing must make allowance for all costs, including all taxes. If the rates of the telephone gross earnings tax were to be increased, the increase would in time result in higher service charges to telephone users.

Furthermore, unlike the railroad gross earnings tax, the telephone tax is not surrounded by any legal barriers if the legislature should deem it wise to subject the telephone companies to some other form of taxation. The legislature could, for example, return the telephone properties to ad valorem taxes. Such a move would have the advantage of broadening the property tax base and providing the local units of government with greater direct revenue. On the other hand, it would require the state to levy more taxes to replace the revenue from the telephone gross earnings tax which now goes to the general revenue fund. If, for example, this were to be done by increasing the general property tax levy, it would require about a 2½ mill increase at present rates and assessed values, to produce the necessary revenue.

Other Gross Earnings Taxes

Minnesota levies several other gross earnings taxes including those imposed on telegraph companies, railroad freight lines, sleeping car revenues, express companies and rural electric cooperative associations. None of the witnesses who appeared before this Commission recommended any change in these taxes and, as the revenue from all of them totals only a little over half a million dollars, no special study has been made of them. As all of these taxes have been imposed by legislative action, it is presumed they were approved by past legislatures for good and sufficient reasons. It is difficult to see how the Minnesota tax structure could be materially improved by any changes in these taxes.

Insurance Companies

Among other forms of special business taxes, the 2 per cent levy on gross premiums received by insurance companies deserves special mention. It produced $6,155,000 in revenue in the fiscal year ended June 30, 1954, all of which was credited to the general fund of the state. Payment of this tax by insurance companies is in lieu of personal property taxes on such property as is used in conducting the business. This tax is not in lieu of real estate or income taxes.

There is a general agreement among the states to levy this tax on insurance companies, and there are reciprocal nonconformity penalties imposed on companies doing business in Minnesota, but organized in states which do not have tax laws conforming to the national pattern both as to general provisions and to the 2 per cent rate. Other states have the same provision in their laws; hence Minnesota insurance companies doing business in those states would be penalized if the Minnesota laws did not conform to theirs. Hence it would be very difficult to change the rate or method of taxation of insurance companies in Minnesota unless all the other states affected would agree to such changes.

The only other question for consideration in respect to this tax is whether or not all of the revenue should be credited to the general fund of this state. This subject is treated specifically in the section of this report entitled "State and Local Relationships."

An additional tax of one half of one per cent is levied on fire insurance companies for the purpose of providing the general revenue fund with sufficient revenue to support the state fire marshal's office. A further special tax with variable rates applies on fire insurance premiums for first class cities to provide necessary funds for their firemen's relief funds.

Banks

Another tax surrounded by special circumstances is the 8 per cent excise tax measured by the net income of banks, which is in lieu of all taxes upon capital, surplus, property, assets and shares of the banks except taxes imposed upon real property. This special form of tax for banks stems from the provisions of the federal law (Sec. 5219 U.S.R.S.) relating to national banks which places restrictions on the taxes the states may impose on these institutions. This federal law further provides that competing state banks cannot be subjected to lower taxes than those applicable to national banks. The proceeds of the bank tax are distributed to state and local government in proportion to their share of personal property levies.

Other Special Taxes

There are several other special taxes on business in Minnesota which are of two general types: selective excise taxes and special taxes in lieu of ad valorem levies. Another interim committee is charged with the responsibility of analyzing and recommending any changes in the gasoline tax and other motor vehicle levies.

Minnesota receives substantial revenues from its other selective excise taxes on liquor, beer, cigarettes and nonanimal-fat oleomargarine. The Minnesota tax rate on liquor is above the average of the other states. The cigarette tax is about average, and the levy on oleomargarine is essentially the use of a tax for nonrevenue purposes. The liquor and cigarette taxes are shared with local government, as discussed in the "State and Local Relationships" section of this report.

Handlers and processors of grain are subject to a unit (grain bushel) tax in lieu of a personal property tax, similarly coal dock operators are taxed on each ton of coal handled. A special tax (vessel-tonnage) tax in lieu of ad valorem levies is placed on owners of vessels registered at Minnesota ports. The owners of airplanes for commercial aviation using a Minnesota airport in the course of their operations are subject to a state-assessed and state-collected airflight property tax. Other airplanes are subject to a state license, the fee for which is also state-collected. Gasoline used in aviation is subject to a special state tax which, in effect, incorporates for substantial users, a reduction in the average rate. This feature is intended to compensate, at least in part, for the national character of the business, and to offset particular locational factors with respect to refueling in Minnesota.

All of the state aviation taxes are retained by the state and are used to finance the state program of airport development.

The proceeds of the grain bushel tax and the coal dock operators tax are distributed to state and local government in proportion to their share of personal property levies.

Minnesota imposes a 5 per cent admission tax on boxing and sparring exhibitions and a 5 per cent gross receipts tax on the proceeds from the lease or sale of radio, motion picture and television rights therein. The proceeds are first paid to support the state athletic commission, which commission's expenditures are limited to a maximum of $12,000 annually and are lower if the proceeds are not sufficient to provide this sum. Any excess is paid annually to the division of social welfare to assist in the support of the state tuberculosis sanatorium and for the payment of state aid for the support of county tuberculosis sanatoria. The total proceeds from this tax in the fiscal year ended June 30, 1954, were only approximately $4,000, so the yield was insufficient to continue to provide the maximum support for the state athletic commission.

At the time that any mortgage on real estate in Minnesota is recorded or registered, a mortgage registry tax of 15 cents per $100, or fraction thereof, is imposed on the principal debt or obligation secured by any mortgage of real property. The proceeds are apportioned—one sixth to the state general revenue fund, one sixth to the county revenue fund, and the balance is divided equally between the school district and the city, village or town in which the real estate described in the mortgage is situated.

Additional Taxes

In the course of the hearings conducted by this Commission, several methods of taxation not presently included in the Minnesota tax structure were suggested, either for replacement purposes or to raise additional revenue. A brief description of each proposal appears desirable, together with some general observations regarding each of them. All of these taxes would be new to the present Minnesota tax structure, but few of them are "new" taxes as such.

The proposals will be considered in the following order:

1. Utilities Use Tax
2. Value Added Tax (Michigan)
3. Graduated Land Tax
4. Hotel Occupancy Tax
5. Racing Tax
6. General Sales Tax

Utilities Use Tax

Some witnesses appearing before this Commission advocated the enactment of a general sales tax to provide sufficient revenue to permit the repeal of all taxes on personal property. One group, who felt that personal property taxes should be repealed, was opposed to the general sales tax and advocated the adoption of a utilities use tax as a preferable method of obtaining the needed revenue. While the proponents of this use tax might not favor its adoption if the revenue to be derived from it were applied to some other purpose, it is the intention to analyze here a utilities use tax as a revenue producing measure regardless of the purpose to which the revenue might be applied.

This tax is a surcharge on the users of utility services and may be calculated as a percentage of the total bill or at differing percentages depending upon the class or type of service, or it may be applied in fractions of cents to the unit of service such as cubic feet of gas consumed or kilowatt hours of electricity used. It may be shown on the consumer's bill as a separate item or simply included in the price of the service.

Regardless of the method employed in applying the utilities use tax, in the final analysis it is simply a specialized sales tax. This state already imposes three special sales taxes, gasoline, liquor and tobacco and also a gross earnings tax on telephone companies, all of which produce substantial revenue.

A tax of this type has some merit. It has a moderately broad base, is relatively easy to collect and does not require expensive policing. It can be designed to produce substantial revenue with rates that appear to be low. Insofar as the tax rests directly on the individual consumer, it might be an equitable adjustment of the Minnesota tax structure because, as pointed out elsewhere in this report, this state collects a below-average percentage of its taxes directly from the individual taxpayer.

However, there are other factors that must be considered in connection with levying a utilities use tax. Although commonly thought of as monopolies, the utilities are subject to a fair degree of competition. The private automobile has driven the streetcars from the streets of Minnesota cities, and contributed to the increase in bus fare rates. Urban streets and homes, formerly lighted by gas, now use electricity for that purpose. On the other hand, the consumption of coal for heating purposes has declined materially because of the construction of pipelines to provide communities with natural gas and oil at a cost lower than coal. This competition among fuels has reached a point where natural gas no longer has a distinct competitive advantage in some of the territory served as well as in some areas not now served by that fuel. Federal and local taxes, as well as increased cost of gas at the wells, in addition to increased costs of transporting it to consuming areas, are contributing factors. When the problem of a high demand in the winter for heating purposes and a low demand during the summer must be met, it becomes a question whether the Federal Power Commission will find the construction of the pipeline "economically feasible"—a finding that Commission must make before the pipeline can be constructed. This situation is to be found in the northern portion of Minnesota. Under such circumstances, increasing the cost of gas to the consumer by adding a tax he would not pay on competing oil or coal might be sufficient to deprive the people of some parts of this state of natural gas.

With the citizens of Minnesota now showing some interest in attempting to attract new industies into this state, a tax on the power these industries would consume would be another roadblock to overcome in trying to induce them to locate in Minnesota. Even though the tax appeared small, they would naturally fear that the rate would be increased by some future legislation.

While it can be argued that applying this form of tax to commercial enterprise simply increases the cost of doing business in Minnesota, and that this cost will ultimately be reflected in higher prices to the consumer, nevertheless, as pointed out in other sections of this report, this state and its subdivisions are already collecting too high a proportion of their taxes by this method, and adding to the burden already placed on business is undesirable.

Some communities in Minnesota are already using some utility use taxes for local revenue, and this Commission is of the opinion that all applications of this levy for any unit of government should be subjected to exhaustive study and be designed so that the burden is placed on individual consumers of those utility services which can competitively carry the added cost, and that the tax should be shown as a separate item on the customer's bill for services.

Value Added Tax

Publicity is being given to the new Michigan Business Receipts tax which that state adopted on a trial basis at their 1953 legislative session, and which will be up for reconsideration during the 1955 session.

Simply stated, this is mainly a tax on manufacturers based on their expenditures for salaries, wages, depreciation and profits. The tax obtains its name from the process used in its computation. The manufacturer first determines his gross receipts, from which he deducts all purchases of raw materials and supplies (not including capital equipment), and the remainder, commonly known as the "value added," is the base for the tax. The Michigan law makes liberal exemptions and contains several technical provisions intended to make the application of the tax more adaptable to varying conditions. The rate of tax is one mill for public utilities and four mills for all other taxpayers.

Such a tax is more stable than an income tax because it must be paid even though the firm operates at a loss. Under the present Michigan law the tax has the desirable feature of low rates, but it fails, on several points, to measure up to the general requirement of a good tax. It has a narrow base, and will be difficult for some of the small concerns to compute. Like the income tax, it will require constant policing and auditing by the state. It penalizes the manufacturers for expanding their operations and creating more jobs in the state of Michigan.

However, Michigan does not have a net income tax on either individuals or corporations, and to that extent the manufacturers may pay less taxes in that state under this new tax than Minnesota manufacturers do through the taxation of their incomes.

Graduated Land Tax

The graduated land tax proposes to tax large farms at a higher rate than small farms irrespective of the productivity and fertility of the land. The larger the number of acres in a given farm, the higher the tax rate. The purpose of such a tax is to encourage small farming units. Some farmers appeared before this Commission and contended that many would-be farmers, especially sons of farmers, are unable to purchase farms.

Because of modern methods of farming with improved machinery, larger farms are becoming a more economical unit. To place a higher tax on a more economical unit of operation in order to maintain a less efficient one would have the effect of increasing the cost of producing food. Furthermore, such a proposal, in the final analysis, is nothing more nor less than an attempt to use the state's power to tax to obtain a social end—in this instance, small farms. Such a tax can only be supported on social grounds—it has no place in the tax structure as a revenue measure.

A somewhat similar graduated land tax was submitted to the voters of North Dakota on June 29, 1954, and was disapproved. This was the fourth time in recent years that the voters of North Dakota refused to accept such a measure.

Hotel Occupancy Tax

To bring in some additional revenue to the state, a hotel occupancy tax has been suggested. For tax purposes, broadening the definition of a hotel to include lodging houses, boarding houses, resorts and tourist courts was also proposed.

Such a tax is, in effect, another special sales tax. However, unlike a general sales tax, it rests on a narrow base and would require high rates to raise any appreciable revenue. It would, of course, be paid in a large measure by visitors from outside Minnesota who, generally speaking, make only a small direct contribution to government in this state. A hotel occupancy tax is perhaps better suited to augment local revenue than it is to produce the larger sums needed at the state level. In fact, local governments have been, and now are, seeking legislative authority to impose such a tax.

Before such a tax should be considered, a careful study should be made as to the number of rental units available, their average occupancy, the rate of tax needed to raise the desired revenue, and the types of rental units which should be included for tax purposes. As this is essentially a tax on the occupant, if it is to be levied, it should be added to the bill as a separate item.

Racing Tax

One of the proposals made to this Commission during the course of its hearings was to legalize pari-mutuel betting on races in Minnesota, and apply a tax on the proceeds. While many citizens of this state would doubtless oppose such a move on moral grounds, it is also true that many citizens would approve. This Commission is passing no judgment on the moral issue involved, but feels obligated to comment on the proposed tax strictly as a revenue measure.

There are 23 states in the nation that now have legalized pari-mutuel betting on races, and in 1952 they collected approximately $137 million in taxes from this source. This tax is in the same class as those imposed on amusements—a luxury type of tax. No one is compelled to go to the theater or place bets on races. It is therefore a voluntary burden on those who pay it, many of whom may be from other states. It is easy to administer, difficult to evade, and might produce a fair amount of revenue. Nevertheless, the tax rests on a narrow base and the revenue would be subject to fluctuations depending upon the public appeal of the races and general economic conditions.

Various methods are used in the application of racing taxes. Some states take a percentage of the total amount of the bets, while others apply a tax to the amount of payments to the winners, which, because of the deduction for track expenses, is a somewhat smaller sum. Still other states levy the tax against the admission charge to the grandstand so that no tax is directly applied to the betting. There is also a means of obtaining substantial revenue from license fees charged to owners, jockeys and other personnel, and also for each racing entry. Another source of governmental revenue from betting can be obtained by requiring that all unclaimed money due bettors be turned over to the state together with the amounts remaining from rounding the payments to bettors to the next lowest five or ten cents. One state has built a veterans rehabilitation hospital from the proceeds of these latter items alone.

General Sales Tax

As a means of securing the necessary revenue to lighten the burden of some existing Minnesota taxes, it was suggested by some witnesses that this Commission consider a general sales tax—a proposal which met with vigorous opposition from other witnesses.

This tax, probably more than any other, has become involved in partisan politics in Minnesota to a point where many citizens cannot impartially judge the position it might occupy in the state's tax structure. As set forth in the section of this report entitled "Scope, Method and Philosophy," no tax should be advocated on a partisan basis. All taxes should be considered in the light of what is best for the citizens of this state.

In Minnesota it is often claimed that a sales tax, for example, is a tax which conservatives should be for, and liberals, against. A quick survey of the 32 states which have a sales tax gives no clue as to whether the state is generally a Republican or a Democratic state. Of the 32 states which have a sales tax, six of them adopted the tax under a Republican administration while 26 adopted it under Democratic administrations. Eliminating the states of the solid South, most of which have a general sales tax and which are traditionally Democratic, the remaining sales tax states are divided between Democratic and Republican administrations at the time of adoption of the tax. Of the three sales tax states bordering Minnesota, Iowa and South Dakota passed their sales tax under Democratic administrations, and North Dakota passed its sales tax under the administration of the Non Partisan League.

Regardless of the intensity of the arguments for and against a general sales tax, this Commission is of the opinion that it would be doing something less than its duty if it failed to give this form of taxation adequate consideration in this report. People are opposed to all taxes—particularly to direct taxes. Nevertheless, 32 of the 48 states now have some form of a general sales tax, and that fact alone is reason enough to examine the effect of such a tax on the Minnesota structure. The general retail sales taxes in the 32 states produced a total revenue in fiscal 1954 amounting to $2,535,956,000,[1] and an estimate was made that a 3 per cent tax on retail sales in Minnesota, exempting food and medicine, would produce approximately $75 million annually in revenue.

Strictly from a technical point of view, a general sales tax conforms to many of the principles of a desirable tax. It has a broad base; it produces substantial revenue with low rates; it is difficult to evade. The cost of collection and enforcement is low. There are no deferred payments to be made at times that may be inconvenient for the taxpayer, and the revenue is relatively stable, unlike the income tax, gross earnings taxes and the occupation tax on iron ore which vary widely with the ups and downs of the business cycle. That this tax would collect revenue for Minnesota from visitors from outside the state is a factor not to be overlooked.

The main objection to a general sales tax is that if, as its name implies, it is imposed on *all* retail sales, which is the case in some states, then its burden will fall more heavily on the lower-income group. Furthermore, the low-income group spend a greater proportion of their earnings on the necessities of life than those with larger incomes, and as a result the tax has a tendency to reduce the standard of living of the low-income group. To overcome this objection, some states do not apply the tax to sales of food, medicine and lower priced clothing. While this pro-

[1] As shown by states in the Appendix.

cedure tends to make the tax somewhat more difficult to administer, narrow the base of the tax and consequently the revenue, statistics indicate that such a device produces a progressively greater burden upon individuals as their respective incomes increase.

Exempting other classes of goods and services from a retail sales tax can only be justified by considering the burden of other taxes upon the same taxpayer, or the economic effect on the entire tax structure. In respect to the latter point, the section of this report entitled "Taxes on Individuals" shows that individuals in Minnesota pay a smaller proportion of their state and local levies in direct taxes than is the case in neighboring states. Imposition of a retail sales tax in Minnesota would tend to increase the proportion of direct taxes paid by individuals in this state, and if the sales tax were used as a replacement tax for some of the present indirect taxes, the proportion of direct taxes would be still greater. This would be an improvement in the over-all tax structure. It must be realized that many individuals in this state who own little or no taxable property still have the economic ability to pay taxes, but, with the lighter direct burden on the individual, the only way the Minnesota structure reaches them is through the income tax and the indirect levies included in the goods and services they buy.

Returning to the point mentioned above, the burden of other taxes on the individual who pays the sales tax is well demonstrated by the farmer who purchases a tractor which is subject to a sales tax, and that tractor is then also subject to annual personal property taxes. The same can be said for the manufacturer who purchases production equipment and, carried to an extreme degree, for the insurance agent who buys a typewriter. If exemptions from a sales tax are to be granted because of these overlapping levies, there is almost no end to the arguments that can be put forth why still other property should or should not be exempted—all of which narrows the tax base and reduces the revenue.

Most of the individuals who advocated the imposition of a sales tax in Minnesota also made it clear that they favored it only as a substitute for other taxes now being levied, and more particularly as a replacement for the revenue now being obtained from personal property taxes which they recommended be abolished.

If such a proposal were to be adopted, it would result in a radical change in the Minnesota tax structure—it would abolish a tax that is now levied mainly for local revenue and substitute a tax that would be collected by the state. As set forth in the section of this report entitled "The Property Tax Base," one of the acute problems in Minnesota taxation is the narrowing of the property tax base upon which local government is mainly dependent for its revenue. The personal property tax provides about one quarter of all local tax collections and, even though the revenue currently received by local government would be replaced by a grant from the state, the local unit would lose future control of that segment of its income except only as it could persuade the legislature to make changes which would affect the entire state.

Furthermore, the fact that the sales tax would be collected by the state, and if it were to be a replacement for the personal property tax, it would necessitate the establishment of a formula for its redistribution to local government. Any such formula is always subject to tremendous argument as each unit of government tries to obtain a larger share, and in the end a compromise is reached which may satisfy only a few. The present controversy over the distribution of the highway user revenues and dissatisfaction with the basis of granting welfare and school aids are cases in point.

This Commission Makes No Specific Recommenations Concerning the Adoption of Any of the Forms of Taxation Discussed Above, But It Concludes That:

1. A desirable state and local tax structure should provide and encourage responsibility on the part of local units of government. Each unit of government spending public money ought to have the responsibility to levy upon its own citizens as much as possible of the taxes needed to meet the expenditures it chooses to make. In the long run, local governments are better off if they levy taxes according to their needs instead of looking to the state for grants—a practice which usually results in the state directing how the expenditures shall be made.

2. As the services of state and local government to the people are expanded, and the costs of government increase, it becomes ever more clear that increased direct taxes upon the people of Minnesota will be inevitable. If substantial additional revenue is required, the existing tax structure will exempt many people in whole or in part, from paying their just share of the cost of government. Every person making a living in this state will have to make a direct contribution through the application of a broad-based tax measured by a flat rate applied to what he buys or what he earns.

APPENDIX I

MINNESOTA SESSION LAWS OF 1953, CHAPTER 736

AN ACT

CREATING A COMMISSION TO MAKE A COMPLETE STUDY AND INVESTIGATION OF THE PRESENT TAX STRUCTURE OF THE STATE OF MINNESOTA, RECOMMEND A NEW OVER-ALL TAX STRUCTURE FOR THE STATE, RECOMMEND REVISION AND RECODIFICATION OF PRESENT TAX LAWS, INCLUDING RECOMMENDATION FOR CONSTITUTIONAL AMENDMENTS, IF NECESSARY, IN ACCORDANCE WITH SUCH PLAN, AUTHORIZING THE ACCEPTANCE OF GIFTS AND CONTRIBUTIONS TO BE USED IN CONNECTION WITH SUCH INVESTIGATION, AND MAKING AN APPROPRIATION THEREFOR.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. A commission is hereby created to make a study of the present tax structure of the state, including but not limited to income taxes, excise and occupation taxes, general property taxes on real and personal property, gross earnings taxes, inheritance and gift taxes, aircraft and aviation taxes, bank taxes, and iron ore taxes; recommend an over-all tax structure which will produce the necessary income with a minimum of duplication and hardship on individuals, particularly those in lower income brackets, and which will create a friendly, healthy atmosphere for present and future industries; recommend revision and recodification of present tax laws, including such constitutional amendments as may be necessary to give effect to the over-all plan; make any other studies or investigations relating to a desirable tax structure as may be necessary in pursuing the above objectives, including but not limited to the theory of dedicated funds.

Sec. 2. The commission shall consist of not more than 15 members, ten of whom shall be members of the legislature, consisting of five members from the House of Representatives who shall be appointed by the Speaker of the House and five members from the Senate who shall be appointed by the Committee on Committees and five members who shall be appointed by the governor and who shall be citizens of this state who have experience and an interest in matters of taxation, who are representative of various segments and interests of the population of the state, including but not limited to agriculture, education, labor, finance, mining, forestry, transportation and all industry, trade and commerce in general. Appointments to the commission shall be made following the passage of this act and vacancies existing or occurring shall be filled by the appointing power. The members of this commission shall serve without compensation.

Sec. 3. The commission is authorized to act from the time its members are appointed until the commencement of the next regular session of the state legislature, and it shall make and file a report of its findings and recommendations to the governor not later than December 1, 1954.

Sec. 4. The commission shall have the authority and power to hold meetings and hearings at such times and places as it may designate, and it shall have such power to examine such existing financial statements and records in the offices of the state treasurer and other state officers as may be required to accomplish the purposes set forth in this act. The commission shall elect a chairman, vice-chairman, and such other officers and committees from its membership as it may deem necessary.

Sec. 5. The commission is empowered to accept gifts or contributions with which to help defray the expenses of the commission. Any offer of gifts or contributions shall be in writing, shall impose no conditions whatsoever upon the commission, and the acceptance of such gift or contribution shall be by majority vote of the commission. All gifts or contributions so made and accepted shall be deposited to the credit of the appropriation provided by this act.

Sec. 6. Members of the commission, while serving without pay, shall be allowed and paid their actual traveling and other expenses necessarily incurred in the performance of their duties. The commission may employ clerical and professional aid and assistance; may purchase stationery and other supplies, and do all things reasonably necessary in carrying out the purpose of this act.

Sec. 7. In addition to any gifts or contributions which may be received in connection with the foregoing section 5, there is hereby appropriated out of any monies in the state treasury, not otherwise appropriated, $25,000, or so much thereof as may be necessary to pay expenses incurred by the commission. For the payment of such expenses the commission shall draw its warrants upon the state treasurer, which warrants shall be signed by the chairman and at least two other members of the commission and the state auditor shall then approve and the state treasurer pay such warrants as and when presented. A general statement of all receipts and expenditures shall be included with the commission's report.

APPENDIX II

MINNESOTA'S CLASSIFICATION SYSTEM

(From the highest percentage, 50% to the lowest, 5%, and with notation for real or personal property)

CLASS	RATE		DESCRIPTION	STATUTORY TYPE OF PROPERTY	
(Where It Is Specified)	(Per Cent Applied to Assessor's Full and True Value to Determine Assessed Value)			Real	Personal
1	50		Mined and unmined iron ore	X	
1a	48½—30		Low grade iron bearing formations	X	
4	40	(1)	Non-homestead urban real estate	X	
		(2)	Urban homestead, assessor's full and true value above $4,000	X	
		(3)	Urban homesteads of totally disabled veterans, assessor's full and true value above $8,000	X	
		(4)	Structures on railroad land		X
		(5)	Equipment of gas and electric utilities (except as otherwise noted), public elevators, billboards, steam and motor boats, etc.		X
(No class given)		(6)	Electric transmission lines in rural areas		X
3	33⅓	(1)	Non-homestead rural real estate	X	
		(2)	Rural homestead, assessor's full and true value above $4,000	X	
		(3)	Business inventories and equipment		X
		(4)	Airflight property of commercial airlines		X
(No class given)	27		Real property of petroleum refineries	X	
2	25		Household goods, jewelry, clothing, musical instruments[1]		X
3c	25		First $4,000 of the assessor's full and true value of urban homesteads	X	
3b	20		First $4,000 of the assessor's full and true value of rural homesteads	X	
3d	20		Livestock, tools, and machinery of owner used in agricultural pursuit		X
(No class given)	17		Personal property of petroleum refineries		X
1a	15		Direct products of blast and open hearth furnaces that are utilized in the form produced and are not further processed		X
3a	10		Agricultural products in the hands of producers		X
3cc	5	(1)	First $8,000 of housing units for permanent and totally service-connected disabled veterans	X	
(No class given)		(2)	Electric distribution lines in rural areas for distribution of electricity for sale to farmers at retail		X

SOURCE: *Minnesota Statutes, 1953,* Sec. 273.

[1] This is the only class where assessed value is not synonymous with taxable value. From the equalized assessed values returned by the commissioner of taxation to the county auditors on or before Nov. 15, the exemption of $100 of assessed value is then subtracted to arrive at the taxable value.

APPENDIX III

GENERAL RETAIL SALES TAX COLLECTIONS, BY STATE, 1954

State	Date of Enactment	Rate of Tax Per Cent	Total Collections Fiscal Year Ending 6/30/54 (In Thousands)
Alabama	1937	3	$ 60,689
Arizona	1933	2	24,913
Arkansas	1935	2	29,094
California	1933	3	463,733
Colorado	1935	2	33,855
Connecticut	1947	3	53,773
Florida	1949	3	65,889
Georgia	1951	3	102,676
Illinois	1933	2	208,557
Indiana[1]	1933	½, ⅝, 1¼[1]	139,174
Iowa	1934	2	61,825
Kansas	1937	2	46,680
Louisiana	1942	2	63,459
Maine	1951	2	13,777
Maryland	1947	2	32,797
Michigan	1933	3	288,658
Mississippi	1930	2	33,436
Missouri	1934	2	92,201
New Mexico	1933	2	27,566
North Carolina	1933	3	55,507
North Dakota	1935	2	12,770
Ohio	1934	3	188,293
Oklahoma	1933	2	43,493
Pennsylvania	1953	1	37,012
Rhode Island	1947	2	13,649
South Carolina	1951	3	45,662
South Dakota	1933	2	12,145
Tennessee	1947	2	53,073
Utah	1933	2	17,985
Washington	1933	3[2]	138,050
West Virginia	1921	2[3]	66,798
Wyoming	1935	2	8,767
Total (32 states)			$2,535,956

SOURCE: 1. *State Tax Collections in 1954,* Department of Commerce, Bureau of the Census, Governments Division, August 28, 1954 (G-SF 54—No. 4).

2. *Statutes of the States.*

[1] The Indiana tax is a tax on gross incomes. The rate used in computing the tax depends on the source of the income and is as follows:
- Display advertising, wholesalers and jobbers .... ½ of 1%
- Retailers, dry cleaning and laundering .... ⅝ of 1%
- Public utilities, banks, public terminal grain handlers, and all other income 1¼%

[2] Business and Occupation Tax given as ¼ of 1% additional.

[3] Business and Occupation Tax given as ½ of 1% additional.

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