League of Women Voters of Minnesota Records

FACTS and ISSUES
FINANCING STATE GOVERNMENT

League of Women Voters of Minnesota

October 1976

Primer of Minnesota Taxes

This *Primer* is the first of four "Facts and Issues" prepared by the League of Women Voters of Minnesota to explain how government is financed in Minnesota. It contains a history of legislative trends in taxation, an explanation of criteria used in evaluating taxes, and a glossary of terms used in explaining both taxation and government expenditures in Minnesota.

The League of Women Voters of Minnesota (LWVMN) has been observing government tax policy and expenditures since 1965. In March 1976, LWV members throughout the state conducted a survey to find out what Minnesotans knew about government financing in Minnesota and how they felt about it. Results of the survey are included with the glossary and are used throughout these four "Facts and Issues" in discussing specific taxes and public expenditures.

The other three "Facts and Issues" will explain Minnesota's basic tax structure, legislative trends in spending, and how the state spends most of its money.

HISTORY

Taxation in Minnesota formally began with statehood in 1858. The new State Constitution provided for a property tax, on real and personal property, which would finance almost all the needs of state and local governments. Since then, tax legislation has occurred in piecemeal fashion, with little regard for overall structure, long-range planning, or clear-cut goals. Two trends are clear, though. One, of course, is the great increase in taxes as the government has needed more and more revenue to serve a growing population, to keep pace with urbanization, industrialization, and technology, and to fund the growing government support of education and health and welfare services. Another trend is the legislature's desire to broaden the tax base, relying on many different segments of society to provide revenue, and to depend less on regressive taxes, like the property tax, and more on progressive taxes like the income tax.

While local governments still rely heavily on property taxes for their revenue needs, state government began an early move toward more diversified sources of revenue by assessing a gross earnings tax, instead of a property tax, against railroads, insurance company premiums, telephone, telegraph, railroad car and express companies. The tax was based on varying rates until 1887, when a uniform gross earnings tax was enacted for railroads, and by 1903 these gross earnings taxes were producing more revenue for the state government than property taxes. Meanwhile, though, the legislature was still concentrating much of its efforts on improving the administration of the property tax.

Then, in 1906, a constitutional amendment, called the "wide-open" amendment, was ratified, greatly enlarging the legislature's taxing powers. An inheritance tax and mortgage registry tax soon followed, and in 1913 the legislature worked out a "classified" property tax, allowing for four classes of property taxed at different rates. In 1920, special taxes and royalties on iron ore mining were introduced.

From 1920 to 1957, major changes in Minnesota tax policy reflected national economic and social conditions — the advent of the automobile, the Depression and World War II. The automobile brought a constitutional amendment in 1920 authorizing the financing of highways by motor vehicle and gasoline taxes. These were the state's first direct "use" taxes and were so lucrative that by 1932 they would be providing more than half the $44,000,000 in tax revenue collected by the state.

The "Great Depression" of the 1930's brought the state income tax, passed in 1933. As the depression worsened, people's incomes dropped and state and local tax revenues decreased, too, as property taxes, which were levied by the state and local government units, became increasingly difficult to collect. Assessed values declined as prices fell. Meanwhile, costs of such government responsibilities as education stayed nearly constant, and general relief expenditures mounted rapidly as unemployment increased. The repeal of Prohibition made possible new taxes on alcoholic beverages and their manufacture, but this was not enough. Faced with the conflicting demands for both property tax relief and additional revenues, the legislature responded with the Income Tax Act of 1933. There had been attempts to enact an income tax before, but the way was finally made clear when the Attorney General ruled that the income tax could be introduced without a constitutional amendment. Some favored the new graduated income tax as a desirable alternative to the property tax, others saw it as a means of establishing a progressive, more equitable tax system. Those opposed to the tax were concerned mostly with how its revenue would be distributed. Today, the income tax is the backbone of the state's tax structure, with the property tax the primary source of local government tax revenue.

World War II eased or eliminated much of the financial stress of the 1930's. Tax revenues rose sharply and relief expenditures went down as employment and farm incomes increased and industries went into wartime production. Moreover, many government spending projects had to be curtailed because workers and materials were unavailable. A big backlog of maintenance, replacement, and expansion of public facilities built up. In the postwar period, spending for such projects soon outran the income from existing taxes and tax rates and used up the surpluses built up during the war. Moreover, high postwar birthrates meant new schools had to be built, and postwar inflation widened the gap between the government costs and the revenue potential of the existing tax structure.

The 1947 legislature responded by looking for ways to increase state revenues and to help local governments collect property taxes more effectively. A new tax was imposed on cigarettes, and taxes on liquor, iron ore, and mining royalties were increased. County boards of commissioners were required to appoint either county assessors or assessment supervisors, thus attempting to professionalize assessment personnel and to make their procedures more businesslike and more uniform.

By 1955, however, Minnesota was in financial trouble again. Legislative appropriations voted during the regular session greatly exceeded potential revenue, and the state's revenue balance was too small to cover the deficit for fiscal 1956-58. The legislature met for a one-day extra session and passed an "omnibus" tax bill which added a 5% surtax on individual income taxes, a 1% surtax on corporate income taxes, and a 15% surtax on iron ore occupation and royalty taxes.

It was obvious that new ways of financing state government had to be found, and in 1956 Governor Orville Freeman appointed a Tax Study Committee to review the state's entire tax structure. This "blue-ribbon" committee included twenty members representing business, finance, industry, labor, farm and university interests. The committee recommended simplification and consistency in the property tax — there were 2700 different assessment officers at that time — by having a county assessment system rather than a local one and by valuing all property at 100% of its market value — values were typically assessed far below market values. It also recommended reduction or elimination of personal property assessments. It urged an additional 1% surtax on corporate income taxes and a gross earnings tax, which would be set aside for property tax relief. Other committee recommendations were aimed mostly at making taxes easier to understand and to levy.

TAX REVENUE SOURCES OF STATE GOVERNMENT IN MINNESOTA BY PERCENT OF TOTAL STATE REVENUE

SELECTED FISCAL YEARS, 1922-1975

Source of Tax Revenue	1922	1932	1949	1954	1962	1969	1975
Property Tax	34.9%	22.7%	5.2%	5.3%	6.0%	—	—
Individual Income	—	—	20.3%	21.3%	31.1%	33.3%	40.4%
Sales and Use	—	—	—	—	—	19.0%	19.0%
Corporate Income	—	—	10.4%	5.3%	7.6%	8.1%	8.9%
Bank Excise	—	—	0.7%	0.8%	1.3%	0.9%	0.8%
Gross Earnings	28.1%	13.6%	9.9%	8.0%	5.5%	3.3%	2.7%
Insurance Premiums	3.6%	4.3%	2.8%	2.7%	2.7%	2.0%	1.7%
Inheritance and Gift	3.0%	4.2%	1.4%	1.7%	2.3%	2.3%	2.1%
Iron Ore Occupation	—	3.2%	7.5%	12.6%	3.7%	1.6%	1.6%
Iron Ore Royalty	—	1.4%	1.3%	1.5%	0.6%	0.2%	0.2%
Alcoholic Beverages	—	—	8.6%	5.8%	5.0%	3.1%	2.4%
Tobacco Products	—	—	5.6%	4.7%	6.4%	3.7%	3.9%
Gasoline	—	26.8%	16.5%	17.9%	15.1%	12.7%	7.1%
Motor Vehicle	29.7%	23.6%	9.5%	12.0%	11.0%	6.9%	6.7%
Other	0.7%	0.2%	0.3%	0.4%	1.7%	2.9%	2.9%
Total Tax Revenue	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

SOURCE: 1922-1962: *Report of the Governor's Minnesota Tax Study Committee, 1962*

1969: *Minnesota State Tax Collections:* Prepared by Minnesota Dept. of Taxation, Research & Planning Div.

1975: *Minnesota State Tax Collections:* Prepared by Minnesota Dept. of Revenue, Research & Planning Div.

The only one of these recommendations enacted into law by the next legislature was the removal of the state tax on household goods, with county boards directed to phase out this tax by 1968. Few of the committee's other recommendations have ever been implemented. There was, in fact, very little tax activity in the legislatures of 1959, 1961 and 1963. Existing tax rates were increased, but the basic structure stayed almost the same. Meanwhile, though, the need for new revenues continued to increase. The state government's share of local expenditures grew steadily as proportions of the very young and the very old in the population increased, requiring an increase in education and social welfare spending. With local government units allowed to tax only property, the burden on property owners became so great that the 1963 legislature responded by funding a commission to study the property tax. The study's findings resulted in the Tax Reform and Relief Act of 1967. It eliminated the state's portion of property tax revenue and the personal property tax on farm machinery and livestock, and permitted manufacturers to be taxed on the value of their inventories or their tools and machinery. It gave some property tax relief to older persons and renters and created the property tax relief fund and a county assessor system. To cover the loss in property tax revenues to local government units, a state sales tax was enacted. Part of the revenue from this highly controversial tax was designated for property tax relief through the homestead credit, and to increased state aid to schools and localities. In the next two years, however, local governments greatly increased their spending, and property taxes rose about 40% in Minnesota; there was increased public pressure, particularly from senior citizens, for lower property taxes.

The 1971 legislature tried to do what the 1967 legislature had tried but failed to do. This time, though, the legislature was determined that property tax relief would be permanent. It imposed tax levy limitations on all units of local government, then went to work to find the money to make up the local governments' revenue losses. Rates were increased for individual, corporate, and bank income taxes, certain excise taxes, and the sales tax. Corporations and banks were no longer allowed to deduct federal taxes from their state taxes which, in effect, doubled their state income taxes. Most of the increase in revenue was channeled into property tax relief through increased state aid to local governments and school districts.

The 1973 legislature went still further by increasing the homestead credit and enacting a property tax "freeze" for citizens over 65 which would refund the difference between the current property tax and that paid in the year the property-owner reached age 65. The 1975 legislature added an income-adjusted property tax credit for every taxpaying property owner, and offset the lost tax revenue for counties and municipalities by enacting new state aids for welfare and general municipal expenditures. It also enacted an income tax forgiveness and relief program for low income workers. Overall, it continued the trend away from the property tax and toward the income tax and the sales tax as major sources of revenue.

The Tax Revenue Sources table illustrates trends in state government financing over the past 55 years. Note that the property tax in 1922 was only slightly less important as a percentage of total tax revenues than the income tax is today. Note also the decline in importance of the gross earnings and motor vehicle taxes, although these sources of revenue have greatly increased in dollars since 1922. Their decline in importance indicates the tremendous increase in total state tax revenues, from $29,400,000 in 1922 to over $2,000,000,000 in 1975. (This table does not include the revenues of local government units. Thus there is no property tax revenue shown in the last two columns, because the state property tax was eliminated in 1967.)

The General Revenue Sources table shows the importance of revenue other than taxes for financing state and local governments. Federal aid has become an increasing source of revenue, rising at a faster rate in the past 15 years than revenue from state and local sources.

GENERAL REVENUE SOURCES OF STATE and LOCAL GOVERNMENTS IN MINNESOTA

FISCAL 1960, 1967 and 1974

SOURCE	1960 million dollars	1967 million dollars	1974 million dollars
All sources:			
From Federal Government	143.4	314.3	820.9
From Own Sources	926.6	1,626.9	3,528.1
TOTAL	**1,070.0**	**1,941.2**	**4,349.0**
STATE and LOCAL SOURCES			
Taxes	743.4	1,278.8	2,725.6
Charges & Misc.	183.2	348.2	802.4
	926.6	**1,626.9**	**3,528.1**

CRITERIA

What makes a tax good or bad, fair or unfair? How can we judge the effects of a widely diversified tax system, such as we have in Minnesota, on individuals — on people? Are taxes a burden on the majority of people? On a minority? Are the people getting their "money's worth"?

Over the years, various criteria, or standards of testing, have been applied to individual taxes as well as to the total tax system. Beginning with Adam Smith's statement that a tax should be "simple, certain and convenient," and his expansion of these objectives in his 1776 "canons of taxation" from *The Wealth of Nations,* criteria for evaluating taxes have been expanded and refined. Some are useful for individual taxpayers in evaluating taxes, others are important to government.

Whether a tax is *equitable,* or fair, is probably the most important criterion. It is most important to the people, and it is also important to government, inasmuch as elected officials try to please their constituencies. The concept of equity assumes that a tax should affect people in similar economic situations the same, and includes such guidelines as ability to pay, benefits received, and widespread participation in paying the tax. Equity is probably the most difficult quality to measure.

In using *ability to pay* as a criterion for evaluating the equity of a tax, we need to know three definitions: 1) A tax is *progressive* when it takes a bigger percentage of a large income than a small one (state and federal income taxes are generally *progressive* taxes). 2) A tax is *proportional* if it takes the same percentage from everybody. 3) A tax is regressive if it takes a bigger percentage of a small income than a large one (a general sales tax with no exemptions is *regressive).*

If we use *benefits received* as a measurement of equity, we are asking whether people who benefit from a government program should pay for it. This was a fairly workable idea in the days when government was primarily concerned with serving the property owners who paid most of the taxes. Today, however, a great deal of government money is spent on welfare and education, and those who benefit can hardly be taxed to pay the costs of these programs. Current examples of application of the benefits received principle find government using excise taxes on motor fuels to pay for highways, selling game and fish licenses to help finance the state's Department of Natural Resources, and charging tuition at state universities.

Philosophically, the criterion of *widespread participation,* which requires a broad segment of the population to pay a tax, assumes that people's interest in and awareness of government increases with the level of taxes they pay, and considers this a good thing. However, the Minnesota 4% retail sales tax, while allowing for widespread participation and therefore by definition being equitable, is also regressive, because it takes a larger proportion of income from the poor, who spend all their income and do not have any surplus, such as wealthier people do, for savings, investment, charity, and so on. Minnesota has tried to make its sales tax less regressive by exempting food and clothing and prescription drugs.

So far, we've been talking about people-oriented criteria. The government also has criteria for evaluating taxes. An important one is the concept of revenue yield, which includes such factors as *adequacy, productivity, reliability, stability, flexibility* and *elasticity.* The Minnesota income tax, for example, takes all these factors into consideration. It is adequate and productive, because it provides enough revenue to pay for the needs for which it was adopted. It is reliable and stable, because it gives government a predictable source of revenue and gives people some certainty of the amounts they are expected to pay. Yet it is also flexible and elastic, because it is a progressive tax, and thus mirrors changing economic conditions. As incomes rise, the total tax yield increases more than total taxable income, because more people move into higher income brackets, which are taxed at higher rates. This flexibility makes the government happy, and it's also good for the taxpayer, because it imposes a lower tax rate when incomes drop. In times of inflation, however, the taxpayers whose incomes rise only to keep pace with inflation will find themselves in a higher income bracket, and their real income will be reduced.

It is also important that people who pay taxes and people who collect them are able to understand and easily obey the tax laws. If a tax is administered equitably, efficiently and economically by the government, and if it is easy, convenient, and predictable for the taxpayer, everybody will benefit. Economical, efficient tax-collecting leaves more funds to provide public services for people; a tax which is simple (easily understood by people) and convenient (easily paid) enables government to enforce compliance with the tax law and reduce tax evasion. Withholding taxes on wages and salaries, and collecting retail sales tax at time of purchase, are examples of making taxes convenient for people to pay, although the items exempted from the sales tax to make it less regressive have confused some and made it harder for retailers to compute and pay their sales taxes. A similar complication may arise from the 1975 Income-Adjusted Homestead Credit, which was first applied in 1976. It was designed to make the property tax less regressive by considering each property owner's income, but property owners and even tax experts have found it extremely complicated to compute, and administrative and compliance costs may be unjustifiably high in relation to the benefits of adding this "ability to pay" factor to the property tax.

Attention to the whole picture also should include an understanding of a comparatively new development — government manipulation of general economic conditions through taxing, spending and borrowing. The old assumption was that a tax should be "economically neutral", should not work to the hardship or advantage of any specific group in the community. Today, some taxes are levied precisely because they are not economically neutral, because they influence individual or business behavior. Revenue policy is used primarily at the federal level to affect economic growth, distribution of income, and use of resources. In Minnesota, the state gives income tax credits for pollution control devices. This is one way of using tax policy to influence business decisions.

A final important factor in determining the economic impact of a tax is its *incidence* — that is, who eventually pays it. The *impact* of a tax falls on the first person or business paying it. But if that person or business can shift the tax to someone else, it becomes an *indirect tax* whose *incidence*, or final resting place, is always on people, even though the original tax may have been on business or property. An example is the corporate income tax, which in the final analysis is paid by consumers in higher prices, workers in lower wages, or stockholders in smaller dividends. Another example is the shifting of property taxes to renters; this can be compensated for by giving tenants' rent credits, either as an income tax credit or refund, or as a cash payment.

When applying criteria to taxes, it is important to remember that some criteria are compatible, some are direct opposites. No tax can meet all criteria. *Who* does the evaluating is also important, for personal values and self-interest can influence the relative importance of criteria to different people. Taxes also must be evaluated in the context of the total tax and expenditure structure, which includes federal, state, and local taxes, both direct and indirect. And still another factor making application of criteria difficult is that a multi-tax system like Minnesota's dilutes the inequities of any one tax, since the inequities of each tax may fall on a different group. It also may make for lower tax rates in some areas, since there are so many different sources of tax revenue.

In the pamphlet describing specific taxes in Minnesota, appropriate criteria will be applied to each tax in an effort to help the reader evaluate them.

GLOSSARY

The following terms refer to both taxation and expenditures in public financing and will be used in all four "Facts and Issues." They will not be fully defined each time they are used in the texts. Most of the terms are used universally in the field of public finance; those referring only to Minnesota are so indicated.

ability to pay: the principle that a tax should be levied on individual taxpayers in accordance with their ability to pay, rather than in proportion to benefits they receive or how much it costs the state for services rendered.

apportioned tax: a tax collected by one political unit but distributed among several.

assessment: (1) a value placed on property for the purpose of taxing it; (2) amount exacted as a tax.

assessed value: in Minnesota, the actual market value of property is reduced by a specified percentage set by the government; the resulting "assessed value" is the valuation used in computing taxes on the property.

benefits-received principle of taxation: the principle that taxpayers should pay taxes in proportion to the benefits they receive.

capital outlay expenditure: direct expense of construction and/or purchase of equipment, land, and buildings used to produce income.

circuit-breaker: in Minnesota, refers to the income-adjusted homestead credit — a property tax credit based on income and amount of property taxes paid.

classified property tax: a tax system in which property is classified according to its nature and purpose, so that different tax rates can be applied against each class; some classes may be exempted from taxation.

compensatory principle of taxation: see benefits-received, above.

consumption tax: a tax levied on some phase of the production or distribution of goods and services, and sometimes applied to customs duties; see excise tax, below.

current operation expenditure: money spent for wages and salaries, and for supplies, materials and contractual services, excepting capital outlay.

delinquent tax: a tax that remains unpaid after the date due.

discriminatory taxation: (1) taxation designed to favor certain industries; (2) any tax exemption or allowance which seems to favor one taxpayer at the expense of another; (3) regressive taxes which put a heavier burden on low-income persons than on high-income persons.

EARC ratio: in Minnesota, the percentage relationship between the assessor's market value and the state-determined market value of property.

EARC values: in Minnesota, actual market value of a tax district's property as determined by the Equalization Aid Review Committee (EARC); made by comparing selling price of properties with the market values at which the properties were assessed.

equalization: adjustment of locally-determined market values in each assessment district, such as county, so that the valuations in each district represent the same percentage of actual market value.

estate tax: tax levied on estate of a deceased person before the estate is divided among the heirs.

excise tax: a selective sales tax; see consumption tax, above.

expenditure: money paid out by government, excepting debt payments, investments, loans, and transactions between government agencies.

foundation aids: in Minnesota, state aids provided to school districts on the basis of pupil units; supplements local property taxes.

franchise tax: tax levied on some special privilege extended by government to a private enterprise.

general expenditure: all government expenditures except those necessary to operate public utilities, liquor stores, and insurance trust funds.

general revenue: all revenue of a government except revenue from operation of public utilities, liquor stores, and insurance trust funds.

general revenue sharing: money received by state and local governments from the federal government under the State and Local Fiscal Assistance Act of 1972.

gift tax: a tax imposed on property transferred from one person to another as a gift.

hidden tax: an indirect tax which is part of the price of goods and services; the taxpayer doesn't know he or she is paying it.

homestead: in Minnesota, a residence occupied by its owner; a property owner may have only one homestead.

incidence of taxation: who really pays a tax irrespective of how or against whom it is levied (for example, a sales tax is almost always paid by the consumer although the seller is the one formally taxed; thus the incidence is on the consumer).

income tax: federal, state or local tax on corporate or individual income, which includes wages, rents, interest, dividends, royalties, profits, commissions, etc.

indirect tax: a tax which can be easily passed on to someone else by the person required to pay the tax; see incidence of taxation, above.

inheritance tax: tax paid by an individual who receives property from the estate of a deceased person.

intergovernmental expenditure: payments from one unit of government to another as grants-in-aid, shared revenue, payments in lieu of taxes, or reimbursements for services.

joint return: for tax purposes, combined report of income of husband and wife.

levy limits: amount local governments are permitted to levy against their property tax base for certain services.

license tax: see occupation tax.

limited market value: in Minnesota, properties reassessed at more than 10% above former value, or ¼th of the increase in valuation, must be increased in increments; the old value plus the incremental increase constitute the limited market value, which is then used for computing the tax on the property.

local government aids: in Minnesota, state aids to counties, cities, towns and special taxing districts, based on population, mill rate and sales ratio.

luxury tax: a tax imposed on articles not considered essential to a normal standard of living.

market value: what the assessor says a property is worth, and supposedly what the property would be worth if it were sold; however, market value varies in Minnesota sometimes 20-30% from actual value.

mill: a unit of value used to determine taxes on Minnesota property and payrolls; if one mill is levied by local government, the taxpayer pays $1 on every $1,000 of assessed value, a two mill levy would mean $2 on every $1,000, etc.

miscellaneous general revenue: money government receives from charges for public services, special assessments against property owners, interest earnings (excluding interest earned on insurance trust funds), and any other money taken in except taxes and intergovernmental revenue.

occupation tax: (1) fee charged for license issued by the government for certain occupations and professions; (2) generally, a tax levied on a particular occupation or profession, also known as a privilege tax or a license fee.

payroll tax: tax levied against an employer, based on wages and salaries he pays to his employees.

personal property tax: see property tax.

privilege tax: see occupation tax.

proceeds: money a tax yields after collection costs are deducted.

progressive taxation: a tax which takes a larger percentage of income as income increases.

property tax: a tax levied on any kind of property, including land and buildings (real property) and stocks and bonds or home furnishings (personal property).

proportional taxation: a tax which takes the same percentage of income from all income levels.

public revenue: government income from taxes and all other sources.

real estate tax: see property tax.

regressive taxation: a tax system which takes a larger percentage of low income than of higher income.

revenue: all money received by a government, except that received from borrowing, liquidation of investments, and agency and private trust transactions.

sales ratio: in Minnesota, the comparison between the assessor's estimated market value and the actual selling price of property as determined by the EARC.

sales tax: tax levied on sale of goods and services.

severance tax: tax levied on value of natural resources taken from land or water.

shifting of taxation: see incidence.

special aids: in Minnesota, school aids for specific purposes such as transportation, education of the handicapped, etc.; see foundation aids.

special levies: in Minnesota, levies which are not covered by the levy limitation law, principally welfare and bonded debt levies.

surtax: (1) an extra tax on an amount which has already been taxed; (2) additional tax calculated as a percentage of a tax already levied.

tax base: a unit of value, privilege or object used as a base for calculating a tax to be levied; it may be property, income, an estate, a corporate franchise, an occupation, or the volume, number, quality, or other characteristic of certain articles. To this the rates are applied: base times rate equals tax.

tax exempt: persons, property, or goods not subject to taxation.

tax limit: constitutional or legislative limitation on kind of tax and maximum rate.

tax revenue: all revenue a government gets from taxes it imposes, including interest and penalties.

tax sharing: a tax levied and collected by one jurisdiction and shared with others; see general revenue sharing.

use tax: tax designed to reach taxable persons who have not paid the sales tax.

value added tax: a tax on all levels of manufacturing, processing and distribution based on the amount each operation adds to the price.

Statewide Survey Results

In March, 1976, members of 52 Leagues of Women Voters conducted a statewide telephone survey on people's attitudes and knowledge of government financing in Minnesota. 244 people, chosen by random sample, were surveyed. The questions and responses are shown here. Although 244 people were surveyed, totals may be different since not all people answered all questions.

1. *Of the three major taxes in Minnesota, the individual income tax, the property tax, and the sales tax, which do you feel is the most fair?* individual income - 74, property - 31, sales - 125
   Which do you feel is the least fair? individual income - 84, property - 101, sales - 40

2. *Of all the taxes collected by state and local governments, do you happen to know which raises the most money?* individual income - 87, property - 36, sales - 28, not sure - 86

3. *Do you feel the services you receive from state and local governments are adequate in relation to the taxes you pay; that is, do you think you're getting money's worth?* yes - 108, no - 92, uncertain - 42

4. *Do you happen to know on which of the following items you pay a sales tax?* food - 17, automobiles - 205, drugs and medicines - 41, household appliances - 203, fur coats - 150

5. *Many people feel the income tax forms are too complicated, too hard to understand and fill out; do you pay someone to help you fill out your income tax forms?* yes - 150, no - 67, not sure - 5

6. *Do you know whether any of your state income tax moneys are used to help run your local city or county government?* yes - 146, no - 30, not sure - 65

7. *Do businesses in MN pay more of the total income tax than individuals?* yes - 62, no - 106, not sure - 73

8. *Does state government levy general property taxes?* yes - 68, no - 101, not sure - 73

9. *By state law, assessors are required to assess property at its full market value. How do you feel most property in your community is assessed in relation to its actual market value?* higher - 51, lower - 88, about the same - 60, no opinion - 41

10. *If the assessment of a piece of property is raised, will the tax on that property automatically be raised?* yes - 146, no - 20, not necessarily - 45, not sure - 30

11. *Do you happen to know, on the average, what portion of the local property tax goes to finance local schools?* ¼ - 42, ½ - 58, ¾ - 25, not sure - 117

12. *Of all the money that will be spent on public assistance (welfare) programs in MN, do you happen to know how much comes from local tax sources?* 8% - 34, 29% - 50, 57% - 22, not sure 133

13. *Do the taxes you pay have an influence on who you vote for?* yes - 80, no - 148, not sure - 14

14. *Are there any government services you'd like to see improved even if it would mean increasing taxes?* "nothing" or "none" was mentioned most (66 times); others mentioned often were: local law enforcement, health and hospitals, education, highway building and maintenance; other answers mentioned at least once covered the entire scope of governmental services.

    Are there any services you'd like to see cut back? "nothing" or "none" mentioned 65 times; welfare and highways were also mentioned (although many welfare responses were categorized as welfare "reform"); many of the responses referred to administrative costs or bureaucratic excesses in many different areas of governmental services.

Correct Answers:

2. *Property taxes 31.8%*
   Individual income tax 25.6%
   Sales and use taxes 13.8%
   Corporate income tax 6.2%
   All 1975 estimated figures from MN Dept. of Revenue

4. *yes — household appliances, fur coats (usually) although automobiles are* ***exempt*** from the MN Sales Tax, they are subject to a 4% motor vehicle tax.

6. *yes — state supplements local government revenues from the property tax via local government aids (aids to counties, municipalities, townships, special districts, and aids to school districts).*

7. *no — of total income taxes collected in 1973, 16.5% came from corporation tax.*

8. *no — local governments levy property taxes; counties collect and administer them.*

10. *not necessarily — the amount of tax is determined by the mill rates of the government units in the county. If all assessments were raised equally, the mill rate could be lowered and taxes remain the same.*

11. *½ — statewide average is 54%.*

12. *8% — the major portion comes from federal sources.*

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FACTS and ISSUES
FINANCING STATE GOVERNMENT

League of Women Voters of Minnesota

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Minnesota's Multi-Tax System

This "Facts and Issues" contains a description of every tax used for raising revenue in Minnesota. The major taxes, personal income, property, and sales taxes, are presented first. The other taxes are grouped by type. Each tax is explained in terms of who is taxed, how much is collected, which government unit collects and distributes the tax, and which criteria can be used to evaluate the tax. Collection figures for each tax are for the fiscal year 1975, running from July 1, 1974, to June 30, 1975. The total collected by the Minnesota Department of Revenue and other state agencies in fiscal 1975 was $2,019,936,000; this does not include property tax revenue, collected by local governments, estimated at $1,001,208,000 in fiscal 1975.

PROPERTY TAX

One of the first taxes levied by civilized man was the tax on property. As early as the fourth century B.C., the Greeks and Romans were working out definitions for terms like "property," "equitable assessment," and "administration." The property tax survived through the years despite considerable criticism, perhaps because (1) it raises revenue needed by local government units, (2) it has a certain "relevance," because it pays for services to those who are taxed (e.g. street maintenance and fire and police protection), and (3) it is easy to locate for assessing because real property is mostly fixed or immobile. Today, property taxes account for about one out of every six tax dollars collected in the United States.

In computing property taxes in Minnesota, each local taxing district — cities, counties, townships, and special taxing units like school districts — decides how much money it needs from the property tax for the coming year. This amount, called a levy, is applied against the assessed values to arrive at the mill rates required to raise necessary amounts. Then all the mill rates for a given area are applied to the assessed value of each piece of property within the area to compute the tax on that property. The property owner pays the taxes to the county treasurer, who returns the money to each local government or taxing unit in proportion to the unit's mill rate.

Not to be confused with property tax are special assessments levied on property for improvements like storm sewers, curbs, water mains, and sidewalks. Such improvements may benefit the property receiving them and may increase the market value of the property, but special assessments are levied for specific projects and appear on property tax statements as a separate item.

Although the state no longer imposes or collects the property tax, it still regulates many of its aspects. Sometimes, such regulation becomes extremely complicated. For example, state law requires that all property in Minnesota must be valued at market value for tax purposes. This means that the assessor's estimated value for each real estate parcel should be the same as the probable selling price of the property, thus "equalizing" taxes for individual property owners and taxing districts. Actual practice, however, varies considerably, despite the law. Studies have shown that estimated market values in the state range from 50% to 140% of actual market value; this ratio of estimated market value to probable selling price at the time of assessment is called the sales ratio. Recognizing this variation, and recognizing its special importance to local governments and school districts, whose municipal aids and state school aids are based on the equalization principle, the state has established the Equalization Aid Review Committee (EARC). The state commissioners of education, revenue, and administration meet as the EARC to review such studies and adjust assessed values where necessary. Assessment/sales ratio studies also provide valuable information for taxpayers, assessors, the legislature, and tax administrators.

The state legislature also limits the amount of revenue each taxing unit can raise by property tax levies. The first such legislation was passed in 1971. Today, there are two basic levy limitation laws; one pertains to local governments and one to school districts. Local governments with a population over 2500 are limited to a percentage increase per year, while school districts are limited to increases based on the maximum mill rate.

There are also numerous tax advantages in the form of classifications, credits, and exemptions by which the legislature has tried to make the property tax less burdensome and more equitable. The first of these devices was classification, adopted in 1913. The legislature divided real and personal property into four classes, with the tax rate applied to varying proportions of assessed value. The homestead classification was adopted in 1933 to help property owners in danger of foreclosure and eviction. It was also supposed to encourage homeownership, because it reduced the tax levied on real property occupied by its owner. The homestead classification now includes mobile homes, and defines a farm homestead as up to 120 acres of land contiguous to the dwelling. The number of classifications has increased steadily over the years; currently there are more than 30. This makes Minnesota's tax system complex and cumbersome to administer, and makes property difficult to assess. Some classification of property may be desirable, but many experts deplore the results of the system: favored treatment of one group or class of property is nearly always achieved at the expense of other groups.

The Tax Reform and Relief Act of 1967 introduced the first tax credit for property owners through the homestead credit. Low-income senior citizens and renters were also given special property tax relief by the 1967 legislature. Each legislative session since 1967 has made changes in the credit. In 1973, for example, totally disabled and legally blind persons became eligible for the credit, and a special property tax "freeze" was enacted, freezing the net homestead property tax at the amount it was when the homeowner reached age 65. This freeze now depends on income.

In 1975 the legislature created the income-adjusted homestead credit. It introduced the concept of personal income as a factor in the property tax system. This was Minnesota's first "circuit breaker" type legislation, so-called because it prevents an overload on taxpayers, just as an electrical circuit breaker prevents an overload on an electric power source. It authorized the state to "pay" the taxpayer, in the form of a credit against his income taxes, if property taxes exceeded a certain percentage of household income. Renters also benefit from this circuit breaker. They may assume that 20% of their rent goes for property tax, and apply for a refund or state income tax credit. The income-adjusted homestead credit, and the other special freezes and credits, are administered through the income tax, and are further explained in that section.

Another legislative device concerns certain kinds of property which are exempt from taxation — property owned by religious, educational, charitable, and governmental entities, certain personal property, Indian lands, real and personal property used to control air, water or land pollution, and industrial commercial tools, machinery and equipment. Certain types of public utilities property are also exempt, but are subject to the gross earnings tax instead. Federally owned land is also exempt from taxation except for specific cases authorized by Congress. Some experts view exempt property as beneficial, because tax-exempt private institutions, for example, render services to the community that would otherwise have to be provided at public expense. However, in a community with a high proportion of exempt property, non-exempt taxpayers carry a heavier portion of taxation.

Minnesota's pioneering Fiscal Disparities Act, passed in 1971, acknowledges the wide differences in taxing capabilities of the more than 300 units of government in the seven-county Minneapolis-St. Paul metropolitan area. It recognizes that benefits of local services flow across the boundaries of the taxing governments, among suburbs, between suburbs and central cities, and among school districts. It calls for pooling 40% of the growth of the commercial and industrial tax base in the metropolitan area. The pooled tax base is then redistributed to local taxing units, both governments and school districts, by a formula based on population and need.

The state legislature has also used its tax regulatory powers to try to achieve more equitable property taxation in other areas. The 1967 Agricultural Property Tax Law, known as the "green acres" law, defers tax increases and special assessments on property in urban fringe areas which is used for agricultural purposes. Although the land may increase in value because of its potential for residential or commercial use, the tax continues to be based on the value for agricultural use until it's sold or is no longer used for agriculture. It is then subject to additional taxes equal to the difference between its agricultural value and its market value for the three years of deferment immediately preceding the sale. Thus increases in land values do not discourage property-owners on the urban fringe who want to continue farming. Here too, however, tax relief granted to one group must be borne by other groups.

Two other taxing methods offered by the state and designed to encourage use of land for conservation practices are the Tree Growth Tax and the Auxiliary Forest Tax. Owners of five or more acres of forest land may apply to have their land taxed under the "tree growth" tax law instead of paying any other type of property tax on it. Charges for the land differ according to its current productivity. Land suitable for growing commercial timber, in lots of no less than five nor more than 40 acres, may be taxed as "auxiliary forests" if the county auditor approves. This levy supersedes any property tax. Salable timber or mineral interests in the land are taxed separately.

The 1975 state legislature passed a number of laws which affect property taxes. In addition to the income-adjusted homestead credit, the legislature (1) directed the state to assume 90% of non-federally funded medical welfare costs which counties had been funding primarily through the property tax. (2) increased state aid to local governments and revised the formula for distributing such aids; (3) modified tax levy limitations to reduce restrictions on local spending; (4) repealed the 5% assessment limitation on increases in property valuation so that all property assessments may be brought up to market value within four years; (5) changed homestead assessment procedures to make them more responsive to inflation; (6) increased the taconite production tax and changed its distribution formula; (7) increased the school maintenance mill reduction for agricultural property and seasonal recreational property.

Revenue from property taxes in Minnesota was estimated at $1,001,208,000 in fiscal 1975. While this figure has been rising, it has grown smaller as a percentage of total revenues in the state, reflecting the legislation drawn to afford relief to property owners. In fiscal 1974, for the first time, the property tax lost its distinction as top revenue raiser in Minnesota, being surpassed by the combined total of personal and corporate income tax revenues.

STATE INCOME TAX

If economists and politicians were polled on which kind of tax they preferred, most would probably choose the income tax. Economists like it because it can be structured in accordance with the taxpayer's ability to pay; politicians like it because it is a relatively easy way to raise substantial sums of money. Minnesota first levied a state income tax in 1933; today it is the state's major source of tax revenue. In fiscal 1975 it produced $807,100,000, or about 40% of state tax revenues. Collected by the Minnesota Department of Revenue, it goes to the state treasury, where it is credited to the general revenue fund.

The Minnesota income tax is levied on most income, including wages, salaries, tips, dividends, interest, pensions, and annuity payments. Wages and salaries are taxed by withholding a specified portion; other forms of income are taxed in quarterly prepayments based on a declaration of estimated tax. By law, Minnesotans must file an income tax return if their Minnesota income exceeds a certain specified amount, the amount varying with such factors as age and marital status.

The taxpayer does not pay income tax on gross income. Instead, he pays taxes on what is called taxable income. To arrive at taxable income, the taxpayer must first compute his Minnesota adjusted gross income. This is all the money received during the year which is subject to Minnesota taxation, including any federal income tax refund, minus federal taxes paid for the year. Then the standard or itemized deductions allowable are subtracted from this adjusted gross income; what's left is taxable income.

Besides being able to reduce the net income on which taxes must be paid, the taxpayer may be able to reduce the tax itself by using tax credits. Minnesota law provides two types of credits, refundable and non-refundable. Refundable credits may be paid to the taxpayer in cash, non-refundable ones are subtracted from his tax liability. There are five *non-refundable credits*. (1) *Personal and dependent credits*, allowed since 1972, include $21 each for the taxpayer, his or her spouse, each dependent, and the estate of a family member who has died during the year, plus an additional $21 for the spouse if they are 65 or older. (2) *Income tax paid to other states* can be credited if the income was derived from personal or professional services, if the other state doesn't allow a credit for Minnesota residents, and if he must pay income tax to the other state on the earnings. (3) *Pollution control equipment credit* can be taken for items purchased to reduce air, land, or water pollution. (4) *Political contributions* to a party and candidate can be used as a tax credit up to 50% of the contribution up to $12.50, or to $25 for a married couple filing jointly. When the contribution is only to a party, the credit is $5 for an individual and $10 for a joint return. (5) *Low income credit* "forgives" all or part of income tax owed by the so-called "working poor." The amount of qualifying income varies according to family size, from $4,400 for a single wage-earner to $7,800 for a family of six or more.

There are three *refundable credits* which may be paid in cash to the taxpayer if they exceed his total state income tax liability. (1) *the income-adjusted homestead credit (circuit breaker)* — enacted by the 1975 legislature — attempts to tie property tax liability to a renter's or homeowner's income. It is based on whether the homeowner's property tax, or the portion of property tax included in rent, exceeds a certain percentage of the taxpayer's gross income. The percentage rises with income and is determined by a sliding scale. Homeowners over 65, disabled persons, and renters may claim this credit against their income taxes or receive a cash payment if the amount due exceeds their tax liability; other homeowners can claim it only as a credit against their income tax. It does not replace the existing homestead credit allowed against a homeowner's property tax, but the income-adjusted credit is reduced by the amount allowed for the homestead credit. (2) The *property tax freeze credit* freezes a homeowner's property tax when he reaches 65. The state then pays the county any difference between the amount at which the tax was frozen and the amount due in subsequent years. The 1975 circuit breaker legislation partially removed the freeze for senior citizens with incomes over $10,000; those with annual incomes of $19,500 or more must pay current property taxes in full. (3) There is also an *exempt agricultural electricity credit*, which refunds sales tax paid on electricity used for farming.

Although taxpayers lament about having to pay income taxes, this form of taxation does meet a number of the common criteria for judging a tax. One of the chief advantages is that it matches the taxpayer's ability to pay, because the rate structure is progressive up to $20,000 of taxable income, and it can be personalized through deductions and credits so that, for example, a single taxpayer with an income of $8,000 pays more than a married taxpayer trying to support a spouse and two children on the same $8,000.

Another feature of the income tax which is attractive to government is that it is elastic. It is the only major tax which grows faster than overall economic activity. A 10% rise in personal income can yield a 15% increase in tax collections, because as a taxpayer's income rises, he or she moves into higher tax brackets. Much of the $200,000,000 surplus in the state treasury at the end of the 1975-76 biennium was a result of the elastic nature of the income tax. Income tax receipts in fiscal 1975 increased 15% over 1974, although the rate structure stayed the same.

Other qualities of the income tax desirable to government are its high yield and the relative ease with which it is administered.

The Minnesota income tax does have its limitations, however. Some contend that the current flat rate of taxation on incomes over $20,000 should be changed to make the rates progressive at higher levels of income. One way to accomplish this would be elimination of the federal deductibility provision, which would raise taxes substantially for persons with higher incomes by no longer allowing Minnesota taxpayers to deduct federal taxes paid from their state taxable income. The federal rate structure is more progressive than Minnesota's, so if Minnesota eliminated federal deductibility, people in higher income brackets would see their taxable income increase by a larger percentage than people with lower incomes.

In considering the merits of this suggestion, it might be instructive to examine the impact of federal deductibility on state revenues. The federal income tax is the single most important deduction Minnesotans make in computing their taxable income; it comprised 48% of all deductions in 1968. As a result of this deduction, 14% of gross income earned in Minnesota is not subject to Minnesota income tax. In fiscal 1967, removal of federal deductibility would have increased state tax revenues by $87,000,000, or 34%, and by fiscal 1973, the increase would have been $360,400,000. Given the accelerating demands on state government, it's easy to understand why the proposal to eliminate federal deductibility has strong support.

Proponents of this measure also put forward several other arguments in its favor. They claim that permitting federal deductibility makes Minnesota dependent on the federal tax system and its periodic rate changes. They also point out that if federal deductibility were eliminated, the legislature could lower the rate structure and still raise as much as, or more than, the state collects now.

An argument put forward against removal of federal deductibility is that it is unfair to tax income used to pay taxes, but supporters of the idea counter by pointing out that many other taxes are not deductible, and that taxes are simply part of the cost of living, just as goods and services are. The argument for maintaining federal deductibility is strengthened by the fact that Minnesota consistently ranks in the top ten states in income tax rates. Without lower rates, a rise in individual tax liabilities could become a political liability for many a state legislator.

Another criticism frequently leveled at the Minnesota income tax structure is that the family with one wage-earner is penalized, since it pays taxes at a significantly higher rate than the family with two wage-earners. This happens because Minnesota tax laws make a different distinction between married and single taxpayers than federal laws do. A family with one wage-earner who earns $20,000, for example, pays approximately $1,315 in state income tax, but a family with two wage-earners who together earn the same $20,000 might pay only $947, depending, of course, on other deductions. Those who favor the present plan contend that families with two wage-earners incur additional expenses, such as child care and transportation, which should be reflected in their tax liability. They also like the balanced contrast Minnesota taxes offer to federal taxes, which fall more heavily on the single taxpayer.

Other proposals for the income tax are concerned with simplification of forms and rates, or changes which would allow more people to use standard rather than itemized deductions. Since taxable income is based primarily on figures from federal income tax determinations, changes proposed in Minnesota are sometimes limited in impact by what happens to the income tax at the federal level.

SALES AND USE TAX

As the demand for state government services expanded in the 1960's, Minnesota had to find additional sources of revenue, and in 1967 the legislature introduced a 3% sales tax. The sales tax was part of a major tax reform and relief act, and was designed to cover revenue losses projected by elimination of personal property taxes and state property levies. In 1971, the legislature raised this tax to 4%.

Most retail sales are subject to this tax. The important exceptions are food, clothing, and prescription medicines and drugs. Sales taxes are also collected on admissions, amusement devices, furnishing of meals, drinks, and/or take-out food, hotel and motel rooms, electricity, gas, water, and certain telephone services. Coin-operated vending machines which make taxable sales are subject to a tax of 3% of their gross receipts. There is also a use tax, a sales tax primarily intended to cover purchases from out-of-state retailers. It is imposed on the storage, use, or consumption of taxable items, and serves the useful purpose of preventing Minnesotans from evading the sales tax on "big-ticket" items like large appliances, carpeting, or boats by purchasing them in a nearby state. Motor vehicles are exempt from the sales and use tax, but they are subject to a 4% excise tax collected by the Department of Public Safety.

Together, the sales and use taxes netted $350,000,000 in fiscal 1974 and $383,000,000 in fiscal 1975. They are expected to generate 17% of all state and local taxes during the 1975-77 biennium. Every person who leases, rents or sells taxable items at retail in Minnesota must have a Minnesota Sales and Use Permit; he must impose the tax on the buyer and report it and pay it to the state. The money goes to the state treasury, where it is credited to the general fund.

The sales and use tax, like any tax, has both advantages and disadvantages. One of its major advantages is that it is reliable, and its yield grows automatically as the economy grows. Another advantage is that it is economically neutral — that is, it does not materially affect business decisions of either industry or labor. A third advantage is that, because it falls on the ultimate consumer, it is easy to increase or decrease the tax "take" from a given category of users. (A tax increase at any other point in production or sales would involve such things as inventory counting; and setting up new reporting and collecting procedures.) Another advantage of the sales tax in a tourist state like Minnesota is that it is also paid by visitors from out-of-state, who come to enjoy the state's recreational and vacation facilities. By paying sales tax, they help pay for many government services which benefit them, too.

The sales tax is apparently popular with taxpayers — 54% of respondents in the LWVMN telephone tax survey chose it as the "most fair" tax, and it is also popular with the tax collector. Among the reasons are these: (1) it's relatively painless, because it's collected in small and often unnoticed amounts; (2) the taxpayer is always current, never in arrears; (3) there are no lump sum payments to make or deadlines to meet; (4) the government can collect large amounts of money despite the low rate. For example, increasing the sales tax from 3% to 4% in fiscal 1971 brought in an additional $96,000,000 in tax revenue. Politicians like the sales tax because it seems to incur less voter resistance than other taxes; businessmen like it because it doesn't interfere with how they run their business, and it doesn't take away the incentive to work.

One of the disadvantages of the sales tax is the confusion both buyers and sellers sometimes face when the specific use of an item determines whether it's taxable. If a person is buying upholstery fabric (which is taxable) to make a skirt or vest (which are wearable items of clothing and thus tax-exempt), no sales tax should be charged. The true cost to retailers of these and other collection details is hard to compute, but can be substantial. Another disadvantage of the sales tax is that it is regressive, because it taxes the poor, who must spend a large proportion of their income for necessities, at the same 4% rate as higher-income people. Minnesota tax law combats this regressive feature by exempting food and clothing from the sales tax, although it does not exempt certain high-priced, so-called "luxury" items. Fur coats, for example, are an item of clothing, but the buyer must pay sales tax, if the value of the fur is more than three times the value of the next most costly material in the coat. In this way, relatively affluent people who buy expensive items like boats, furs, and recreational goods and services make large sales and use tax payments each year, while low income people whose earnings go primarily for such necessities of life as food and clothing make relatively small sales tax payments. Thus, though the sales tax is still regressive, it is less so in Minnesota than in many other states, except, perhaps, for the very poor and the very rich.

OTHER TAXES

Corporate Excise Tax

Every state that taxes personal incomes also taxes corporate incomes. By law, a corporation has no tax-paying ability separate and apart from that of its stockholders, so Minnesota calls its tax a corporate excise tax, and defines it as a tax on the value of the privilege of operating in the state. In contrast to the personal income tax, which is progressive, the corporation tax is proportional, in that it taxes all income at the same rate.

In fiscal 1975, Minnesota collected $180,482,000 in corporate excise taxes. Although this was 18.2% of all income tax collected, it was only 9% of total state tax revenues, compared to 40.1% in 1941 and 16.5% in 1973. This decrease in percentage of total tax collections occurred despite an actual increase in collections. The corporate excise tax rate was increased from 7% to 12% during that period, but the addition of new taxes (like the sales tax) and increases in other tax rates made the percentage difference.

A Minnesota corporation is required to file an annual tax return if its gross income is over $5,000 or its taxable net income over $500. Since 1973, every such corporation must pay at least the minimum tax of $100. Net taxable income is determined by total gross income, less business expenses paid during the year and a number of exemptions and credits. For example, there is a formula for exempting out-of-state sales from state income taxes. This formula, in effect, encourages Minnesota-based manufacturers to expand manufacturing, research and office facilities in the state, and serves as an incentive for those firms to sell finished products or services nationwide. There is also a $500 credit for every corporation filing a return, and there are credits for dividends received from another corporation, contributions to the state and its political subdivisions (but not individuals), and contributions to nonprofit organizations operating in Minnesota. A 5% credit for the cost of buying, installing, and using pollution control equipment is allowed up to a maximum of $50,000, with feedlot operators allowed 10% and no maximum. Taxes paid to the federal government or to foreign countries are not deductible.

Revenue from the corporate excise tax is deposited in the state treasury and credited to the general fund. Quarterly pre-payments are required if the annual tax is expected to be over $1,000.

Minnesota's 12% rate for corporate taxes is the highest in the country, and has been a source of conflict between Minnesota business firms and state officials in recent years. A series of articles in the *Minneapolis Star* in December, 1975, examined the issue and concluded that each side had been "overstating" its case. The series made the point that the level of public services the state provides is high enough to bring companies into the state in spite of the high tax rate. Moreover, a recent U.S. Bureau of Economic Analysis report predicts a faster growth of employment in Minnesota through 1990 than in neighboring states which have lower corporate taxes. This could seem to discredit corporation claims that high taxes are costing the state money and jobs.

An important point to remember is that the burden of corporate taxes does not fall on an impersonal business; it falls on people. The corporation's taxes are absorbed by stockholders, who receive reduced dividends, by consumers, who pay higher prices, or by workers, who receive lower wages. The specific incidence of the tax, however — who eventually pays what part of it — is controversial and difficult to measure, although economists continue to investigate this tax-shifting process in an effort to measure the tax burden on different groups in the population more accurately.

Government views the corporate income tax as providing stable, reliable growth in yield. It is easy to administer and there are few attempts to evade the tax.

Bank Excise Tax

The bank excise tax is a 12% tax on the net income of every national and state bank in Minnesota. Each bank is considered a separate corporation, even if it is part of a large bank system or group. Net income is determined just as it is determined for other corporations, with additional adjustments for certain investments and dividends. Filing requirements and tax minimums are also identical to those for corporations. This tax contributed $15,412,000 to state revenues in fiscal 1975.

The bank excise tax is in lieu of all taxes on capital, surplus, property assets and shares. However, banks do pay the local property tax. Until 1973, part of the revenue from the bank excise tax also went to local taxing districts. Now all revenues are deposited in the state treasury and credited to the general fund.

Like the corporate excise tax, the bank excise tax is stable, grows steadily in yield, and is easy to administer and enforce. Unlike corporate excise taxes, it is not a subject of widespread criticism, perhaps because the tax rate was reduced in 1973 from 13.34% to the present 12%.

Employer's Excise Tax

Minnesota is the only state with an employer's excise tax. Enacted in 1973, this tax is imposed on payrolls over $100,000 per calendar year. Specifically exempted are freight, express, sleeping car and taconite company railroads, incorporated public institutions, government-owned corporations, and public charitable institutions. The tax rate is two mills per dollar (.2%) on payroll excess over $100,000, or 1% if an employer has no net taxable income. It is reported and paid quarterly, and all revenue is credited to the state general fund. Revenues from this source totaled $15,180,000 in fiscal 1975.

The employer's excise tax is stable, efficient, economical and easily administered, but employers call it unfair. They claim it is not based on ability to pay because it does not take corporate income into consideration, and they cite it as an example of the so-called anti-business climate the state legislature has created in the state. The question of who really pays what part of this tax is unanswerable. Obviously, the costs are passed on to stockholders, employees, and customers, just as they are with corporate and bank excise taxes. Legislation to repeal this tax passed the state senate during the last session, but not the house.

Inheritance and Estate Taxes

The inheritance tax is levied when real or personal property is transferred to a new owner after the death of the original owner. The 1976 legislature made several changes in the inheritance tax law. It doubled the amount of property exempted from the inheritance tax from $30,000 to $60,000, extended the period of time in which the tax can be paid from one year to five when more than $5,000 in tax is involved, removed sex designations so that the law refers to the "surviving spouse" rather than the "widow," added an "undue hardship" deferral provision, and increased the deduction which is an amount allowed for survivors' living expenses for one year.

In addition to the inheritance tax, estate taxes may also be levied on estates exceeding $60,000, but seldom are. This is because such estates are taxed by the federal government; the state estate tax, if one is assessed, is the difference between the maximum federal credit allowed for state death taxes and those actually paid, and the difference is usually minus. Both the inheritance and the estate tax, if any, are collected by the state and credited to the general fund, but 10% is returned to the county it came from. Inheritance and estate taxes brought in $39,209,000 in fiscal 1975.

Gift Tax

Taxes are imposed on property transferred from one person to another as a gift. Gifts up to $3,000 in any calendar year are exempt, as are gifts to the country, state, locality, non-profit organizations and employees. Exemptions are also allowed on gifts to relatives, with the exemption increasing with the closeness of the relationship between the giver and the recipient. State income from this tax in fiscal 1975 was $2,482,000.

Alcoholic Beverage Taxes

Minnesota charges taxes on liquor, wine, and malt beverages (beer and ale) at the wholesale distribution level, in addition to the regular 4% sales tax at retail. The tax rate for wine and malt beverages depends on the amount of alcohol they contain. All distilled spirits (liquor), however, are taxed at $4.39 per gallon, no matter what the alcoholic content. These taxes brought in a total of $48,878,000 in fiscal 1975.

Cigarette and Tobacco Taxes

Cigarettes are not subject to the regular Minnesota sales tax. Instead, they have their own excise tax based on weight. This tax on a pack of cigarettes is now 18 cents, with other tobacco products taxed at 20% of the wholesale price. A small discount is allowed for large volume purchases. State income from these taxes was $78,785,000 in fiscal 1975.

Mortgage Registry Tax

When a mortgage on real property is filed — that is, recorded by the county recorder in the county in which the transaction takes place — the mortgagee pays a tax of 15 cents on each $100 of debt secured by the property. This tax netted $4,672,000 for the state in fiscal 1975, with 95% of the proceeds retained by the state and 5% by the county.

Deed Transfer Tax

This tax is imposed on the transfer of all land and buildings. The tax is based on a certificate of value which must be presented before the transfer is recorded by the county auditor. Documentary stamps purchased from the auditor are used to pay the tax. Proceeds from this tax go to the state's general fund and in fiscal 1975 were $4,197,000.

Motor Vehicle Recycling Tax

Purchasers of new or used vehicles weighing more than 1,000 pounds pay a fee of $1 which the state uses to recycle or dispose of abandoned vehicles and scrap metal. All these dollar bills added up to $816,000 in fiscal 1975.

Gross Earnings Taxes

Certain kinds of companies are exempted from property taxes and instead pay a percentage of their gross earnings. This includes railroads, taconite railroads and express companies, which pay 5%; freight lines, which pay 7%; and sleeping car and telegraph companies, which pay 6%. Telephone companies with annual gross earnings of $1,000 or less pay 30 cents for each phone they have connected, while the rest pay a percentage of gross earnings based on the population of the area served (4% for rural or small town service, 7% for larger areas). The state retained all of the $53,800,000 collected in gross earnings taxes in fiscal 1975 except for taconite railroad taxes, of which 6% is retained by the state and the remaining 94% is distributed to local government units in the districts where the taconite railroads are located.

Insurance Premiums Taxes

Taxes paid on insurance sold in the state depend on the type of insurance sold and the type of company. The tax is allowed as a credit against the corporation excise tax, and for many companies this credit reduces the amount of income tax they pay to the minimum of $100. Domestic and foreign insurance sales companies are assessed a 2% tax on gross insurance premiums, both general and life, less returned premiums for all business received in Minnesota. In addition, all companies except mutual and township fire insurance companies must pay ½ of 1% on fire insurance premiums, minus returns, to maintain the office of the fire marshal. Town and farmer's mutual, mutual insurance companies like Blue Cross, and fraternal organizations like Lutheran Brotherhood are taxed only on fire, lightning and sprinkler premiums. Proceeds from these taxes in fiscal 1975 came to $34,443,000.

Rural Electric Cooperatives Tax

Electric utilities cooperatives operating in rural areas pay a tax of $10 per 100 members in lieu of property taxes on their lines. This tax brought in $32,000 in fiscal 1975.

Boxing Exhibition Tax

Gross receipts from professional boxing or sparring exhibitions and receipts from lease or sale of radio, movie, and television rights to such exhibitions are taxed at 5%. The tax must be paid within 24 hours after the event, and brought the state $18,000 in fiscal 1975.

Airflight Property Tax

This tax is levied on the flight property — that is, the equipment — of all air carriers operating in Minnesota under Civil Aeronautics Board certificates. Carriers without a CAB certificate pay a 1% aircraft registration tax or may choose to pay this tax if computations result in a lower amount. To compute the tax, the airline's total flight property value is determined. Then an amount is apportioned to Minnesota based on the airline's tonnage, time in flight, and number of revenue ton miles of passengers, mail, express, and freight flown in the state. This Minnesota portion is then multiplied by the state's average rate of property taxes to determine the tax owed. The airlines paid $2,334,000 in taxes to Minnesota in fiscal 1975.

Severance Taxes

A severance tax is a specialized business tax imposed in Minnesota on all minerals taken out of the ground. There are three kinds of Severance Taxes — Occupation, Royalty, and Production — and there is also a Severed Mineral Interests Tax. Most of these taxes are paid in lieu of state income taxes; the exception is taxes paid on copper-nickel ores, which may be credited against state income taxes.

The *Occupation Tax* is an excise tax on the occupation of mining, and is computed at various percentages for different minerals, averaging about 15% of the value of the mineral being mined. Net proceeds from this tax in fiscal 1975 were $9,820,000 on iron ore and $10,235,000 on taconite. This revenue is divided between Iron Range school districts, the University of Minnesota, the Iron Range Resources and Rehabilitation Commission, and the general fund.

The *Royalty Tax* on mining is the state's share of the profits paid to the owner of the property on which the mine is located. The mining company pays at a statutory rate of about 15%, depending on the type of mineral. In fiscal 1975, net proceeds from this tax were $1,532,000 on iron ore, $2,356,000 on taconite, and $2,000 on copper-nickel. This revenue all goes into the general fund.

The *Production Tax* applies only to taconite and is based on the amount produced. In 1975, the state legislature increased this tax; the current production tax of 22.5¢ per ton will almost triple by 1979, increasing to 61.5¢ a ton. In fiscal 1975, net proceeds from the taconite production tax were $11,952,000. This revenue is divided among the cities, towns, school districts, and counties in which the taconite is mined.

The *Severed Mineral Interests Tax* applies to the entrepreneur who owns mineral rights without owning surface rights on land which is taxed some other way, or is tax-exempt. The mineral rights are taxed at 25 cents an acre, with a minimum of $2. Twenty per cent of the proceeds from this tax is earmarked for loans to Indians who want to start or expand a business, and 80% is distributed to local government units in the same way as general property tax revenues.

Motor Vehicle Excise Tax

Automobiles are not subject to the 4% Minnesota sales tax; they are, however, subject to a 4% tax called a motor vehicle excise tax, which is collected on sales of both new and used automobiles and trucks. Exemptions include government purchases, gifts between family members, and voluntary or involuntary transfer between husband and wife in a divorce proceeding. The motor vehicle excise tax is paid to a deputy registrar, and must be paid before license plates or a certificate of ownership can be issued. The net amount collected in fiscal 1975 was $51,346,000. Revenues are deposited in the state treasury and credited to the general fund.

Motor Fuel Taxes

Minnesota's highway users help pay for their roads through dedicated funds, which are specific tax revenues set aside for a specific purpose. The principal sources of highway funds collected by the state are the motor fuels (gasoline) tax and the motor vehicle registration tax (license plate fee). An excise tax of nine cents per gallon on gasoline for motor vehicles operated on public highways goes to the Highway User Tax Distribution Fund, which is part of the Trunk Highway Fund. Under the so-called "62-29-9" amendment to the state constitution, ratified in the fall of 1956, 62% of the Trunk Highway Fund is allocated to trunk highways, 29% to counties and municipalities under 5,000 population, and 9% to municipalities over 5,000 population.

The highway gasoline tax netted $142,446,000 in 1975, the motor vehicle (and aircraft) registration fee $84,201,000. Because Minnesota is on a 90-10 sharing arrangement with the federal government on interstate highway projects and a 70-30 sharing plan on most state highway projects, the state received $86,638,828 in federal matching funds in 1974.

The same fuels excise tax of nine cents per gallon is also imposed on marine and aviation fuels and on combustible gases and liquid petroleum products, except for petroleum substitutes manufactured from waste materials. The revenue from this part of the motor fuels excise tax goes to various state agencies depending on type of fuel. Taxes paid for off-road vehicle fuels (marine, snowmobile and aviation) may be refunded to the individual who paid the tax if he files a claim with the Department of Revenue. Unrefunded revenue collected on fuel for snowmobiles goes to the Commissioner of Natural Resources for snowmobile trail and area maintenance and construction; unrefunded marine gasoline tax monies are divided equally among the state park development account, the game and fish fund, and the general fund for boat and water safety. Unrefunded revenues from aviation and special fuels are credited to the aviation fuel tax fund.

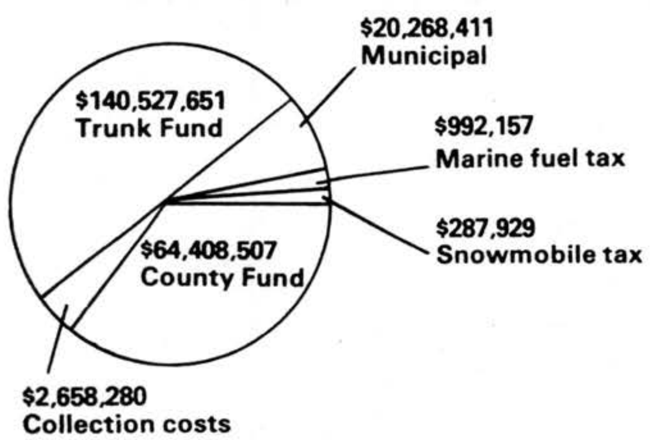
Motor Vehicle Licenses (Registration Tax for License Plates)

Minnesotans pay a variety of license and registration fees, some to support activities connected with the license (motor vehicle and game and fish), and some to simply add to state general revenues. All of them add an aspect of widespread participation to the general tax system and provide a dependable source of revenue to the state.

Motor vehicles using the public streets and highways are taxed to help pay for them. Rates vary according to the vehicle's age and use. New passenger cars are taxed at a rate of $10 per vehicle plus 1.25% of the base value, which is the manufacturer's suggested retail price, plus destination charges, but excluding cost of accessory items or optional equipment. The base value is decreased by a certain percentage each year, reflecting the decreasing value of the car as it gets older. Other vehicles, like farm trucks, buses and recreational vehicles, are taxed according to weight, with depreciation usually starting after the third year. Licenses must be renewed every year.

Motor vehicle licensing fees brought in $83,574,000 in fiscal 1975. They are collected by the registrar of motor vehicles, paid into the state treasury, and credited to the Highway User Tax Distribution Fund.

HIGHWAY USER TAX DISTRIBUTION FUND (1974 figures)



Motor Vehicle Operators Licenses (Driver's Licenses)

Everyone operating a motor vehicle in Minnesota must have either an instruction permit or a drivers license. As of January 1975, there were 2,455,000 licensed drivers in Minnesota. Of the three classes of license, the most familiar is class "C," the license issued to passenger car drivers. The others are for single unit vehicles (like buses) and for all other vehicles (trucks, etc.). Licenses must be renewed every four years. Minnesota residents paid $3,859,000 for drivers licenses and permits in fiscal 1975, of which 90% was credited to the Trunk Highway Fund and 10% to the general fund.

Watercraft Licenses

There are four categories of watercraft license fees — canoes and sailboats used by non-profit organizations for teaching water safety, watercraft for rent, privately-owned watercraft, and dealers. Fees range from $2 to $15 for a three-year license, and are collected by the Department of Natural Resources and dedicated to administration and enforcement of water and watercraft safety laws, inspection of watercraft, and acquisition and development of sites for public access to Minnesota waters. Up to 75% of the monies may be paid to counties to defray expenses for these activities. Total yield from this source in fiscal 1975 was $646,000.

Snowmobile Registration Fees

This fee is divided into three categories. Manufacturers and dealers pay the higher fees, snowmobile users — that is, private citizens — the lowest fee. The former must re-register annually, but private citizens register only every three years. In fiscal 1975, $1,282,000 was collected in snowmobile fees and deposited in the state treasury for the general fund.

Boxing Exhibition Licenses

This license is in essence an amusement tax, and is in addition to the 5% tax on boxing exhibitions. It is issued by the Boxing Commission to persons conducting a boxing or sparring exhibition. The fee varies according to population and whether the exhibition is amateur or professional. A minor source of tax revenue, this fee raised $7,000 in fiscal 1975.

Game and Fish Licenses

These licenses are required for both residents and non-residents who plan to hunt or fish in Minnesota. Costs vary according to resident or non-resident status, method of taking the animal, and type of animal, with various exemptions. Persons under 16 years of age and over 64 do not have to buy a fishing license; others with qualifying physical and mental disabilities are also exempt. The county auditor issues the licenses, retaining 10% of the fee, and sending the remainder to the Department of Natural Resources; the yield in fiscal 1975 was $9,611,000.

Wild Rice Licenses

This license fee varies according to who is doing the harvesting, with special consideration given to Indians on certain reservations. Only Indians or other reservation residents may harvest rice on the White Earth, Leech Lake, Nett Lake, Vermillion, Grand Portage, Fond du Lac and Mille Lacs reservations. The state regulates types of boats used and methods and hours of harvesting, and also specifies how much rice can be harvested each year. 6,122 licenses were sold in fiscal 1975, raising $22,476 for the state.

Business Licenses and Permits and Corporation Fees

There are 78 kinds of occupations or businesses which require state permits or licenses. The fees and restrictions are determined by state statutes and many are renewable annually. Revenue from these sources were $16,100,000 in fiscal 1975. All corporations operating in the state are required to file with the Secretary of State; this fee is paid only once and yielded $774,000 in fiscal 1975.

LOCAL TAXES

Local Cigarette Licenses

Any city or town can license and regulate retailers who sell cigarettes and cigarette paper. A county can also do so if it has no organized municipalities. The maximum annual licensing fee, set by the state, is $12, with proceeds going to the levying body.

Sand and Gravel Occupation Tax

Clay, Wilkin and Norman counties tax persons whose business is removing gravel from pits. Proceeds go to the three counties' road and bridge funds, and are also used to restore abandoned pits.

Trust Companies Gross Earnings Tax

Trust companies must pay 6% of their gross earnings to the counties in which their principal place of business is located. The revenue derived is distributed to local government units within the county.

Utility Companies Gross Earnings Tax

St. Paul and Minneapolis levy their own gross earnings taxes on utilities operating within their borders. St. Paul gets 8% of gross earnings on gas, steam, and electricity sold within the city; Minneapolis gets 3% of gross revenue on gas and electricity sold within the city.

Local Sales Tax

Duluth, Bloomington, Minneapolis, Rochester and St. Paul all impose some kind of local sales tax. Most involve payments for lodging, some for admissions and amusements, and one, Duluth, has a 1% "piggyback" sales and use tax which is charged in addition to the state sales and use tax.

COMPARISONS

Chart A General Revenue of state and local governments from own sources per $1,000 of personal income, fiscal 1973 & 1974

State	Amount (dollars)		As a % of U.S. average		Rank (among 50 states and D.C.)	
	1973	1974	1973	1974	1973	1974
U.S. average	161.36	156.83	100.0	100.0	—	—
Wisconsin	193.04	180.73	119.6	115.2	5	7
Minnesota	193.63	176.24	120.0	112.4	4	9
South Dakota	175.09	144.85	108.5	92.4	13	31
North Dakota	184.35	140.44	114.2	89.5	7	38
Iowa	156.34	139.93	96.9	89.2	26	40

Many sets of statistics are available for comparing tax revenues in Minnesota with those in other states. However, these statistics, like others, must be used with caution when making generalizations; one can almost always find supporting statistics for both sides of an argument!

Information on revenue and expenditures is compiled regularly by the Government Division of the U.S. Bureau of the Census. The Bureau uses uniform data classifications for all states and localities, but one should be cautious in using them to make comparisons among states, for the following reasons. (1) State figures are actual totals, but local government information is estimated from a random sample from each state; this makes aggregate state-local figures more reliable than local figures alone. (2) Comparing specific individual taxes or using either state or local revenue alone can be misleading, because states vary widely in their dependence on a particular tax as a percentage of total revenue. (3) Incomes of individuals in a state may vary considerably from one year to the next, changing certain tax revenues as a percentage of the state's total revenue. (4) Some states rely on revenue primarily from tax sources, but others rely more on charges for public services and other non-tax revenue.

Some of the more meaningful comparisons can be made by using both total state and local collections per $1,000 income and total collections per capita. (See charts A and B.) Another interesting question concerns what services the state provides in relation to its level of revenue. Chart C shows per capita general expenditures for two years.

Chart B Per Capita General Revenue of state and local governments from own sources fiscal 1973 & 1974

State	Amount (dollars)		As a % of U.S. average		Rank (among 50 states and D.C.)	
	1973	1974	1973	1974	1973	1974
U.S. average	719.18	784.80	100.0	100.0	—	—
Minnesota	832.05	900.71	115.7	114.8	7	6
Wisconsin	812.57	859.03	113.0	109.5	10	12
North Dakota	680.64	803.61	94.6	102.4	23	19
Iowa	667.36	750.59	92.8	95.6	25	23
South Dakota	643.02	685.82	89.4	87.4	29	34

People's attitudes toward taxes and services color their comparisons of one state's taxes with another's, and are important political considerations as well. But people seldom base their attitudes on statistical knowledge. The LWVMN telephone survey showed that people do not know how the Minnesota tax system works, but they have definite ideas, nevertheless, about what is "fair" or "unfair" about the system. More than half the respondents said the sales tax, which is actually a regressive tax, is the "most fair" tax, even though many did not know which items are taxed and which are not. And of those who said the property tax was the "most unfair," many did not know how property values are assessed, or how property taxes are computed.

The charts show that Minnesotans are taxed more than residents in most states, but that Minnesota also spends a great deal per capita on services to its citizens. One reason for those high levels of taxation and public expenditure is the high proportion of Minnesotans under 18 and over 65, two population groups who cost more to care for. In 1974, for example, 40.2% of state and local expenditures — four out of every ten tax dollars collected — went for education. Another reason is Minnesota's size in relation to where Minnesotans live and what our weather is like; Minnesota spends much more than most states do on highway building and maintenance, and on snow removal. Minnesotans traditionally have demanded a high level of services, and get them, yet only half the people in the LWVMN survey thought they were getting their money's worth, and many couldn't decide on an answer to this question.

In the final analysis, comparisons rely on each person's values and priorities of what is fair about government taxation and spending. The purpose of this "Facts and Issues" and others in the Financing State Government series is to present information, so that attitudes and values of those involved in decision-making processes may be based on fact.

Chart C **Per Capita General *Expenditures* of state and local governments, fiscal 1973 & 1974**

State	Amount (dollars)		As a % of U.S. average		Rank (among 50 states and D.C.)	
	1973	1974	1973	1974	1973	1974
U.S. average	862.93	939.58	100.0	100.0	—	—
Minnesota	965.62	1,041.69	111.9	110.9	11	13
Wisconsin	888.88	978.56	103.0	104.1	17	16
North Dakota	804.84	889.18	93.3	94.6	25	24
South Dakota	818.44	867.42	94.8	92.3	23	26
Iowa	735.36	850.63	85.2	90.5	35	27

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Research for this publication done by Karen Anderson, Margaret Bloyer, Erica Buffington, Ervie Hasbargen, Judy McGuire, Sid Moss, and Joan Strouse. Edited by Rhoda Lewin.

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FACTS and ISSUES #3
FINANCING STATE GOVERNMENT

League of Women Voters of Minnesota

March 1977

Funding a "Quality Life"

This "Facts and Issues" is the third in a four-part series on financing government in Minnesota. It contains explanations for the increase in state spending, a history of spending trends, a review of state fiscal procedures, and some legislative concerns about expenditures in Minnesota. Because it is easy to confuse the terms used, the reader should keep two definitions in mind. One is "appropriation," which is an amount voted by the state Legislature for spending for a two-year period. The other is "direct general expenditures," which is the amount paid out by government and includes funds received from federal as well as state and local sources.

The history of appropriations and expenditures in Minnesota is a history of continual expansion. Appropriations during Minnesota's first state budget, 1858-59, were just under $147,000, and there were only 131 separate line expenditures, ranging from $2,500 for the Governor's salary down to $17.50 for candles and wood for the Auditor's office. Such figures seem almost unreal compared, for example, to 1935-37's omnibus appropriation bill of $37,600,000, or the 1975-77 biennium's $3,300,000,000. And these figures do not reflect total spending by state and local units of government, whose direct general expenditures doubled between 1968 and 1975 to a total of more than $4,500,000,000. What are some of the reasons for this increase in government spending?

Primary causes of the increase in expenditures include demographic trends like population growth, the general shift from being a predominantly rural farm state to an urban industrial state, and the technological changes, especially in transportation, that accompanied this shift. Almost 11% of today's expenditures, for example, are spent on highway construction and maintenance.

Such trends, of course, are nationwide, but in Minnesota their effect on taxes is magnified by administrative and legislative concern with adequate funding for education and health and welfare services, and on creating a "quality life" for all. For example, the state has financed a steadily increasing share of the costs of health and welfare programs, and in effect has provided more money by seeing to it that local governments could provide adequate welfare funds regardless of their ability to raise the funds themselves. This trend began during the depression of the 1930's when local governments found themselves unable to provide these benefits because their property tax base was shrinking and tax delinquencies were growing. The state has continued to provide such funds, which have become increasingly necessary as benefits and programs expanded.

Another major factor in increasing government expenditures is inflation and the general upward trend in salaries, wages, and standards of living. The price of goods and services purchased by state and local governments has greatly increased, going up even faster (68.8% between 1968 and 1975) than the prices of goods and services purchased by consumers (64.4% for the same period).

Another reason sometimes given for increasing expenditures is the public's demand for more and more services. This explanation may be valid, but it is difficult to document. The public may learn to rely on a particular service and expect an increase to keep pace with population growth and inflation, but government administrators, legislators, officials and/or employees responsible for preparing and passing government budgets are the ones who translate "felt" or "perceived" public needs into new or expanded programs. Today's budgets, for example, include appropriations for the State Planning Agency, the Pollution Control Agency, the Metropolitan Council, and the Environmental Quality Council, and for grants to local governments or private agencies for things like reduction of solid waste. All these were unheard of ten or twenty years ago, but it is hard to prove that they were created because of public demand.

The stress both government and the public place on "quality of life" is an item of particular importance to Minnesota expenditures. In 1931, H.L. Mencken wrote a series of articles on "The Worst American State." Minnesota placed 42nd in Mencken's satirical competition (the first place being "worst") and has consistently ranked among the best, and usually among the top 10, since then. In the past five years, for example, Minnesota has been praised for its "quality of life" or described as "a good place to live" in Neal Peirce's book, THE GREAT PLAINS STATES OF AMERICA, and in a number of national magazines, including TIME, NATIONAL GEOGRAPHIC, HARPERS and FORTUNE. However, there is an inevitable correlation between quality of life and taxation, and a recent Minnesota Department of Economic Development investigation showed that the public couldn't have one without the other. Minnesota ranked 9th among the states in per capita tax revenues, 4th in tax revenues per $1,000 personal income, and 4th in the study's composite "quality of life" measurement, indicating that Minnesotans do pay comparatively high taxes, but that the state's level of expenditures is indeed providing Minnesotans with a high quality of life. A dissenting note on this point was voiced in a 1976 League of Women Voters of Minnesota (LWVMN) poll designed to test the public's perception of the relationship between state taxes, expenditures, and quality of life. When the question was asked, "Do you feel the services you receive from state and local governments are adequate in relation to the taxes you pay; that is, do you think you're getting your money's worth?" 108 said "yes," but 92 said "no," and 42 were uncertain.

DIRECT GENERAL EXPENDITURE*
OF STATE AND LOCAL GOVERNMENTS
IN MINNESOTA, SELECTED YEARS 1967-75,
in millions of dollars,
from the U.S. Bureau of the Census

YEAR	STATE	LOCAL	TOTAL
1967-68	694,000,000	1,387,200,000	2,081,100,000
1969-70	846,900,000	1,923,400,000	2,770,400,000
1971-72	1,054,700,000	2,473,600,000	3,528,300,000
1974-75	1,541,800,000	3,165,600,000	4,707,400,000

*Direct general expenditures include all money paid out by a government other than for retirement of debt, investment in securities, extension of credit, or as agency transactions.

Besides quality of life, or perhaps because of it, both government and the public have stressed *equality* — equalization of opportunity and equalization of tax burden. This attempt to achieve equality has resulted in a growing tendency to collect revenues statewide and then channel them back to local governments according to population or need. A locality may receive funds based on how many miles of highway it has, or on the number of school children, or the number of "poor," and so on. This has made it possible for all areas of the state, regardless of the local tax base, to provide such necessary services as education and health, and to provide them on an equal basis. Whether equal spending truly provides equal opportunity is an issue currently being debated in educational, health and other areas, but the principle of equalization seems well established, for several reasons.

One of the benefits that accrues from equalization of the tax burden is that it eases the pressure on individual localities to develop and industrialize in order to increase their tax base. Thus lands that properly should be used as farm acreage or preserved as wilderness areas may be kept for such purposes without penalizing the local government and its schools and other services. Another benefit of equalization is that senior citizens and lower income groups can have property tax relief and special services that local governments might not otherwise be able to provide because of the concentration of these groups in certain localities.

OMNIBUS APPROPRIATION BILLS,
STATE OF MINNESOTA
Selected Legislative Sessions 1935-76

BIENNIUM	AMOUNT (Other than Highways)	HIGHWAYS	TOTAL
1935-37	37,650,740		37,650,740
1945-47	99,569,177		99,569,177
1949-51	224,172,257		224,172,257
1961-63	566,938,926	18,741,695	585,680,621
1969-71	1,279,073,887	42,746,853	1,321,820,740
1975-77	3,094,230,284	249,110,000	3,343,340,284

Additional factors in the growth of government expenditures were cited in a January, 1977, Minneapolis TRIBUNE series of articles by staff writer Bernie Shellum. One is the nature of the progressive income tax, which automatically provides large, unlegislated increases in tax revenues as salaries and wages increase during periods of inflation. With more money coming in, the government spends more, and the high levels of expenditure tend to continue. Another factor Shellum cites is political pressure. As the number of people directly benefiting from government programs grows, the tendency to vote for politicians who support increased government programs also grows. Shellum also points out how difficult it is to trace political accountability for government growth. He writes, "As the complexity of government financing grows, so does the cost in time and money for the citizen who tries to understand what is happening."

STATE FISCAL PROCEDURES

The Minnesota Department of Finance was created in 1973 to consolidate the fiscal responsibilities which had previously been shared by the State Auditor, the State Treasurer and the Commissioner of Administration. The Commissioner of Finance now is in charge of the financial affairs of the state. His responsibilities include preparing a biennial budget and a ten-year cash receipts and disbursements projection, keeping records and accounting systems for all state revenue and expenditures, and financial supervision and control of all state departments and agencies.

BUDGET MAKING

Minnesota operates on a two-year budget basis. The steps involved in preparing this biennial budget have been established by the Legislature. The Commissioner of Finance is charged with preparing the budget subject to the approval of the Governor.

State statutes require that budget estimate forms be distributed to all state departments and agencies by September 1 of each even-numbered year. In actuality, this is done sooner. In 1976 budget forms were distributed along with guidelines from the Governor in July to give adequate preparation time because they must be returned to the Commissioner of Finance by October 1. Departments and agencies are expected to submit program-type budgets, clearly stating goals and objectives, in order to substantiate their requests for funds. Controllers from the Department of Finance assist in the preparation of the budget requests. During October and the first two weeks of November, the budget is evaluated and refined through hearings held by the Department of Finance with each department and agency. Budget requests must be forwarded by November 15 to the

Senate Committee on Finance and the House Appropriation Committee.

The Department of Finance then reviews the budget with the Governor and his staff. The result is the Governor's "budget message," which must be submitted by the Governor to the Legislature within three weeks after the first Monday in January in odd-numbered years, which is the first year of the biennium. The budget message must include recommendations for capital expenditures, and it must be in two parts, with the contents of each part specified by state law. The first part of the budget message contains a general budget summary with the Governor's recommendations for expenditures for the next two years and plans for raising revenue to support those expenditures. The second part contains detailed budget estimates of both expenditures and revenues and a report on state bonded indebtedness, including the present state of the debt and estimates of the use of debt for supporting the two-year proposals. Both parts of the budget also include corresponding figures for the last two fiscal years and the current year.

ADOPTING THE BUDGET

Armed now with both the Department of Finance's estimated budget and the Governor's budget recommendations, the Legislature is ready to begin the lengthy process of budget adoption. The Legislature carries out this process by passing bills for raising revenue or authorizing the appropriation of funds; its responsibility is established by the Minnesota Constitution, which states that "No money shall be paid out of the treasury of this state except in pursuance of an appropriation by law."

Bills for raising revenue must originate in the House of Representatives, but bills calling for expenditures may originate in either the House or Senate. The committees hearing bills for appropriations are the Senate's Committee on Finance and the House's Committee on Appropriations, sometimes called the "money committees." State statutes specify eight major appropriation bills which must be reported out of committee — that is, sent to the floor of the House and Senate for consideration and passage — at least twenty days prior to adjournment. These eight bills cover 1) administrative and judicial expenses of state government for two years; 2) public welfare, health and corrections; 3) education) 4) payment of claims against the state; 5) semi-state activities — those activities only partially state-funded, such as the Minnesota Historical Society; 6) issuance of bonds for public building construction; 7) appropriations for public building maintenance or construction; and 8) highway department. All other appropriations must be in separate bills and can be reported out of the two money committees at any time up to the end of the session.

The Senate Finance and House Appropriations Committees meet first as subcommittees to hear specific parts of bills before they are put together in the full committee as an "omnibus" appropriations bill. For example, a bill calling for an expenditure by a penal institution would be heard first by the Welfare-Corrections subcommittee of Senate Finance and the Health, Welfare and Corrections subcommittee of House Appropriations. If passed, it is heard by the full committee before becoming part of a larger omnibus welfare, corrections and health bill. It then goes through the same process as other bills, facing a hearing on the floor of each house. If passed by both bodies, it is considered by a conference committee of five Senate and five House members who resolve differences in the two bills before it is returned in identical form for both houses to consider. If passed again, it then goes to the Governor for his signature or veto.

Even though each Senator and Representative has the opportunity to express his or her constituents' point of view through a vote on each appropriation bill, it is acknowledged that most decisions on state expenditures are made in subcommittee and committee. A legislator objecting to one part of an omnibus bill will usually vote in favor rather than jeopardize the parts of the bill he/she agrees with. All subcommittee, full committee and conference committee meetings are now open to the public, so that other legislators, the news media and the general public may be aware of the decisions involved in formation of appropriation bills.

COLLECTION AND DISBURSEMENT PROCEDURES

While the Commissioner of Administration is the ex-officio state budget director and purchasing agent, and the Commissioner of Revenue is responsible for the assessment and collection of most state taxes, it is the Commissioner of Finance who controls state funds and is responsible for the accounting system. The accounting system keeps a detailed account of state money showing funds available, funds already spent, and cash balances of all state departments and agencies. All departments and agencies are required to participate in this statewide accounting system except the judicial and legislative branches, which have internal accounting systems.

AUDIT FUNCTIONS

Two types of financial audits are desirable in state government. The pre-audit is a review of transactions before they are made. The post-audit is a review of transactions after they are completed, to learn if and how the money appropriated by the Legislature is being spent.

In Minnesota, audit responsibilities are divided. The Department of Finance does the pre-audit. The State Auditor, an official elected to a four-year term, is responsible for the post-audit of all local governments in the state, including counties, cities, townships, school districts and special districts. The post-audit of all state departments, agencies, boards and commissions is done by the Legislative Auditor. He is appointed by the Legislative Audit Commission for a six-year term and acts as the executive secretary of the Commission. The Legislative Audit Commission, which is composed of sixteen House and Senate members representing both major political parties, is ultimately responsible for the post-audit of state departments and agencies.

INVESTMENT PROCEDURES

The State Board of Investment, composed of the Governor, Secretary of State, State Treasurer, State Auditor and Attorney General, sets policies for the investment of state funds. Although the Board is composed of elected officials, it appoints an executive secretary to administer investment policies and the purchase and sale of securities for the permanent school fund, various state retirement funds, highway funds and other funds which are available for investment as provided by law. Investment income for the 1975-77 biennium will be an estimated $60,280,992 to be credited to the General Fund.

STATE BORROWING

The State Constitution provides for the sale of general obligation bonds and certificates of indebtedness to finance major state building construction, land acquisition, highway building and maintenance, and other specific activities.

Certificates of indebtedness are issued for short periods during a biennium in anticipation of revenue. Bonds are issued based on a 20-year maturity date. The Constitution limits trunk highway bonds to a 5% interest rate and an unpaid maximum of $150,000,000. A three-fifths vote of each house of the Legislature is required to authorize debt contracted for acquisition of land and capital building programs.

During the 1975-77 legislative biennium, the issuance and sale of $135,809,000 in bonds was authorized for things like building programs at the University of Minnesota, other state universities and Metropolitan Community College, and for regional open spaces, water pollution control, and the student loan program. An additional $25,000,000 bond issue was authorized for construction and repair of bridges throughout the state.

At the end of fiscal 1976, Minnesota's outstanding debt totaled $817,455,000.

LEGISLATIVE CONCERNS

Many suggestions have been made for coping with the growth in governmental expenditures. Some states have adopted sunset laws, which write an expiration date into laws which relate to an agency or program. Sunset laws can apply to new programs or to all existing programs; as the expiration date approaches, the program is reviewed to see if it should be continued or allowed to expire. Zero-based budgeting is another concept used in some form in several states. Under zero-based budgeting, department and agency budgets must include justification for all activities, not just new or expanded ones. Another suggestion is indexing of the individual income tax to reduce or eliminate the unlegislated increase in income tax revenues during periods of inflation — an increase in income which encourages government spending. Indexing would adjust rates to compensate for the rate of inflation.

Dedicated highway funds are another legislative concern. The State Constitution dedicates gasoline tax revenues to highway building. Because of the need for other transportation funds, such as mass transit, the 1975 Legislature approved a proposed amendment to the Constitution which would have allowed some of the future increases in these revenues to be put into the state's general fund. The amendment was placed on the November, 1976, ballot but failed to pass, possibly because of wording which made the intent unclear. There probably will be further attempts to change the dedicated nature of highway funds.

Recognizing the public concern about increasing taxation and government expenditures in Minnesota, LWVMN members conducting their regular legislative interviews in 1976 asked state Senators and Representatives how the budget-making process could be improved. The most common suggestions favored some form of zero-based budgeting and some method for holding expenditures to revenue rather than raising revenue levels to meet increases in expenditures. Some mentioned adopting a sunset law or indexing the individual income tax. Several suggested a legislative budget review committee to oversee and coordinate revenue and appropriation bills, and a few suggested that all major committees should be involved in appropriation procedures for items of that committee's interest.

Legislators were also asked to name the primary influences on setting their spending priorities. Those who responded said that priorities are set by subcommittees and committees, and that a legislator has limited input to a committee other than his or her own. However, many cited the voters in their district as a primary influence on their final votes. Other influences named were personal priorities, social conscience, "just plain common sense," testimony from citizens at hearings, legislative staff reports and recommendations, other legislators and lobbyists. Thus it would seem that, when changes are needed in fiscal procedures or when priorities are being set for state expenditures, the public's voice is important. If the public is concerned about the tax burden, or the level of expenditures for education, highways, or other programs, the public can make its voice heard.

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FACTS AND ISSUES #4
FINANCING STATE GOVERNMENT

League of Women Voters of Minnesota

March 1977

Governmental Expenditures in Minnesota

This, the last of four Facts and Issues, is about government spending. It covers primarily state government appropriations and expenditures but also covers expenditures made at local levels of government. The reader should keep in mind that while the major portion of revenue is collected by the state, over two-thirds of all governmental expenditures in the state are made at the local level. This is possible because the state passes on revenue to local governments in the form of state aids, grants and shared taxes. Another important fact to remember is the increasing reliance on federal funds. In fiscal 1975 state and local governments in Minnesota received $961,700,000 from the federal government.

State government expenditures are explained here by function — that is, they are divided into major categories of spending used by the federal government in tabulating spending figures for all the states. Direct expenditures are funds paid directly by the state to perform a function or service; intergovernmental expenditures (sometimes listed on budget charts as "state aids") are those spent by local units of government but received from state or federal sources. Expenditure figures are for the fiscal year July 1, 1974, to June 30, 1975. These are the most current figures available from the U.S. Bureau of the Census.

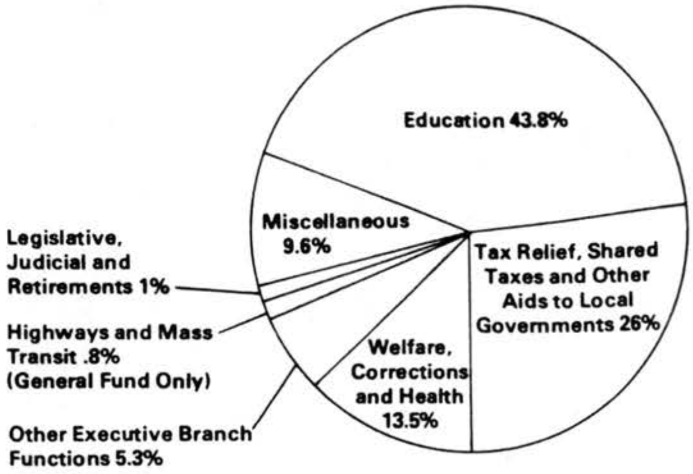
DIRECT GENERAL EXPENDITURE OF STATE AND LOCAL GOVERNMENTS IN MINNESOTA BY FUNCTION, BY LEVEL OF GOVERNMENT: 1974-75 (In Millions of Dollars)

FUNCTION	STATE GOVT.	LOCAL GOVTS.	TOTAL MN.
Total	$1,541.8	$3,165.6	$4,707.4
other than capital outlay	1,275.2	2,524.3	3,799.5
Education Total	576.5	1,363.6	1,940.1
other than capital outlay	502.1	1,186.2	1,688.3
Local Schools	—	1,363.6	1,363.6
other than capital outlay	—	1,186.2	1,186.2
Institutions of Higher Education	510.3	—	510.3
Other Education	66.2	—	66.2
Highways Total	258.0	278.5	536.5
other than capital outlay	91.0	150.2	241.3
Public Welfare	224.3	386.0	610.3
Health and Hospitals Total	164.9	158.4	323.3
other than capital outlay	161.0	137.1	298.0
Police Protection	12.8	98.3	111.1
Fire Protection	—	42.1	42.1
Sewerage Total	—	124.8	124.8
other than capital outlay	—	37.4	37.4
Sanitation other than sewerage	—	20.7	20.7
Local Parks and Recreation	—	84.7	84.7
Financial Administration	25.2	39.2	64.4
General Control	25.1	72.0	97.1
Interest on General Debt	40.9	137.7	178.5
All other general expenditure	214.2	359.7	573.9

Federal data on expenditures are used here because they are often used for comparisons between states. These figures include all expenditures, both for capital outlay and general operating expenses. However, government spending in Minnesota has increased since fiscal 1975, so appropriations made during the 1975-77 legislative biennium are included to give some indication of current spending. These appropriations are for two years of state operations, from July 1, 1975, to June 30, 1977, rather than for the single fiscal year covered by the Direct General Expenditures figures, and also differ from the federal figures in that the state's budget categories are sometimes quite different from federal categories.

Most appropriations are passed during the first year of the legislative biennium, but the 1975-77 Legislature passed several major appropriation bills in 1976. There are three kinds of state appropriation bills — omnibus, miscellaneous, and open and standing — and each functional area, such as education, may receive funds from several different appropriation bills. Omnibus appropriation bills are the two-year appropriations worked out for the legislative biennium and are divided into five areas of functions: education, welfare (which includes corrections and health), state departments, semi-state activities (which are only partially funded by the state), and buildings. Miscellaneous appropriations are usually single bills for a particular purpose. There are three types: 1) recurring, such as bills for claims against the state which are put together into one bill heard each year of the session; 2) non-recurring, or single-purpose, which are for onetime projects like the road to the new state zoo; and 3) new activities appropriations for experimental programs like the Freshwater Biological Institute, which may warrant a single-purpose bill at its inception but later become on-going and therefore part of an omnibus bill. The terms "open" and "standing" are also used in describing appropriation bills and refer to dollar amounts. Open appropriation bills provide authority to collect or disburse funds but contain no specific dollar amounts; standing appropriations provide a specific dollar amount which cannot be changed without a change in the law authorizing the appropriation.

GENERAL FUND EXPENDITURES, 1975-77 BIENNIUM
ESTIMATED TOTAL: $5,027,849,069



STATE APPROPRIATIONS

An indication of the relative size of each functional area of state government is shown by the General Fund Expenditures Chart. The trend toward state sharing of revenue with local governments is seen by the large portion allocated as aids to education and local governments. Property tax relief, shared taxes, and aids to local units of government, in a variety of forms, accounted for over 60% of total disbursements of the state during the 1975-77 biennium. This is a dramatic increase compared to the 1965-67 biennium figure of 45%. The chart shows only a small portion of the general fund being used for highways. Actually, the state spends a larger portion for transportation, but the money comes from constitutionally dedicated funds rather than from the general fund. In 1975 highways accounted for about 11% of spending by all governments in Minnesota; the state spent about half of this percentage.

EDUCATION

Since its earliest days, Minnesota has demonstrated its concern for education. In 1849 a territorial law provided for common schools open "to all persons between the ages of four and twenty-one free," and by 1878 the principle of state aid for high schools had been established. The state has also demonstrated its concern for education through generous funding; for the 1975-77 biennium the Legislature appropriated over $2.2 billion, or 40.6% of its total appropriations, for education.

The Education Appropriations table shows the growing magnitude of state aid to schools. However, it is interesting to note that although the amount appropriated for education has increased dramatically, it has declined as a percentage of total state spending. This is because there have been even greater increases in other areas of state spending.

EDUCATION APPROPRIATIONS, SELECTED YEARS

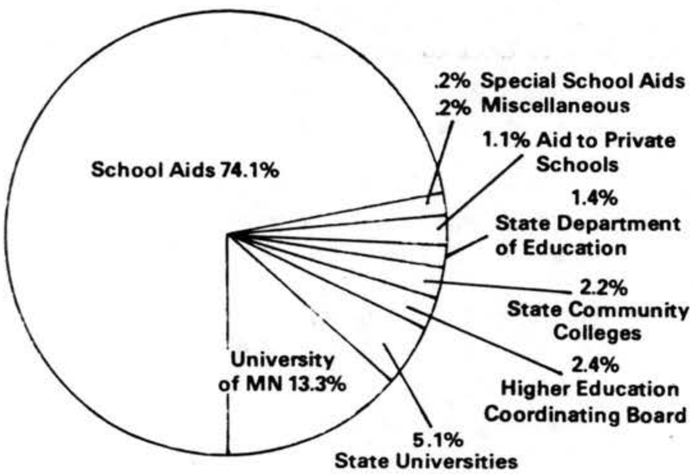
BIENNIUM	TOTAL STATE APPROPRIATION FOR EDUCATION	EDUCATION APPROPRIATIONS AS A PER CENT OF TOTAL STATE SPENDING	PERCENTAGE INCREASE
1959-61	$ 335,576,572	63.6	
1961-63	404,502,803	63.5	20.5
1963-65	455,988,185	63.8	12.8
1965-67	546,816,570	54.3	20.0
1967-69	717,374,019	52.2	31.2
1969-71	1,057,766,539	41.9	47.4
1971-73	1,678,394,875	51.0	58.6
1973-75	1,756,025,750	44.2	4.6
1975-77	2,269,090,121	40.6	29.2

The Legislature uses all three kinds of appropriation bills in authorizing spending for education. Each biennium it passes an omnibus education bill which contains the bulk of appropriations for education, including foundation aid for elementary and secondary schools, funds for post-secondary education, and money to operate the State Department of Education. It also makes open appropriations for education. In the 1975-77 biennium these included funding for a work-study program at the state universities and community colleges and for tuition reciprocity agreements with North Dakota, South Dakota, and Wisconsin. The Legislature also makes special appropriations for education. In the 1975-77 biennium, these included aid for districts experiencing fluctuating enrollment and aid to non-public schools.

The $2,269,090,121 which the 1975 and 1976 Legislatures appropriated for education, an increase of almost 30% over the 1973-75 biennium, still does not represent the total education budget for the state. It does not include $203,891,342 in federal funds made available to the schools, nor does it include $164,111,709 received by the University of Minnesota, state universities and community colleges in the form of tuition and course fees, or $83,285,525 in University Hospital receipts. All of this money, over $450 million, was or is being spent on education in Minnesota.

To get some idea of the size and complexity of education appropriations, it may be helpful to look at some of the items included in that $2.2 billion legislative appropriation for 1975-77.

STATE EDUCATION APPROPRIATIONS, 1975-77 BIENNIUM: TOTAL: $2,269,090,121



The Department of Education, which received $32,669,616 in the 1975-77 biennium, sets requirements for and certifies teachers and administrators, designs curricula for elementary and secondary schools, and supervises the health and safety of students. The Department also supervises aid for libraries and school lunch programs, among other functions.

School aids, accounting for almost three-fourths of the 1975-77 appropriations, went mainly for foundation aids for elementary and secondary schools (see MINNESOTA VOTER, January, 1975). These so-called foundation aids, which are based on the number and grade level of students in each school, accounted for almost $1.2 billion of the money appropriated. Other large items include transportation, which received $129,483,000; special education, $89,275,600; post-secondary vocational schools, $138,600,000 (combined foundation and other aids), and community education, $2,800,000.

For the community colleges and state universities, the major appropriation went for maintenance and equipment, a budget category which covers operating costs and includes salaries. At the community colleges, maintenance and equipment was funded at $48,622,527; at the state universities, $107,527,466; and for the University of Minnesota, $246,000,000. The University also received over $10 million for its Agricultural Extension Service, over $9 million for agricultural research, and smaller amounts for a host of other activities.

TRANSPORTATION

There are more than 12,000 miles of state trunk highways in Minnesota and approximately 30,000 miles of county state aid highways, 15,000 miles of county roads, 56,000 miles of township roads, 12,000 miles of municipal streets, and 2,000 miles of Indian reservation roads and other federal roads. Taking care of them involves continual planning, construction and maintenance, financed by a combination of local, state and federal funds. The Department of Transportation (DOT) was formed in November, 1976, and includes the Highway Department, Aeronautics Department, and the transportation-related functions of the State Planning Agency and Public Service Commission.

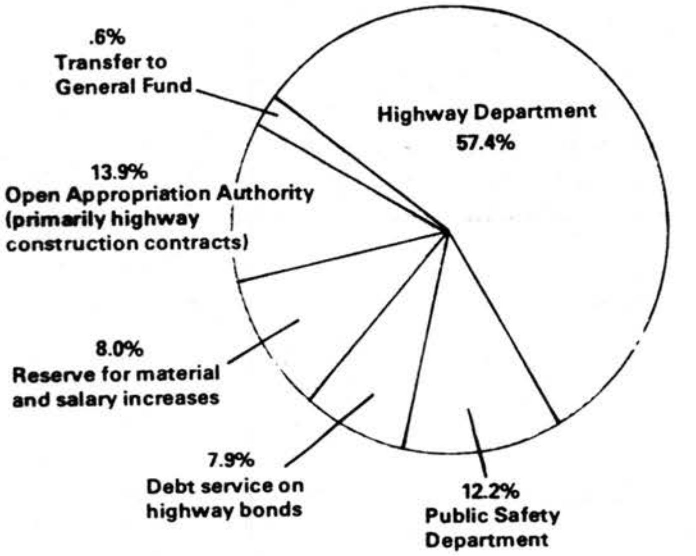
Until 1961, sufficient funds were available from the Highway Users Tax Fund, established by Constitutional amendment in 1920 as a repository for funds generated by excise taxes on motor vehicle registrations and gasoline. In 1961, however, the Legislature found it necessary to appropriate an additional $18,741,695 for costs associated with construction of the new Interstate highway system. By the 1973-75 biennium, the Highway Department had grown in size and scope to include a legal staff, a research and standards program, a planning and programming department, and a staff to adminster state aids. The omnibus highway appropriation for the 1973-75 biennium totaled $183,549,941.

The main reasons for the rapid growth in spending for transportation has been the continuing demand for adequate and up-to-date roads and the rising cost, nearly 40% from the 1975 to 1977 biennium, of building and maintaining roads. Another reason is environmental and ecological considerations like noise abatement, conservation of natural resources, highway beautification, and restoration of land from which highway materials are extracted.

The $207,000,000 omnibus highway appropriations figure for 1975-77 does not tell the whole story of DOT expenditures, which are estimated at $830,481,600 for the biennium. This expenditure figure includes $575,500,000 from the Trunk Highway Fund, of which $215,000,000 are federal funds and $322,100,000 are estimated income from the motor vehicle registration fee and the gasoline excise tax, which the Legislature increased in 1975 from 7¢ to 9¢ per gallon. The state General Fund can also be drawn on for highway dollars, and it was in 1976, when $25,000,000 was transferred from the General Fund for bridge construction. There have also been single-purpose appropriations during the current biennium. $28,100,000 was appropriated in 1975 to fund public transit, including a demonstration public transit program and a Metropolitan Council study of Interstate highway routing in Minnesota, and in 1976 extra funds were voted for an access road to the new zoo, for Interstate rest facilities, and for organization of the DOT.

Part of the income from the gasoline excise tax and motor vehicle registration tax is distributed to local governments as state aids. An estimated $197,800,900 of these tax monies, plus an estimated $10,000,000 in earned interest on investments, are being divided in the 1975-77 biennium between the County State Aid Highway Fund and the Municipal State Aid Street Fund, as provided in the state Constitution. Some $157,100,000 will go to 87 counties, and another $50,700,000 will go to 101 cities for highway and local street work outside the trunk highway and Interstate systems.

DISTRIBUTION OF TRUNK HIGHWAY FUNDS, 1975-77 BIENNIUM
TOTAL: $575,700,000
(The Trunk Highway Fund includes primarily revenue from the Highway User Tax Distribution Fund, Federal Funds and Driver's License Fees — see Facts & Issues #2, p. 7)



WELFARE

The Department of Welfare supports a variety of programs. A combination of federal, state and county funds is used to finance welfare activities and services.

The 1975-77 omnibus appropriation bill for welfare was $599,273,540. This figure was supplemented by an additional $14,713,000 appropriation by the 1976 Legislature, bringing the state's total appropriation to $613,986,540. When federal funding for state welfare expenditures, $679,671,752, and estimated unreimbursed county appropriations of $252,466,062 are added, the total budget for welfare in Minnesota for the 1975-77 biennium comes to $1,646,124,354.

Three major program areas constitute 59.4% of the 1975-77 biennium welfare appropriations made by the state Legislature.

First are the three big public assistance programs which are Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), and Medical Assistance (MA). AFDC is provided through counties to qualifying families who are eligible because of low or no income and a lack of other assets. The federal government pays about 57% of AFDC, the state pays half of the remainder, and the counties the other half through property tax levies. SSI is paid to Minnesota residents who are aged, blind or disabled and get welfare aid directly from the federal government. These supplements are financed 50% by the state and 50% by the county. Medical Assistance payments are made to medical vendors (nursing home operators, physicians, dentists, druggists) on behalf of welfare recipients and others who are eligible because they lack resources to pay for medical care. The federal government pays about 57% of MA, the state pays 90% of the remainder, and the county pays the rest.

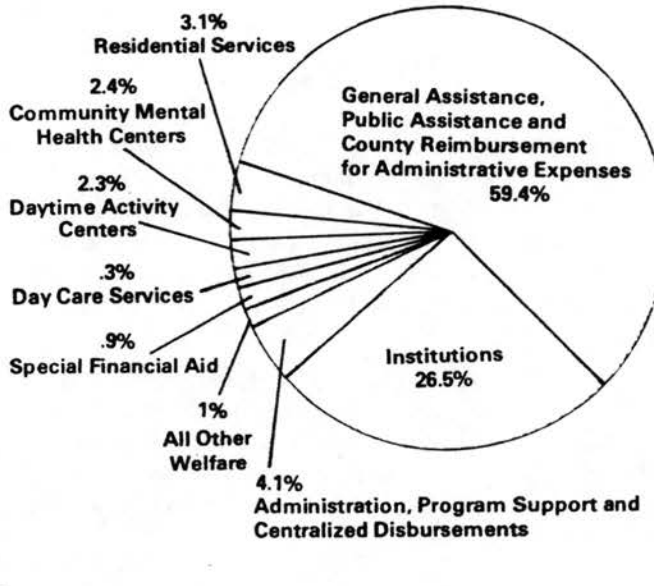
There are also two general assistance programs in operation. General Assistance Maintenance consists of cash payments to eligible poor persons who do not qualify for AFDC or SSI. This program is financed 50% from state funds and 50% from local funds. General Assistance Medical payments are made to medical vendors on behalf of medically indigent persons who do not qualify for federally assisted aid because they do not qualify as present or potential AFDC or SSI recipients. The state finances 90% of this program, and the counties finance 10%.

The state also reimburses counties for 50% of certain administrative expenses for public assistance programs.

Another large portion of the 1975-77 welfare appropriation (26.5%) goes to ten state hospital complexes, two special schools (Braille and Sight Saving School, and the School for the Deaf) and two state-operated nursing homes.

One of the main reasons for recent increases in the state welfare appropriations is that the state is taking over an increasing share of the welfare payments.

APPROPRIATIONS FOR WELFARE, 1975-77 BIENNIUM
TOTAL: $599,273,540



HEALTH

State health services take another substantial cut of Minnesota's budget. This is due in part to the recognized need for more preventive health services, and in part to the rising costs of medical services in the private sector.

Appropriations to the State Board of Health and for health-related activities total $20,950,300 for the 1975-77 biennium, more than double the approximately $9,600,000 appropriated in 1973-75. The chart shows health appropriations by function.

Appropriations by Function

Health Services (persons and preventive)	$11,706,400
Health Systems and Quality Assurance	2,016,600
Management, Planning and Information Services	2,374,000
Dental Health for Elderly	142,500
Water Filtration and Purification System Grants	2,500,000
Cystic Fibrosis — Adult	80,000
Nutritional Program — Women and Children	1,000,000
Health Related Boards	1,130,800

The Department of Health also received additional state funds during the 1976 legislative session totaling $3,393,128, as follows:

Additional Appropriations — 1976

Comm. Health Education (subsidies and grants)	$2,700,000
Administration of Community Health Services	50,000
MN Hospital Administration Act of 1976	125,000
Office of Health Facilities Complaints	67,000
Preventive and Personal Health Service	249,826
Health System Quality Assurance	164,302
Board of Dentistry	37,000

Several of these are new activity appropriations, like the nutritional program for mothers and children. If such programs are continued, they will be added to future omnibus bills.

CORRECTIONS

The corrections field is currently an extremely controversial one, with the debate over determinate sentencing, concern about sentencing and parole policies, and the possibility that one or more state correctional facilities might have to be closed or undergo extensive rehabilitation. The budget requested by the Department of Corrections (DOC) for the 1975-77 biennium was reduced by slightly over $2,000,000, but even so, the omnibus appropriation bill for correctional activities was $64,496,045, an increase of $18,273,348, or 39.5%, over the 1973-75 appropriation.

Of this total, $38,844,300 was appropriated for operation of the Department's seven correctional facilities. Administrative costs accounted for $10,000,000, an increase of slightly over 50% from the previous biennium, due to increased staff at the departmental offices and at institutions as well as cost of living pay increases. $2,312,000 was allocated for health care of inmates in or outside correctional facilities, $278,600 to the Corrections Ombudsman's office, $425,000 to Community Corrections Centers, and $7,369,900 was set aside for grants under the Corrections Subsidy Act for counties wishing to develop and operate community-based correctional systems. Five counties were participating by the end of 1976, and the DOC estimated that 20 additional counties would be involved by the time the biennium ended on June 30, 1977.

In 1975 the Legislature authorized the Corrections Commissioner to utilize corrections facilities in what he feels is the most efficient and beneficial manner. This will allow the DOC to convert some juvenile facilities to adult use and make other program changes, but the law forbids closing the Minnesota State Prison at Stillwater or the St. Cloud Reformatory with legislative consent.

The 1976 Legislature appropriated additional monies for corrections, supplementing the Ombudsman's budget by $10,000, and voting $2,400,000 for repairs and improvements at correctional institutions.

JUDICIAL

The judicial appropriation is one of the smallest in the entire state budget, totaling $9,402,841 for the 1975-77 biennium, or .16% of state spending. This was augmented by $103,310 from federal funds.

The Supreme Court appropriation for the biennium was $2,836,264. The District Court appropriation was $5,351,080, which went for basic salaries of the 72 District Court judges. In Hennepin, Ramsey and St. Louis Counties, each district judge receives an additional $1,500 from county funds.

The remaining judicial appropriations for the 1975-77 biennium were distributed as follows:

State Public Defender	$579,500
State Law Library	423,028
Commission on Judicial Standards	73,704
Judicial Councils	6,000
Tax Court	133,264

NATURAL RESOURCES

This department is concerned with land use and seven natural resources — air, sunshine, water, soil, forests, minerals and wildlife. As our population and degree of urbanization has increased, so have concerns over preservation of these natural resources.

The Department of Natural Resources (DNR) was reorganized in the past biennium in an attempt to reach the people of Minnesota more directly through regionalization and decentralization. Instead of a central office made up of a number of separate divisions, DNR now has a regional structure that divides the state into six geographical areas, each with a regional director responsible for all resources (parks, wild life, fisheries, recreation, forestry, water, etc.) in his or her area.

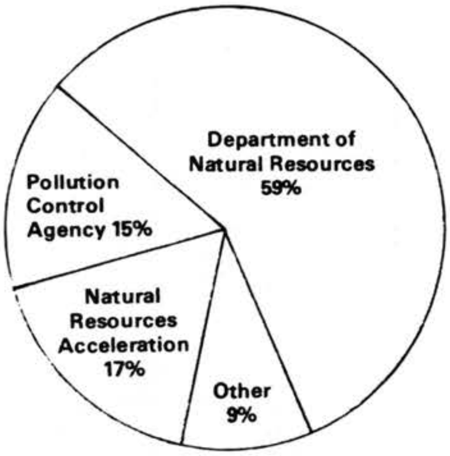
Leadership still comes from the state office through planning, research and administrative services. The planning and research division includes environmental planning and protection, enforcement, fish and wildlife, forestry parks and recreation, water, soils and minerals. Administrative services include engineering, field services, fiscal, license, management information systems, office services and personnel.

Three other major sections also operate out of the Commissioner's office. These are the Bureau of Land, the Bureau of Information and Education, and the Soil and Water Conservation Board. The Bureau of Land acquires land for state parks, state forests, wildlife preserves or other purposes. It also trades land with other government agencies or private owners and can sell or lease out state land. During the 1973-75 biennium, land transactions involved 12,065 acres valued at $507,605. The Bureau of Information and Education plans, produces and distributes materials about Minnesota's natural resources and environment. The Soil and Water Board, an independent agency until 1971, when the Legislature made it part of the DNR, has statutory powers to provide administrative, coordinational, educational and financial assistance to the 92 soil and water conservation districts in the state. Unlike many departments, the DNR does not have its own legal department. Its legal matters are handled by a Deputy Attorney General and Assistants provided by the State Attorney General.

The Legislature appropriated $121,444,579 for natural resources in 1975 and added another $8,145,750 in 1976, to bring the total to $129,590,329 for the 1975-77 biennium. This is 68.65% more than was appropriated for the 1973-75 biennium. This increase is due to public awareness and concern for preserving our many natural resources, which the Legislature translated into increased funding and new appropriations.

Funds provided for natural resources acceleration by the 1975-77 Legislature totaled $23,133,650. This was for acquisition and development of state lands and trails, state forests and wildlife habitat, grants-in-aid for local recreation and natural areas, regional recreation and natural areas, and other specific acquisition and development projects. The Minnesota Pollution Control Agency was appropriated $20,014,669 for the 1975-77 biennium, over half of which was for grants to cities and state agencies for water pollution control and sewer construction projects.

APPROPRIATIONS FOR NATURAL RESOURCES, 1975-77 BIENNIUM
TOTAL: $129,590,329



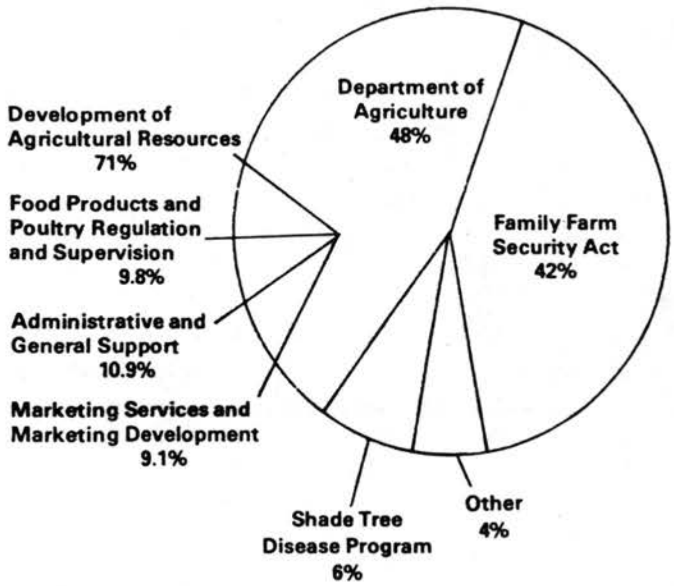
AGRICULTURE

The Minnesota Department of Agriculture enforces laws which protect the public health and works to prevent fraud and deception in the manufacture and distribution of foods, animal feeds, fertilizers, pesticides, seed and other items. In addition to the regulatory powers assigned by law, the Commissioner of Agriculture has the power to enact rules, definitions and standards to explain and clarify the laws, or to cope with changing conditions.

Prior to January 1, 1976, this Department was organized into four major program areas for budget purposes. It is now organized into three basic functional areas: farm production, food processing and staff. Each is headed by an Assistant Commissioner who reports directly to the Commissioner and who has both responsibility and authority for his area's activities.

The 1975-77 Legislature appropriated $25,666,159 for agriculture, which included $12,409,508 for the Department of Agriculture and $10,874,300 for the 1976 Family Farm Security Act, to be used to guarantee loans for the purchase of land by beginning farmers. The Legislature also appropriated $50,000 for a farm census and $1,595,000 for shade tree disease control, which was for assisting local governments in expanding their programs.

APPROPRIATIONS FOR AGRICULTURE, 1975-77 BIENNIUM
TOTAL: $25,666,159



GOVERNOR

The 1975-77 Legislature appropriated $3,457,683 for the Governor. This appropriation covers staff and administrative activities of the office, security protection for the Governor and government buildings, and commissions the Legislature has directed the Governor to oversee. Some of these commission expenditures are contributions to interstate programs which include Minnesota; others are purely Minnesota expenditures, like the $240,000 allocated to the Bicentennial Commission for grants to local projects.

The Governor's budget grew 57% between the 1973-75 and 1975-77 bienniums. Increases in staff and in salaries to keep pace with inflation account for a major part of this budget growth. A 1976 memorandum from the Governor to the Department of Finance promised no further increases in the Governor's staff during the next biennium.

APPROPRIATIONS FOR THE GOVERNOR. 1975-77 BIENNIUM
TOTAL: $3,457,683

GENERAL STATE GOVERNMENT

Appropriations to General State Government are for state departments and agencies which do not have a separate classification in the budget, a carry-over based on the old Auditor's code. Appropriations in this category more than doubled between the 1973-75 and 1975-77 bienniums, to a total of $157,880,333. Much of this increase funded new or expanded programs.

The Minnesota Housing Finance Agency (MHFA) accounted for the largest share of the General State Government appropriation. The MHFA was established in 1971, with a $250,000 appropriation, to be a self-supporting agency financed by service fees and investment income. However, the MHFA received $34,200,000 from the Legislature in 1975 to provide grants and low-interest loans for home rehabilitation and to develop housing delivery systems for low-income households, native Americans and the elderly.

The Department of Revenue received some $34,000,000 to discharge its duties which include supervising the administration of all state taxes and aids to local governments, directing proceedings against tax law violators, collecting and distributing information on property assessments and revenues, and formulating legislation to improve the system of assessment and taxation in the state, such as the circuit breaker for property tax relief.

The Department of Finance budget grew 346% between the 1973-75 and 1975-77 bienniums, reflecting in part new budgetary and management responsibilities transferred to it from the Department of Administration. The Department of Finance also keeps general account books for the state and supervises the general accounting system used by all state agencies and departments.

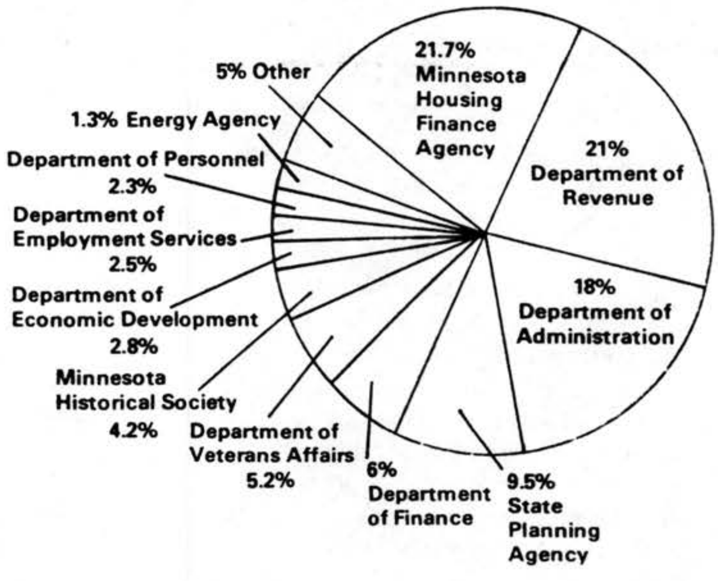
The Department of Administration's 1976-77 budget increased 61% over the 1973-75 budget, even though some of its functions were transferred to the Department of Finance. Several new programs in the Department of Administration were funded in 1975-77, including programs for car pooling, energy surveys, and improvements in government buildings. This Department also works to improve state programs and management of those programs and provides the general services and support services necessary for day-to-day operations of state government, such as procurement and purchasing of materials.

The Energy Agency, created in 1974, grew 432% during the 1973-75 and 1975-77 bienniums, from $380,000 to $2,023,423. This rise reflects the increase in the number and scope of energy programs. The Energy Agency promotes energy conservation in state buildings, disseminates energy conservation information to the public and works to develop alternative energy sources.

The State Planning Agency, created in 1965, has broad authority to engage in comprehensive state-wide planning, to harmonize activities at all levels of government and to render assistance to all government levels. Its budget grew 332% between the 1973-75 and 1975-77 bienniums, reflecting in part a 310% increase in the Environmental Quality Council budget, the addition of several new environmental planning activities, and a $3,250,000 appropriation for railroad line rehabilitation. Most of the $2,500,000 appropriated for land use planning and the $75,000 for training of local public officials went to local governments in the form of grants, as did another $2,062,000 for regional and local assistance.

Localities received $800,000 through the Secretary of State's office to cover the costs of election-day voter registration.

APPROPRIATIONS FOR GENERAL STATE GOVERNMENT 1975-77 BIENNIUM
TOTAL: $157,880,333



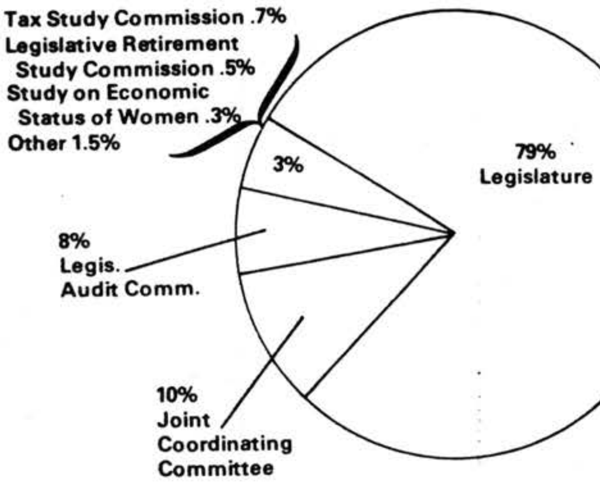
LEGISLATIVE

Appropriations to finance the Legislature increased 36% during the 1973-75 and 1975-77 bienniums, to $26,808,462. This reflects increased salaries and the addition of new activities during the 1975 and 1976 sessions, including the Legislative Audit Commission and a study of the economic status of women.

The Legislative Audit Commission was created to audit the finances of all state departments and agencies at least once a year and to evaluate state-funded activities and programs to determine how well they accomplish their goals and objectives.

Although 79% of the appropriations in this category went to the Legislature, only 16% of this total covered legislators' salaries and insurance benefits. The balance was for travel and per diem expenses of legislative members, staff salaries, printing of bills and journals, and miscellaneous expenses.

APPROPRIATIONS FOR LEGISLATIVE ACTIVITIES, 1975-77 BIENNIUM
TOTAL: $26,808,462



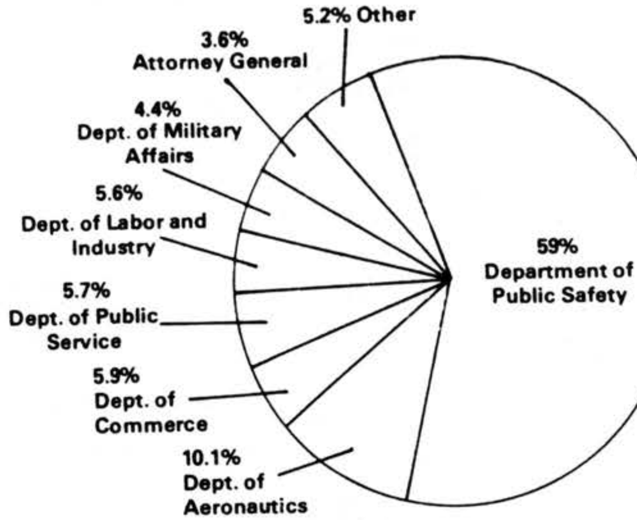
PROTECTION TO PERSONS AND PROPERTY

Appropriations to the state agencies and departments in this category during the 1975-77 biennium increased only 25% over the 1973-75 period, totaling $119,365,269. Agencies and departments in this budget category include the Attorney General's Office and the Departments of Military Affairs, Labor and Aeronautics, and Public Safety. The Department of Public Safety received the largest single appropriation, some $71,000,000, a 27% increase over the previous biennium; its major ongoing activities include motor vehicle inspection and licensing, the sheriffs' teletype network, and the Crime Victims Reparation Board. $1,260,814 was also appropriated to this Department in 1976 for new programs including alcohol safety, bicycle registration and graphic design for license plates.

There was a 34% increase in the Department of Aeronautics budget. Half of this Department's budget went to the construction and improvement of Key Systems Airports (airports being used by or intended to be used by large, multi-engine and jet aircraft), a 115% increase over 1973-75.

Localities were granted $3,289,293, including $2,519,293 for a teletype communications network, $700,000 for training peace officers, $60,000 for air warning systems, and $10,000 to the local airport at Orr.

APPROPRIATIONS FOR PROTECTION TO PERSONS AND PROPERTY
1975-77 BIENNIUM TOTAL: $119,365,269

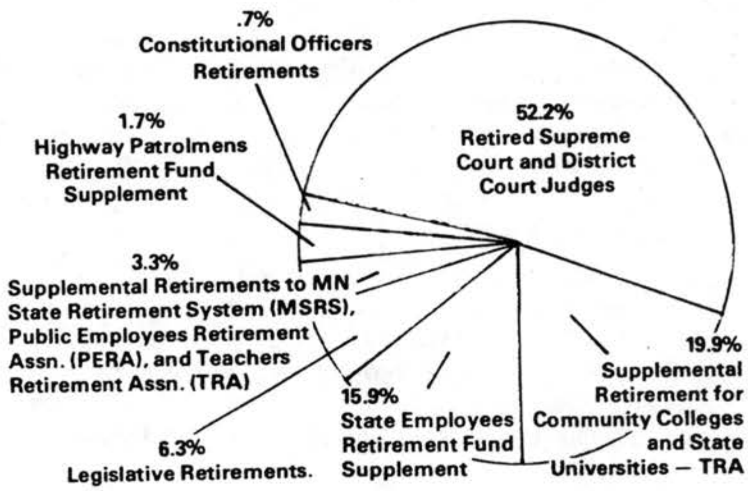


RETIREMENT

Pension funds were a "fringe benefit" developed after the World War II wage freeze to make public employment and public service more attractive and more competitive with higher salaried private sector jobs. However, the matching contributions made by employees and employers to pension funds have not been enough to finance retirement benefits, for several reasons. One is that the original programs required only a five-year investing period, so that early retirees collected far more than they contributed, and another is that benefits have been increased to counter inflation and to meet the demands of new public employee unions. Financing of public pension funds will become even more difficult as the pool of contributing employees shrinks relative to the large number of future retirees in the "baby boom" generation.

Supplemental appropriations are made by the Legislature to offset some of the accrued liability. Appropriations for supplements to state and local pension funds and to fund retirement programs for judges and legislators increased 156% between the 1973-75 and 1975-77 bienniums, from $5,439,460 to $13,918,436.

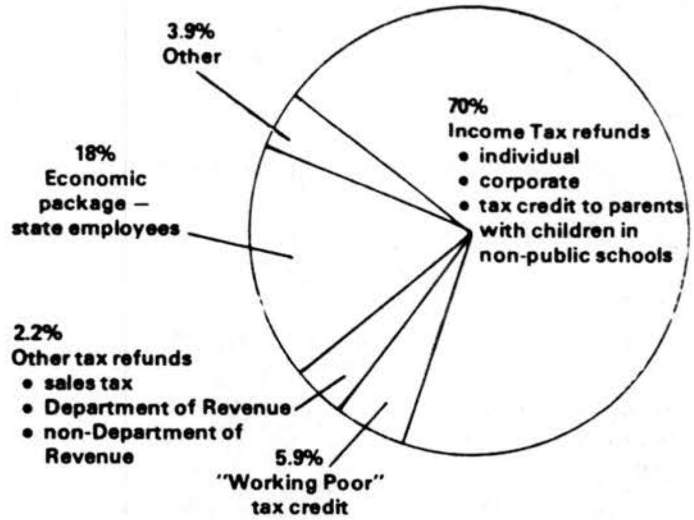
APPROPRIATIONS FOR RETIREMENT PROGRAMS AND PENSION FUNDS
1975-77 BIENNIUM TOTAL: $13,918,436



MISCELLANEOUS

Items in this budget category are those which are not or cannot be charged to an operating department. One example is tax credits or refunds, which increased 30% between the 1973-75 and 1975-77 bienniums. Another is the General Fund Contingent, which was transferred from the Legislative budget to the Miscellaneous category in 1976 because it does not reflect legislative spending. This $4,000,000 fund, which increased 86% between the 1973-75 and 1975-77 bienniums, is used as needed to supplement funds appropriated to state programs. The Miscellaneous category also includes appropriations made for salary and benefit increases for state employees. The total budget for this category in 1975-77 was $530,394,506.

APPROPRIATIONS FOR MISCELLANEOUS EXPENDITURES
1975-77 BIENNIUM TOTAL: $530,394,506



FINANCING LOCAL GOVERNMENT

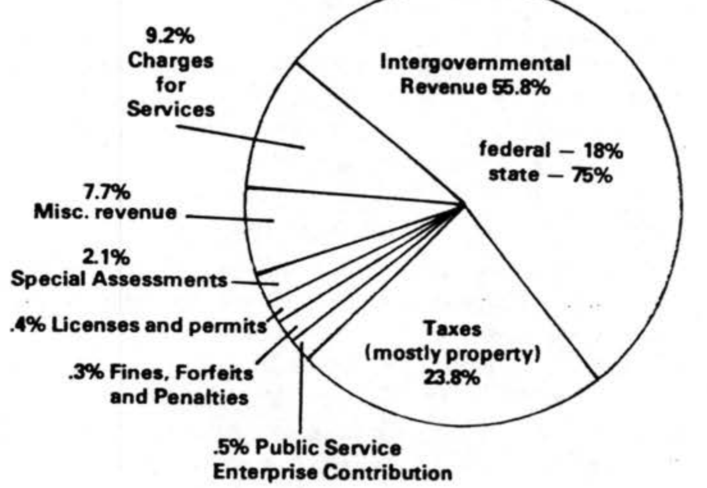
Minnesota had 3,388 local units of government in 1976, each an agent of the state and subject to varying degrees of control by the state. There are 87 counties, 855 cities, 1,798 townships, 436 school districts, and 211 miscellaneous special tax districts, such as the Metropolitan Council and the Mosquito Control District. All are required by the state to provide certain services, and all have some taxing power, although the state imposes certain restrictions on raising of revenue and on the rates levied. Together, these units received revenue of $3,870,779,772 in fiscal 1974-75, of which 20% went to counties, 17% to cities, 1% to townships, 37% to school districts, and 23.6% to other agencies (including metropolitan agencies, housing authorities, and the University of Minnesota).

In recent years there has been a marked change in the relative importance of property taxes and intergovernmental revenues, which are revenues received from the state and federal government, in financing local government. In fiscal 1963-64, 67% of local revenues came from property taxes and only 15% came from intergovernmental revenue. Today the figures are almost reversed, as in fiscal 1974-75, when 23.8% came from property taxes and 55.8% from intergovernmental revenue. This decline in the importance of property taxes as a source of local revenue is a national trend.

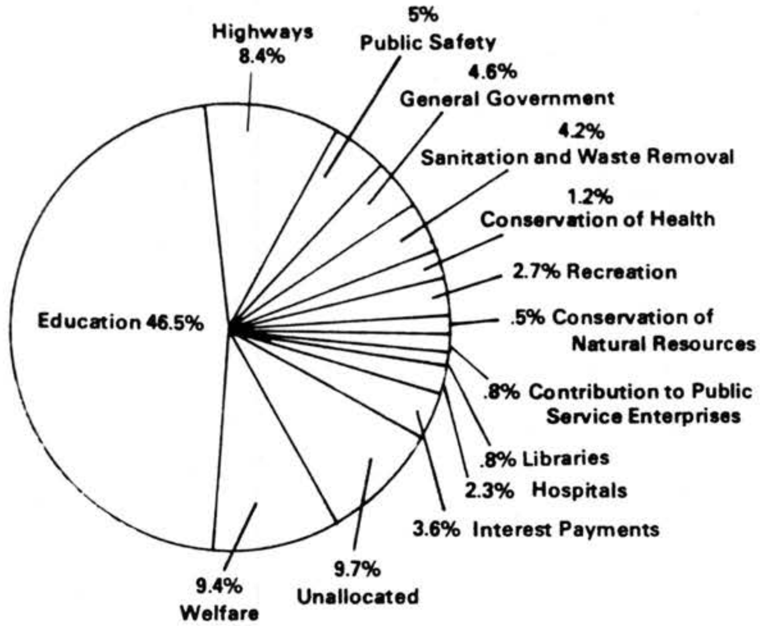
The changing emphasis on who collects the tax money and who spends it stems from a number of causes. One was the need for property tax relief, which led the 1971 Legislature to, in effect, enact such tax relief by limiting the total dollar amount local governments might levy, although certain additional special levies and assessments outside the overall limit were allowed. This levy limitation law applies to all county governments, cities of 2,500 population or more, and towns of 2,500 population or more with statutory powers.

Another important piece of legislation in 1971 which changed the collection and distribution of tax monies was the local government aid law. This law, which has been amended several times, provides for regular quarterly payments to counties, cities, towns and special tax districts in accordance with a statutory formula. The formula takes into account population, average mill rate for the past three years, and the aggregate sales ratio. In fiscal 1976-77 the state will pay out $171,258,145 in local government aids, and will also make intergovernmental payments in the form of property tax relief, shared taxes (inheritance and taconite and occupation taxes) and other grants and special aids. All of these bring the amount appropriated to local governments by the 1975-77 Legislature to $1,342,140,288, a figure which would be far larger if it included aids to school districts.

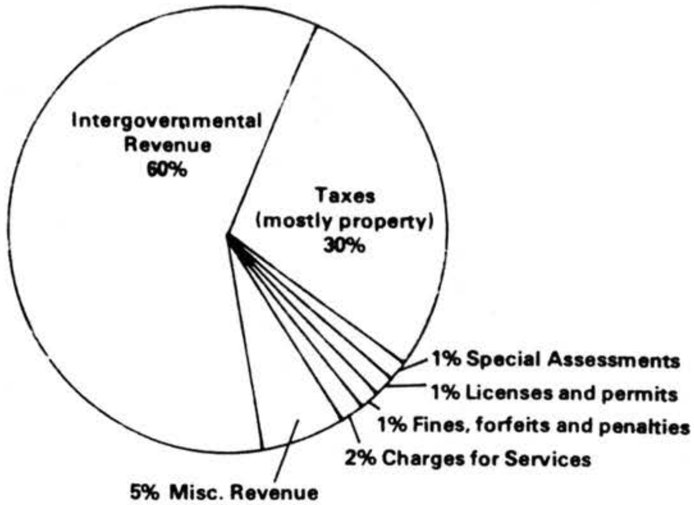
TOTAL REVENUE OF LOCAL GOVERNMENT UNITS IN MINNESOTA, FISCAL 1974-75 TOTAL: $3,870,779,772



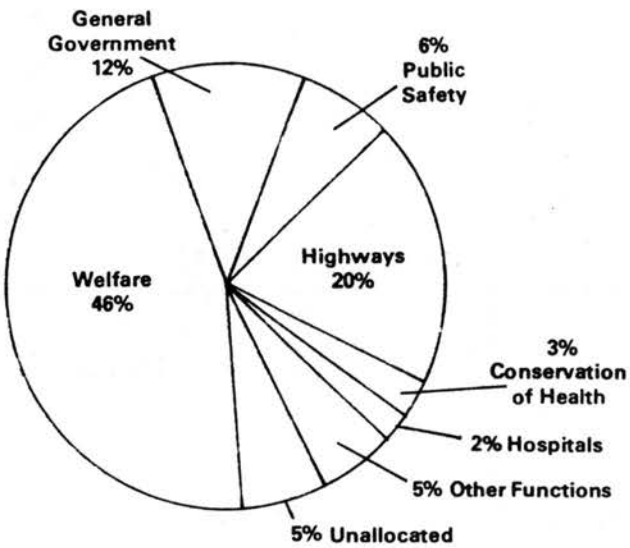
TOTAL EXPENDITURES OF LOCAL GOVERNMENT UNITS IN MINNESOTA, FISCAL 1974-75 TOTAL: $3,863,976,294



REVENUE OF COUNTIES IN MINNESOTA, FISCAL 1974-75 TOTAL: $785,734,980



EXPENDITURES OF COUNTIES IN MINNESOTA, FISCAL 1973-74 TOTAL: $791,417,163



Combined Expenditures of all Local Governmental Units

Local governments collectively spend much more money than the state government does on its own operations. Total expenditures for fiscal 1974-75 for all local government units in Minnesota amounted to $3,863,976,294, representing an increase over the preceding 10 years of 146%. The largest dollar increase in expenditures was for education, which accounted for 46.5% of total expenditures. Next in amount spent was welfare, which accounted for 9.4% of total expenditures; county governments today spend some 99% of all welfare funds.

Counties

Minnesota's counties vary in size from Ramsey county's 160 square miles to St. Louis county's 6,281 square miles. Their populations range from 3,574 people in Cook county to 960,000 in Hennepin county. The 1974 total assessed valuation of property ranged from Lake of the Woods county's $18,250,000 to Hennepin county's $9,734,200,000.

Counties are responsible for administering such functions as rural secondary roads, county courts, certain welfare, health and education services, shorelands management and solid waste management systems. They also have authority for law enforcement, administration of elections and tax levies, and planning and zoning.

During the ten-year period between 1964 and 1974, total revenues and expenditures of counties more than tripled, but this was due in large measure to a shifting of responsibilities for welfare payments and other items. Counties had $785,734,980 in total revenue in fiscal 1974-75, about 30% of which came from local property taxes and special assessments and 60% from intergovernmental revenue.

Cities

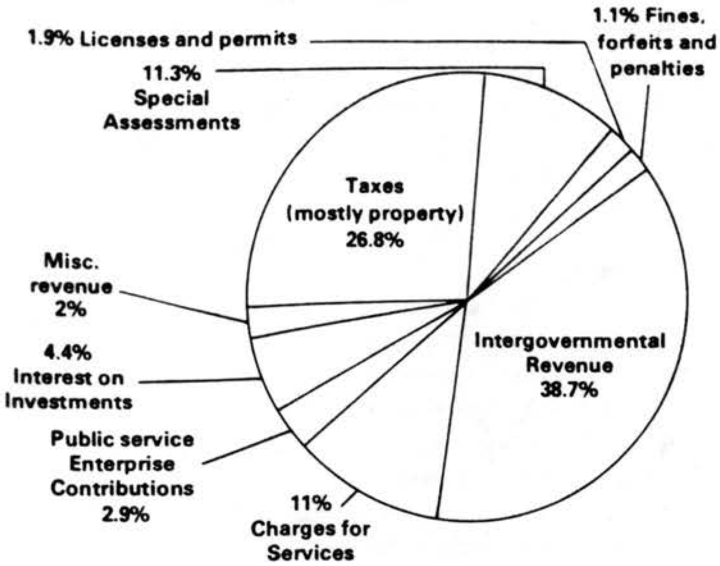
Minnesota's 855 cities range in population from more than 400,000 in Minneapolis to less than 100. Once they were called villages, boroughs or cities, but since January, 1974, they are all officially cities. The terms village and borough can no longer appear in state statutes or be used in legal proceedings, although they are still used informally out of habit or local custom.

Cities are subdivisions of the counties, although some cross county lines. Their residents vote for county officers, pay county taxes and benefit from county services. Cities are also part of school districts which may encompass a different area and maintain a separate governing body from the city. Thus residents of cities benefit from state aids to their city, as well as from state aids to their county and their school district.

Cities are responsible for such things as streets, sewers and sewage treatment plants, fire and police protection, public libraries, hospitals, waterworks, parks and general governmental administration.

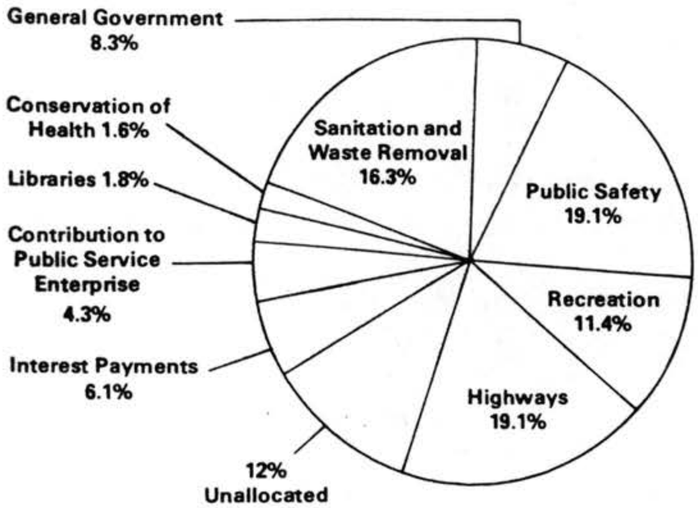
REVENUE OF CITIES IN MINNESOTA, FISCAL 1974-75

TOTAL: $670,363,200



EXPENDITURES OF CITIES IN MINNESOTA, FISCAL 1974-75

TOTAL: $745,235,017



Townships

Minnesota is divided into townships, which are geographical areas usually six square miles in size. When the people living in a township organize a local government, it is called township or town government. Because of this, the word "town" should not be used in Minnesota to mean a village or small city. The unorganized townships — areas in which no town government has been organized — are found mostly in the less populated northern part of the state and are governed by the county in which they are situated. The prime responsibility of towns is maintenance of township roads and bridges. Some also provide fire protection and law enforcement.

In fiscal 1974-75, towns accounted for 1% of the state's total local government revenue and slightly more than 1% of total local government expenditure. 59% of total township revenue came from intergovernmental revenue and 33% from property taxes. 69% of total expenditure was for highways and 15% for general government.

School Districts

Minnesota has 436 local school districts charged with providing educational services for students in grades kindergarten through twelve. There are also 4 elementary districts that do not provide high school education. Prior to large-scale school district consolidation mandated by the state Legislature in 1964, there were 1,515 school districts, only 481 of which provided education at the secondary school level.

Expenditures of local school districts depend on the number of *pupil units* in the district. In computing pupil units, kindergarten students are each counted as .5 of a unit, students in grades one through six as 1 pupil unit each, and students in grades seven through twelve as 1.4 pupil units each. The differential is based on the relative cost of educating the different age levels. For the 1974-75 school year, districts varied in size from Verdi, with only 164 pupil units, to Minneapolis, with 63,540 pupil units. The lowest expenditure per pupil unit in 1974-75 was $935, the highest $3,282. Total expenditures per pupil unit include all of the district's expenditure — salaries, supplies, transportation, food services, building maintenance and operation as well as capital and debt service expenditures.

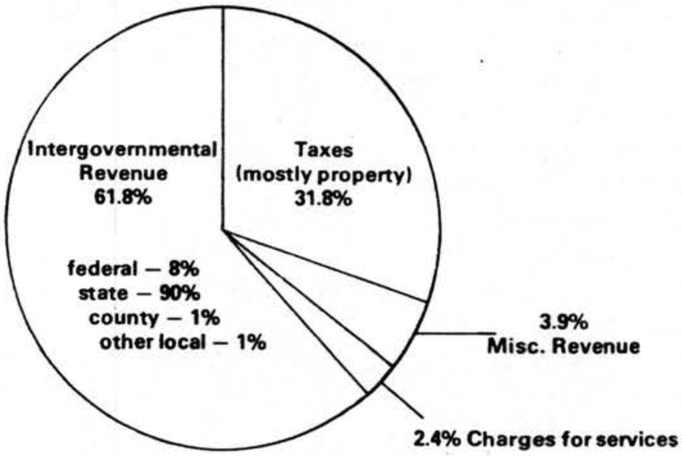
The school aid formula is explained in the January, 1975, LWVMN VOTER, "The Minnesota Miracle." The formula dictates how much income a local district will be allowed to receive in a given year as well as how much of that income will come from the state. The Legislature appropriated $1,686,290,284 for elementary and secondary education in the 1975-77 biennium. This included school aids and special school aids for the two-year period.

However, the appropriation figures are not a reliable measure of local expenditures. The school aid formula dictates how much each school district may receive from state and local sources but does not require that each local district spend the entire amount it receives. A local district may put some of its receipts in a reserve account for spending in future years.

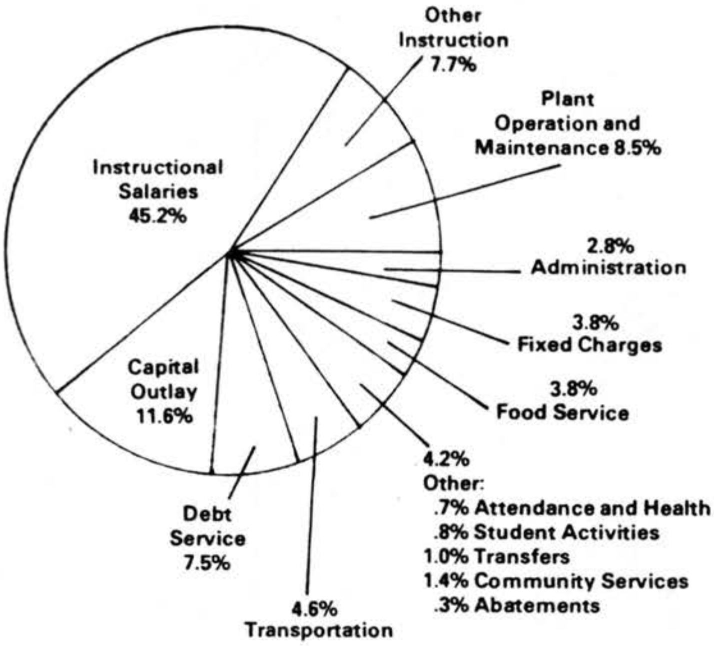
This is one reason why total expenditures by all local school districts in 1974-75 totaled $1,515,717,689, or $56,700,180 more than total revenues.

TOTAL REVENUE OF SCHOOL DISTRICTS, FISCAL 1974-75

TOTAL: $1,459,017,518



TOTAL EXPENDITURES OF SCHOOL DISTRICTS, FISCAL 1974-75
(Individual districts may vary greatly from the average)



CONCLUSION

This series of publications, designed to explain how government is financed in Minnesota, is a result of the continuing concern of members of the League of Women Voters of Minnesota to inform themselves and the public about governmental issues. How state government is financed has been of interest to the LWVMN since the early 1950's and is of particular interest in the 1970's when government costs are rising at a rapid rate. Minnesota is faced with hard decisions on sources and allocations of funds. These decisions affect all taxpayers and the services they receive from government. The wrong decisions may be costly, not only in money but in terms of human needs.

It is hoped that these Facts and Issues will help prepare citizens to help state legislators make these choices. Our democracy depends on the interest and informed participation of its citizens, a concept around which the League of Women Voters is organized. Financing state government is a complex subject, but it can be understood by those who want to. If everyone makes the effort, a "quality life" may prevail in Minnesota.

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Research for this publication done by Karen Anderson, Margaret Bloyer, Erica Buffington, Lorry Clugg, Kathy Gilder, Ervie Hasbargen, Judy McGuire, and Sid Moss. Edited by Rhoda Lewin

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Published by the League of Women Voters Education Fund

Financing State Government

Proposed Concurrence Statement

The LWVMN supports a balanced and diversified revenue system which relies on a combination of broad-based taxes and user fees. The LWVMN supports the following criteria for evaluating individual revenue sources and the overall revenue system: Competitiveness, efficiency, equity, progressivity, reliability, responsiveness, and simplicity.

The LWVMN supports a **progressive income tax** with a graduated rate schedule.

The LWVMN supports a **broad-based sales tax** with exemptions for essential items to reduce the impact on low-income persons.

The LWVMN supports the use of an **equitable property tax** as the primary source of financing for services provided by local governments and a partial source of financing for education. (*See Financing Education position.)*

The LWVMN supports a **corporate franchise tax** which is competitive with other states providing a comparable level of public services and which equitably taxes all coporations earning profits from their business activities within the state.

The LWVMN suports the use of **other sources of revenue**, such as user fees and special assessments, for funding specific actiivities and projects. These charges should be structured and levied with a sensitivity to the criteria established to judge the overall revenue system.

The LWVMN generally supports achieving social policy goals through **open and visible expenditures** rather than by granting deductions, exemption and credits. *If deduction, exemption and credits are granted*, they should be evaluated on the basis of their compliance with the criteria established to judge the overall revenue system; determined to be the most cost-effective means of achieving the intended purpose; and reviewed periodically to justify continuance.

The LWVMN supports the **distribution of state-collected revenues** to local governments based upon the following principles:

- •It is appropriate for the state to share in the cost of services provided by local governments that benefit all Minnesotans.
- •Local governments should fund local community services unless state sharing is necessary to assure that services are available on an equitable basis. The state should not impose statutory limits on local governments' ability to raise and spend revenue for local community services.
- •Programs which distribut state-collected revenues to local governments should enhance the equity, progressivity, and efficiency of the overall revenue system.
- •Once enacted, promised distributions of state-collected revenues to local governments should be a reliable source of revenue to local governmental units.

The LWVMN supports **long-term financial management** of all state government funds. Long-term projections of revenue and expenditures should be considered when making budget decisions. An adequate **budget reserve** should be established during good exonomic times to be used in recession years to sustain expenditures for necessary services.

FINANCING STATE GOVERNMENT STUDY
Concurrence Discussion Guide

The Concurrence Process:

"Concurrence is the act of agreeing with—or concurring with—a statement or position. A decision-making technique used by the League for some time, concurrence can work in several ways. Groups of League members can concur with (1)recommendations of a resource committee or a unit group; (2) decision statements formulated by League boards; or (3) positions reached by another League or Leagues." [1]

The Financing State Government Study Committee decided to present all local Leagues with a proposed position statement for their concurrence. We think this will prove a simpler and more satisfying way to deal with this very complex topic. If all the complex possibilities for each of the large number of items were considered in separate questions, an unacceptably long and repetitious discussion would be necessary. And then we would be faced with developing the position wording that reflects the agreement we found. Unlike our most recent experience with concurrence (adopting the LWV Minneapolis position on Preventing Violence) we will **not** just vote "yes or no" on the whole position. Instead each section of the proposal will be considered separately for discussion and agreement or disagreement.

The proposed position was written over many months by the Study Committee after thorough study of the issues and review of positions adopted by other state leagues.

Introduction

The concurrence statement emphasizes broad, general principles. It is NOT meant as a detailed tax-by-tax study. The Committee has worked and re-worked the wording to provide the exact language thought to be most useful for a future lobbying position. We hope to create a position that will enable League lobbyists to react to the wide variety of fiscal issues that the state will face in the coming years , even though the specific nature of those issues is not known with any certainty at this time.

Your job will be to lead a discussion at the unit meeting that centers on these bigger ideas, and determine whether your members agree with each part of the concurrence statement. (You may use the back of the report sheets for additional space to elaborate on your discussion.) This discussion guide is designed to define the wording used and briefly explain the implications of adopting this set of basic principles.

Opening Statement:

I. "The LWVMN supports a balanced and diversified revenue system which relies on a combination of broad-based taxes and user fees."

This general statement supports use of a variety of revenue sources because there is no "perfect" source of revenue. We achieve an acceptable overall revenue system by thoughtfully "balancing" collections from many sources so that the inadequacies of one revenue source are offset by the strengths of another. Use of a variety of taxes assures that taxpayers cannot totally avoid taxation by adjusting their economic activity. *For example, taxpayers who avoid paying income taxes on their interest income by investing in tax exempt bonds issued by Minnesota municipalities pay a retail sales tax if the income is used to buy a car or other taxable item.*

The statement recommends that **broad-based taxes,** rather than narrowly targeted taxes imposed upon a small specific group or activity, make up the principal source of revenue. The so-called **"sin" taxes** currently represent a relatively small part of all state revenue sources and should continue to do so. (The statement does not specifically affirm or reject the use of a specific narrow tax, such as the cigarette tax, to raise revenue for a specific program such as health care nor does it directly deal with special issues related to revenue obtained from operation of the Minnesota lottery. The general nature of the statement would, however, enable limited League activity in both of these areas.)

User fees are collected from specific beneficiaries of products or services and are generally used when benefits are received by a clearly identifiable person or group. The user fee is generally set to cover all or a part of the cost of producing the product or service provided to the beneficiary. User fees such as tuition at state supported colleges and universities make up an important source of revenue to the state and are an important part of the overall revenue system.

Criteria

"The LWVMN supports the following criteria for evaluating individual revenue sources and the overall revenue system:"

This is perhaps the most important section of the concurrence statement. It asks League members to think about the basic criteria to be used to evaluate individual revenue sources and the overall revenue system. The criteria agreed to in this part of the concurrence will give League lobbyists a powerful tool to use when new revenue sources are proposed by legislators and when changes to existing sources are debated. Though many of the criteria sound like "motherhood and apple pie," a critical part of your discussion should center around the implications of adopting the criteria.

Members should be advised that no single revenue source will meet all of the criteria, but that a properly balanced revenue system can satisfy all of them when it is viewed overall. League lobbyists will use the accepted criteria to evaluate the desirability of individual revenue sources. They will also use the criteria to consider how proposed changes affect the overall system. The utility of preestablished criteria for evaluating and amending the revenue system is discussed in the first chapter of Model Revenue System for Minnesota, a study prepared by the Minnesota Department of Revenue.[2] [The criteria are presented in alphabetical order.]

1. Competitiveness - "Allows Minnesota to compete with other states and nations as a location of economic activity recognizing that the revenue system is only one of many factors involved in location choice and that the level and effectiveness of public services affects competitiveness."

Minnesota's ability to attract and retain economic activity is affected by both its tax policy and the type, level, and effectiveness of its public services. Tax policy can have a significant influence upon the type of economic activity that locates here. For example, if Minnesota chooses to tax industrial real estate (land and buildings) more heavily than other states, it will probably discourage businesses that require a significant investment in real property from locating here, all other things being equal. On the other hand Minnesota can encourage certain activities by taxing them lightly. Wisconsin residents living close to the Minnesota border may choose to purchase their clothing in Minnesota because clothing is exempt from our retail sales tax. Minnesotans flock to Wisconsin to purchase liquor because of differences in the two states' liquor tax policies. Countries do this, too. Ireland, for example, has become the home of many authors and poets because Ireland grants favorable tax treatment to income derived from book royalties.

Competitiveness is often mentioned by business groups when they oppose a tax. Their arguments can be very persuasive. Comparisons of tax amounts and rates support the contention that Minnesota's business tax rates are high in comparison to those levied by most other states.[3 and 4]

However, the concurrence recognizes that the location decision involves a multitude of factors. Some of these factors, such as the amount and type of taxes levied and the level and effectiveness of public services provided, can be directly affected by government action. Other significant factors, such as proximity to markets and climate conditions, cannot. Therefore, competitiveness should not be defined by tax policy alone. The statement recognizes that the level, type and effectiveness of government services affects our ability to attract economic activity. Good education, plowed streets and highways, amenities such as parks, clean air and water can also help the state attract and keep individuals and businesses. In fact most studies indicate that growth in employment and business activity in this state has exceeded that of surrounding states over the last ten years even though we are generally described as a high tax rate state.[5] Many organizations that rank business climate show that despite high tax rates, Minnesota is a good business location when the effectiveness of public services is taken into consideration.[6] Scholarly studies often confirm that high quality government services are important to all taxpayers.[7] To be competitive we must strike a proper balance between tax collections and services provided.

What are the implications of adopting the competitiveness criterion? The Minnesota Department of Revenue in its Model Revenue System for Minnesota suggests that meeting this criterion implies low tax rates for all taxpayers and avoidance of special tax breaks targeted to specific groups because a tax break for one group of taxpayers requires increased rates for all others.[8] (Also see discussion of Deductions, Exclusions and Credits)

Rejection of this criterion implies that the impact on our ability to attract and keep economic activity should not be an important factor in determining revenue policy.

2. Efficiency - "Maintains a reasonable relationship between administration and compliance costs and the amount of revenue generated."

Tax collection is a costly process for government. Taxpayers, too, incur expenses complying with the tax law. The efficiency criteria suggests that administration and compliance costs should be considered and that they should be reasonable relative to the amount of revenue generated by the tax.

Administrative efficiency requires careful structuring of each tax to assure reasonable collection costs. Generally, collection costs are lowest when a large percentage of taxpayers voluntarily comply with the law so that the expense of dealing with tax evasion and tax evaders is minimized. Administrative efficiency also requires that modern procedures and technology be used by the Revenue Department to reduce the cost of processing tax returns.

Compliance efficiency means paying attention to the costs incurred by both taxpayers and nongovernment collection agents (such as retailers who collect the sales tax) as they comply with the tax law. Taxpayers expend time and/or money to keep records and compute the amount of the tax owed. These costs should also be reasonable when compared to the amount of the tax collected. Compliance costs are generally lower when the tax is uncomplicated and easy to compute. (Also see the discussion of Simplicity.)

Efficiency is a relative concept in that it relates to "cost per tax dollar collected." Keep in mind that taxes often impose subtle costs on society as taxpayers adjust their economic activity to legally avoid paying the tax. **Tax avoidance**

activities reduce collections and impose societal costs. *For example, an income tax which taxes income earned from investments in oil and gas property at a lower rate than income earned from rental apartment units leads taxpayers to shift investment into oil and gas ventures and out of apartment houses. We may drill too many oil wells and build too few apartment buildings.* Tax-motivated economic distortions impose costs on society (too many oil wells and too few apartments) which are very difficult to measure. Tax avoidance activities increase when tax rates on some activities are significantly higher than on others.

Adopting this criterion means that we are concerned about the relationship of all costs associated with collection and compliance (those incurred by government, taxpayers and society) to the amount of tax collected. We would oppose high cost-ratio taxes (costs high relative to revenue collected).[9]

3. Equity - "Imposes a similar revenue burden on taxpayers in like circumstances."

Taxpayers in similar circumstances should pay approximately the same amount of tax. When the concept is applied to a single tax, such as the personal income tax, it means that Minnesotans with similar levels of income should pay approximately the same amount of state income tax. The concept leaves room for fine tuning as we identify conditions that differentiate taxpayers' abilities to pay. *For example, we generally allow taxpayers with more dependents to pay less income tax at each income level.* Proper allowance for special circumstances can improve tax equity. Unfortunately, special allowances can also reduce tax equity by providing favored treatment for favored taxpayers.

The Minnesota Department of Revenue Model Revenue System for Minnesota states

To achieve this **"horizontal equity'"** goal:

- tax bases should be broadly defined with all sources of income taxed uniformly,
- deductions, exclusions and exemption should be minimized, and
- differential rates on essentially similar activities, sources of income, types of wealth or forms of business should be avoided. [10]

Application of the equity criterion to the revenue system as a whole requires a multidimensional interpretation of similar circumstances and consideration of all state and local taxes paid. In general we want to create a revenue system which imposes a similar total tax burden on persons with similar ability to pay, broadly defined.

Acceptance of this criterion will enable the LWVMN to lobby against tax breaks for favored taxpayers unless proponents can demonstrate that a desired social goal will be achieved in a cost-effective way. (See section on Deductions, Exclusions and Credits.) Adoption will force us to think about the circumstances that legitimately differentiate taxpayers. *It might, for example, enable the League to support legislation that equalizes the property taxes levied on a $100,000 market value home to provide for a basic set of city services.* The criterion commits us to consider whether the system, overall, levies equivalent taxes on taxpayers with approximately the same ability to pay.

4. Progressivity - "Requires that those with greater ability pay a larger percentage of their income in taxes."

This criterion refers to **"vertical equity."** Those with different ability to pay should pay a different amount of taxes, and specifically those with greater ability should pay a higher percentage of their income in taxes. Percent of income paid in taxes is difficult to determine because many taxes levied on one party are passed on to another. Who pays the property taxes levied on a commercial building? *Is the tax finally paid by the owner of the building, the re-*

tailer who rents the space, or the customer who buys the retailer's products? The term **tax incidence** refers to "who actually pays the tax." The November 1993, ***Minnesota Tax Incidence Study*** prepared by the Tax Research Division of the Minnesota Department of Revenue attempts to determine who pays Minnesota's household and business taxes.

> "The results show that the combined distribution of state and local taxes in Minnesota is essentially proportional. Overall, Minnesota residents paid an estimated 11.8 percent of their 1990 total income in state and local taxes. With the exception of the first decile, effective tax rates do not vary significantly with income." [11]

In a **proportional tax system,** taxpayers of all income levels pay the same percentage of their income in taxes. The only major Minnesota state tax that is progressive is the individual income tax. All other major taxes - sales, property, corporation income tax, and excise taxes - are **regressive,** i.e. lower income taxpayers pay a higher percentage of their income in taxes. [12]

> "In addressing this policy issue it should be recognized that a proportional state-local tax system is unusual; what little multistate information there is suggests that most states have regressive distributions of state-local tax burdens... An interstate study by the Citizens for Tax Justice (1991) comparing effective tax rates for major state-local taxes concludes that only two states, Vermont and Delaware, have even slightly progressive overall tax systems." [13]

In order to increase overall progressivity in the revenue system we would have to redesign many of our basic taxes to make them income-sensitive or rely more heavily upon the already progressive income tax. League lobbyists could, for example, use the position to support greater emphasis on income-based property tax credits.

Proponents of a progressive tax system argue that wealthier individuals have more income left after providing for basic needs and can, without enduring greater pain, allocate a larger percentage of their income to support the government. Many economists oppose higher tax rates for wealthier individuals because they feel that high tax rates act as a deterrent to economic activity. High tax rates can also lead to an increase in tax avoidance effort. When rates get too high, taxpayers do less of the taxed activity and spend more time seeking tax havens and shelters. Sometimes, higher tax rates result in lower tax collections.

5. Reliability - "Provides a stable source of revenue."

A reliable revenue source can be counted on to provide steady income to the governmental unit. State and local governments need reasonable assurance that revenues will be collected as projected because, by law, these governmental units cannot operate at a deficit. Some taxes are more reliable than others over the economic cycle. Property and sales taxes tend to fluctuate less in good and bad times while income taxes vary more widely. Stability of government revenue over the economic cycle requires long-term planning which includes setting aside taxes collected in good years to be used to compensate for recession year shortfalls. In the ***Model Revenue System for Minnesota***, the Department of Revenue lists the following reliability characteristics:

- "The system should be stable over the economic cycle but provide sufficient growth in step with income over time.
- The revenue system should provide political stability by avoiding frequent tax rate changes.
- A balanced use of income, sales and property taxes should provide greater revenue stability over the business cycle in combination with a state budget reserve or 'rainy day' fund.
- The tax structure should be certain and predictable to facilitate longer-run planning by taxpayers." [14]

Adoption of this criterion suggests that we could support some use of more reliable, but regressive, taxes such as the property and sales taxes. We would support cyclical planning to build reserves to sustain service levels during recessions.

6. Responsiveness - "Adjusts to changes in economic conditions and reflects long term growth."

This criterion emphasizes the importance of designing a revenue system that is sensitive to changes in economic conditions in the short- and long-term. To some extent, sensitivity to changes in conditions can be built into the system so that tax collections automatically adjust in the desired manner. In the short term we want the revenue system to have a positive effect on economic activity. It should not be an excessive drag on the economy during recessions nor should it overly stimulate the economy during booms. Many economists feel that reducing tax collections during recessions helps the economy recover, and that increasing tax collections during inflationary periods slows the rate of increase in prices. A progressive overall tax system, where the percent of income collected in taxes increases as incomes rise and decreases as incomes fall, provides for some degree of automatic adjustment. A proportional system which collects a constant percent of income as incomes change would be second best in meeting this objective.

In the long term we would like a system that generates sufficient revenue to maintain desired public service levels. Government expenditures tend to increase as the general level of income increases because salaries represent the largest cost of providing most government services. A regressive tax system is, over time, more likely to generate a revenue shortfall. A regressive system automatically reduces the portion of rising income collected in taxes, and may result in inadequate revenue to maintain public services when cost-per-client-served tends to increase at about the same rate as incomes rise.

Automatic adjustments to changes in economic conditions may be inadequate. A responsive system also allows for specific legislative action to address special problems.

7. Simplicity - "Is understandable to the taxpayer."

Taxpayers should be able to understand how their tax is determined. Complex tax calculations should be avoided whenever possible. Taxpayers should know which governmental unit is responsible for each tax and, in general, what services are funded by the revenue provided by the tax.[15] Simple tax calculations make it more difficult for government to fine tune a tax and adjust its incidence by using deductions, exclusions and credits which reduce the taxes paid by taxpayers who fall in special categories.

The State of Minnesota has simplified the calculation of the individual income tax by requiring taxpayers to begin their calculation of Minnesota taxable income with Federal taxable income. Adjustments to arrive at the Minnesota taxable income have been reduced so that most Minnesotans fill out a very simple form to calculate the state income tax amount.

Legislators are often tempted to depart from the Federal definition of taxable income, but each adjustment makes calculation of Minnesota taxable income more difficult. Most recently the Legislature considered rejecting the new Federal rules for taxing social security income. Abandoning the Federal computation would have reduced Minnesota income taxes paid by higher income retirees. It would also have added an adjustment to the Minnesota tax form, making calculation of Minnesota taxable income more complicated. In the end the legislature opted for simplicity and more tax revenue.

It should be noted that it is often hard to combine simplicity and equity in a tax. Recognition of special circumstances complicates tax calculations. Allowing limited deduction of large casualty losses may improve the equity of income taxation, but it also makes calculation of taxable income more difficult to understand. (See the discussion of Deductions, Exclusions and Credits.)

Some tax critics have proposed the simplest possible income tax - one low rate applied to all income with no deductions or exclusions.

II. Individual Income Tax
"The LWVMN supports a progressive income tax with a graduated rate schedule."

The individual income tax is the second largest single source of tax revenue to state and local governments. Revenue generated by the individual income tax collections totaled $3,144,639,000 in Fiscal Year 1992 and represented about 29% of total state and local tax collections (in 1990).[16] Revenue from the tax goes into the State General Fund. The tax base is Minnesota taxable income which is closely related to Federal taxable income. There is a graduated rate schedule ranging from 6.0% of the first $20,960 for married couples filing joint returns to 8.5% of Minnesota taxable income over $83,300.[17]

Comparison of tax rates with other states is not always useful because each state has its own unique way of determining the amount of taxable income. [18] The tax is progressive, taking 0.2% of income from taxpayers in the bottom ten percent of the income range and 5.5% of those in the top decile.[19] **(The percentage of income paid in tax is less than the tax rate because deductions and exclusions reduce income that is subject to the tax rates.)** The Minnesota Department of Revenue computed actual 1991 taxes for individual and married filers at various income levels living in each state that levies an individual income tax in order to rank state individual income tax burdens. *The Minnesota income tax burden of a married, two wage earner, household with $15,000 of income ranked 40th in the nation among the 41 states that levy an individual income tax while the tax burden rose to 7th for a household with $200,000 of income.* The Minnesota tax burden is relatively light for married filers with low incomes. Low income, single filers do not fare as well when compared to other states. Minnesota ranks 9th in individual income tax burden for a single filer with $15,000 of income. (In this study, all income was derived from fully taxable wages.)[20]

> "The State of Minnesota has historically had a high personal income tax relative to other states, a fact which has received a good deal of attention from the news media, politicians and others. The rate of taxation is progressive in nature and it reflects to some degree the general philosophical orientation of state policy makers and citizens over the past several decades." [21]

If we adopt this position we would support the use of a progressive individual income tax. We would oppose attempts to make the tax proportional or regressive. (See also discussion of Deductions, Exclusions and Credits.)

Proponents of progressive taxation claim that fairness calls for those with greater capacity to pay higher taxes. The income tax has a special role in the overall tax system. It is the tax that can most readily be given a progressive structure and should therefore be used to offset other regressive state and local taxes.

Opponents fear that high income tax rates on wealthier households stifle their incentive to work and earn income. Furthermore, wealthy Minnesotans may choose to "vote with their feet" and move to lower tax states. Indeed, a two wage earner household with $200,000 of fully taxable wage income could move to 43 other states and pay less individual income tax. A lower income household, with $15,000 of wage income would pay less in only ten other states. (Nine states levied no individual income tax in 1991, the year studied.)

III. Retail Sales Tax

"The LWVMN supports a broad-based sales tax with exemptions for essential items to reduce the impact on low-income persons."

Minnesota's retail sales tax collections including the Motor Vehicle Excise Tax (sales tax applied to motor vehicles) totaled $2,468,871,000 in 1992 and represented about 22% of all state and local taxes in 1990.[22] The basic tax rate applied to the selling price of general purchases is 6.5%.Three cities, St. Paul, Duluth and Rochester, levy an additional .5% tax on retail sales within their jurisdictions. There are separate rates for a limited number of special items such as liquor and beer, which are taxed at a 9% rate. Farm machinery, special tooling and manufacturing equipment are taxed at lower rates of 2.5% to 4.5%. Major exclusions or exemptions include: food for consumption off premises, clothing, prescribed drugs and medications, non-prescribed analgesics, gasoline and special fuels taxed under the motor fuels excise tax, and items purchased for resale in the regular course of business.

The State General Fund keeps the proceeds from the first 4.5% and the Local Government Trust Fund receives proceeds from the remaining 2%. Minnesota's 6.5% rate is higher than the rate charged by surrounding states, but there are more exemptions allowed in Minnesota than in most other states.[23 and 24] The Minnesota retail sales tax is regressive even though its regressivity is reduced by the exemption of many necessary items.

The tax, including allocation of sales taxes paid by businesses, consumes 6.8% of the income of the those in the lowest ten percent of the income range. Those in the second income decile pay 4.4% of their income in direct and indirect sales taxes, but those in the highest income decile pay only 1.9% of their income.[25] (The impact on the lowest decile is misleading because that group contains many households that have experienced unusual, one-time losses which reduce taxable income in one year only. The income of these households often understates their ongoing resources.)

The concurrence statement supports use of a retail sales tax. It affirms exclusions or exemptions for necessary items which reduces the inherent regressivity of the tax. [Staying with our aim for broad, general principles, the Study Committee has made no attempt to define "necessary items."]

Proponents of the retail sales tax find it to be an efficient, relatively reliable revenue source. It taxes money spent as opposed to money saved and thereby indirectly encourages saving in a country where some feel saving rates are too low. Exclusion of food, clothing, and certain medicines reduces the relative tax burden on poor families who spend a higher proportion of their income on untaxed items. The tax is basically easy to compute although identifying excluded items is sometimes difficult.

Opponents of the concurrence statement would probably fall into two camps. Some feel any regressive tax is unfair. Others would eliminate some or all of the exclusions. There is a growing feeling in Minnesota that clothing purchases should be taxed. Elimination of this exclusion would, for example, allow the state to collect taxes on more of the merchandise sold to nonresidents at the Mall of America.

IV. Property Tax

"The LWVMN supports the use of an equitable property tax as the primary source of financing for services provided by local governments and a partial source of financing for education."

Property taxes levied by local governments and school districts totaled $3,713,000,000 in 1992 ($3,552,000,000 after state targeted refunds). They made up approximately 30% of total state and local tax revenues in 1990.[26] The tax base is related to the market value of the property as determined by the county assessor. The market value is multiplied by class rates which are determined by the type of property. (See the Minnesota Tax Handbook, page 71 for details.)[27] Significantly higher class rates are applied to business property than to homesteaded residential and agricultural property. Special **income-adjusted refunds are available** to renters and home-owners whose property taxes exceed a specified percentage of household income. *"Above that level, the state will pay a percentage of the tax, up to a maximum refund. The percent of income, percent of state payment, and maximum refund depend upon the income of the claimant. As the claimant's income increases, the amount the state pays decreases. Eligibility for the property tax refund is limited to claimants with incomes under $60,000 for homeowners and under $35,000 for renters."* "[28]

The Minnesota Tax Incidence Study indicates that even after consideration of the special income-adjusted refund program, Minnesota's residential and business property taxes are regressive. They consume approximately 5.9% of the income of the poorest ten percent of taxpayers but only 3.1% of the wealthiest ten percent.[29]

The concurrence statement indicates that property tax revenue should be the primary source of funds for local community services and a partial funding source for education. It also highlights the **equity** criterion. Property tax equity requires consistent assessment practices throughout the state. Equity might also be interpreted to mean that, across the state, similar properties should pay similar tax amounts for basic local services. Disparities in the amount of property tax paid by similar properties should be related to differences in the level of services that local governmental units choose to provide. They should not occur simply because assessment practices differ, or because tax rates levied for basic services are unequal.

Proponents argue that using the property tax as a primary source of financing local services makes sense because many local services such as fire protection, police service and road maintenance, benefit property owners. Earmarking the property tax for local services makes local authorities accountable to taxpayers for the level of the tax.

Opponents might prefer financing local government services with some other, perhaps less regressive revenue source. For example, local governments could be empowered to levy a local income and/or sales tax.

The criteria adopted in the first section of the concurrence statement could have considerable impact on League lobbying efforts related to the property tax. For example, acceptance of the **progressivity** criterion might support an effort to expand the special income-adjusted refund program or to decrease overall reliance on the property tax. The Model Revenue System for Minnesota recommends that a higher percent of total state and local taxes be collected from the individual income tax than from property taxes in order to avoid regressivity in the overall tax system.[30] We are now raising approximately equal amounts from each of these taxes. Similarly, the **competitiveness** criterion, if adopted, could affect our response to changes in the taxation of Minnesota business property which many experts feel is overtaxed relative to neighboring states.

V. Corporation Franchise (Income) Tax

"The LWVMN supports a corporation franchise tax which is competitive with other states providing a comparable level of public services."

"The LWVMN supports a corporation franchise tax which equitably taxes all corporations earnings profits from their business activities within the state."

The corporation franchise tax is paid on profits earned by corporations on their business activities within the state. Collections from this tax totaled $422,812,000 in FY 1992 and represented about 4% of total state and local tax revenue in 1990.[31] The 9.8% Minnesota tax rate is higher than that charged by many other states. Calculation of the tax base to which the 9.8% rate is applied is incredibly complex. It begins with the Federal taxable income of the corporation adjusted for more than 25 items and multiplied by an apportionment factor.[32]

The **competitiveness** of the corporation franchise tax is emphasized in the concurrence statement. High tax rates may lead businesses to locate and/or do business elsewhere which adversely affects employment and investment within the state. Evaluation of the competitiveness of our corporate income tax requires consideration of the level of public services because competitiveness is also affected by the quality of public services.

The **equity** of the corporation franchise tax is also emphasized in the concurrence statement. While competitiveness is concerned largely with the relationship between the taxes charged in Minnesota and the taxes charged by other states, equity requires that all corporations doing business in the state pay equivalent taxes on their Minnesota generated profits. Equity is a special issue with this tax. Because it is inherently difficult to determine the amount of profit earned on Minnesota business activities by multistate corporations, these firms could escape taxation here by claiming that Minnesota profits are earned elsewhere.

Minnesota has adopted a "unified" approach to calculating taxable income which begins with the corporation's Federal taxable income. After adjustment, an apportionment ratio is applied to determine Minnesota taxable income. The apportionment ratio weights the proportion of the company's property, payroll and sales that are located in Minnesota to estimate the proportion of the company's worldwide profits earned in Minnesota. (For companies doing all of their business in Minnesota, that ratio is 100%.) Profitable corporations doing business both inside and outside Minnesota will pay Minnesota taxes on a part their worldwide profits. Equity demands that both local and multistate corporations pay equivalent corporation income taxes on Minnesota-derived profits, but equity is hard to achieve because it is so difficult to arrive at a universally fair apportionment ratio.

If members adopt this statement, we will support taxation of corporate profits. We will highlight the competitiveness and equity criteria when evaluating proposed changes.

Those who oppose this concurrence statement might argue against taxation of corporation profits at all. If public services could be maintained without taxing corporate profits, competitiveness is maximized at a zero tax rate.

Multistate and multinational businesses fought strenuously against the unified method of determining Minnesota taxable income. They argued that if all states adopted this approach, a multistate corporation might be required to pay state income taxes on more than 100% of its total world-wide profit as each state established its own, unique, apportionment factor. Opponents contend that the effort to tax local and multistate corporate profits equally is doomed to failure.

VI. Other Sources of Revenue
"The LWVMN supports the use of other sources of revenue, such as user fees and special assessments, for funding specific activities and projects. These charges should be assessed with a sensitivity to the criteria established to judge the overall revenue system."

State and local governments raise revenue from charges other than taxes. User fees (tuition charges at state supported colleges and universities, entry fees at state parks, garbage collection charges, etc.) and assessments (for streets, water mains, sewers, etc.) that generally fund specific services or projects are the primary other sources of state and local government revenue. Since many projects or services produced by governmental units directly benefit specific users, it is reasonable to charge those who benefit and set a fee that is related to the cost of providing the service or constructing the project.

The concurrence statement says that we should be sensitive to the criteria adopted for evaluation of the overall system when structuring these charges. Acceptance of a **progressivity** criterion suggests that, in some cases, we might want to consider income level when setting fees for services provided to low-income recipients. Application of the **efficiency** criterion would, for example, discourage charging for low-cost services where collection costs are high relative to the amount of revenue raised.

A portion of the profit from the Minnesota lottery flows into the State budget. The adopted principles should allow the League to indirectly comment on income derived from operation of the Minnesota lottery. Studies indicate that if lottery profit is viewed as a tax, it is a regressive tax with high administrative costs per dollar of revenue generated.[33]

VII. Deductions, Exclusions and Credits
"The LWVMN generally supports achieving social policy goals through open and visible expenditures rather than by granting deductions, exclusions and credits."

Governments adjust the amount of tax paid by individual taxpayers by allowing deductions, exclusions and credits. **Deductions** reduce the tax base to which the statutory tax rate is applied. For example, in 1993, personal deductions of $2,350 were allowed on the individual income tax for the taxpayer, spouse on a joint return, and each dependent. The amount of the tax benefit derived from a deduction depends upon the taxpayer's marginal tax rate. **The benefit equals the amount of the deduction or exemption multiplied by the taxpayer's tax rate.** The benefit is therefore greater for those taxpayers in higher tax brackets.

A Federal personal deduction of $2,350 yields a tax benefit of $658 for a middle class taxpayer in the 28% Federal marginal tax bracket ($2,350 x .28). It results in a $352.50 break for a less affluent taxpayer paying a 15% marginal tax rate ($2,350 x .15)

Deductions offset other taxable income but they cannot reduce the tax base below zero, so only taxpayers with sufficient taxable income can take advantage of deductions. A very low-income taxpayer who pays no income tax receives no tax benefit from the deduction ($2,350 x 0%.)

Exclusions reduce the amount of tax owed in much the same way as deductions. The structure of most taxes allows taxpayers to "exclude" or "exempt" certain items that would logically be included in the tax base. For example, in general, all interest income is subject to income tax, but interest received on investments in certain municipal bonds is excluded or exempt from this tax. *Excluding municipal bond interest lowers taxable income for some taxpayers and hence reduces the amount of the income tax they owe.* Just as with deductions, the amount of the tax benefit depends upon the taxpayer's marginal tax rate with greater benefit accruing to taxpayers with higher tax rates.

Common examples of deductions and exclusions relate to the Federal income tax. These are relevant to Minnesota since the starting place for computing Minnesota taxable income is Federal taxable income. Unless the legislature decides otherwise, each dollar deducted or excluded on the Federal tax return is a dollar also deducted or excluded from Minnesota taxable income. Deductions and exclusions can be a part of the structure of most taxes. *The Minnesota retail sales tax excludes or exempts many food, clothing, and drug purchases from the tax base. The property tax is not charged on property owned by tax-exempt organizations such as churches and colleges.*

Tax credits also reduce the amount of tax owed by individual taxpayers, but the tax reduction is accomplished in a different way. Tax credits provide a **direct reduction** in the amount of tax owed. The amount of the allowed credit is subtracted from the tax liability shown on the tax form. The Federal income tax code gives a tax credit for a part of the cost of dependent care to qualifying taxpayers. Taxpayers utilizing this credit compute their tax liability and then deduct the amount of the credit. The amount of tax benefit provided by a tax credit is unrelated to the taxpayer's tax bracket. Many credits are "refundable" which means that even taxpayers who otherwise owe no tax can receive a refund of the credit amount.

Deductions, exclusions and credits can be used to **improve tax equity** or to reduce regressivity. Personal deductions on the income tax reduce the taxes owed by households with more dependents. The exclusions from the Minnesota retail sales tax for food, clothing and certain drugs are intended to reduce the inherent regressivity of this tax.

Governments also use deductions, exclusions and credits to achieve **social goals.** Government can encourage an activity by direct funding or by giving a tax break to those who engage in the activity. The cost of directly funded programs is visible and open to all. The cost of encouraging an activity via a tax break is much harder to measure.

For example, Federal and state income tax laws encourage owner-occupied homes by allowing a deduction for interest paid on a home mortgage if the taxpayer itemizes his/her deductions. (The tax benefit equals the reduction in taxable income due to the deduction times the tax rate.) **The government, in effect, subsidizes home ownership by allowing a deduction for mortgage interest.** The largest subsidies are provided to households in the highest tax brackets who have the biggest mortgages. The aggregate cost of the subsidy provided to all homeowners, called a **tax expenditure**, is measured in terms of tax revenue lost. This amount is inherently difficult to determine.

[Some people find this term confusing, because it may suggest taxes being spent. *Make sure everyone understands the definition.]*

The amount of the tax benefit provided by exclusions is even more difficult to estimate because many excluded items are not reported on the tax forms. For example, Federal and Minnesota taxable income exclude from the tax base the value of many employee fringe benefits, such as the cost of employer-paid group health insurance. Employer-paid fringe benefits represent income to employees that is never seen on the income tax form. **The exclusion encourages employers to pay employees in the form of fringe benefits.** The amount of the tax benefit received by each employee equals the value of the fringe benefits multiplied by the employee's marginal tax rate so the largest benefits accrue to those in the highest tax brackets whose employers subscribe to the most deluxe benefit plans.

Credits can also be used to enact social policy. At various times we have given special tax credits to those who make certain kinds of investments, generally in plant and equipment, as a way of stimulating capital growth. Investment tax credits reduce the tax bill of the investing company by some percentage of the amount of invested. The cost of subsidizing or encouraging investment in this manner is easier to ascertain than if deductions were used because the exact amount of the credit claimed is listed on the tax form.

Credits can be designed to give the same level of benefit to all qualified taxpayers or they can be structured to give greater benefits to those with lower income (e.g. Dependent Care credit, Earned Income Credit, Minnesota's special income-adjusted property tax credit.) Some credits are refundable so benefits can be claimed by the lowest income taxpayers. *The Earned Income Credit, which encourages work activity in* *lower-income households with children, is an example of a refundable credit that has become a major part of the nation's social welfare system.*

Minnesota Statutes Section 270.067 assigns to the Minnesota Department of Revenue responsibility for estimating the **cost of all tax expenditures granted** by the State. The legislature uses the information to monitor the cost of tax system subsidies. The most recent study, published in February of 1993, estimates the amount of revenue lost in 1993, 1994, and 1995 from every preferential deduction, exclusion or credit included in every state-wide Minnesota tax. The list is astounding—242 separate items. *For example, the estimated 1993 tax expenditures associated with 68 preferential deductions, exclusions and credits attached to the Minnesota income tax is $1,712,800,000. The 1993 state financial assistance provided to Minnesota homeowners via the deduction of interest on home mortgages is estimated to be $231,700,000.*

Some of the major tax expenditure items and their estimated amounts for 1993, 1994, and 1995 are listed in the following table. [34]

Selected Minnesota Tax Expenditures

	FY 93	FY 94	FY 95
Individual Income Tax:			
Exclusion - Employer Pension Plans	284,300,000	296,000,000	308,700,000
Exclusion - Employer Contributions for Health Insurance	255,800,000	289,500,000	321,000,000
Exclusion - Interest on State and Local Government Bonds	41,900,000	43,200,000	44,600,000
Deduction - Interest on Home Mortgages	231,700,000	255,800,000	270,100,000
Deduction - Charitable Contributions	72,500,000	77,400,000	81,100,000
Credit - Child and Dependent Care	10,900,000	11,100,000	11,400,000
Credit - Working Family Credit	10,900,000	12,000,000	15,500,000
Sales and Use Tax:			
Exclusion - Food Products	329,000,000	347,100,000	368,000,000
Exclusion - Clothing and Wearing Apparel	224,500,000	246,200,000	267,600,000
Exclusion - Drugs and Medicines	51,300,000	55,600,000	60,300,000
Property Tax:			
Exclusion - Exempt Property	1,042,500,000	1,038,700,000	1,051,000,000

Source: Minnesota Department of Revenue Tax Research Division, State of Minnesota Tax Expenditure Budget Fiscal Years 1993-1995, Fiscal Years 1993-1995, February 1993, p5-21.

Deductions, exemptions and credits often involve fairly complex tax calculations. The detailed regulations that define who can take advantage of a tax break can be so difficult to understand that taxpayers who qualify may be unaware of the benefit. For example, the explanation of the regulations governing exemptions for dependents takes nearly ten pages of small print and diagrams in Publication 17: Your Federal Income Tax for Individuals, the simplified explanation of Federal income tax rules provided for taxpayers by the IRS. Many taxpayers who qualify for the refundable Earned Income Credit fail to file a tax return to claim the credit. **Simplicity** is often sacrificed when deductions, exclusions and credits are included in the structure of a tax.

The concurrence indicates a preference for open and visible expenditures to encourage specific activities and in general, discourages the use of deductions, exemptions and credits to accomplish social policy goals. It sets out three basic **principles** for consideration when legislators choose to use deductions, exemptions and credits.

1. "IF deductions, exclusions and credits are granted, they should be evaluated on the basis of their compliance with the criteria established to judge the overall revenue system."

Does the structure of the deduction, exclusion or credit help the revenue system meet the criteria set forth in the first part of the concurrence statement? Acceptance of this basic principle would probably lead League lobbyists to support refundable tax credits for low-income working families. The credit assists needy households and encourages work activity. The structure of the credit enhances the **progressivity** of the income tax and the overall tax system. We support the exemption of necessary items from the sales tax because the exemption reduces the regressivity (increases progressivity) of the sales tax.

On the other hand, we might use this statement to lobby against replacing direct government aid to college students with a deduction for college expenses paid by individual taxpayers. Our opposition would be based first upon our preference for open and visible expenditures whose cost can be measured. Secondly, analysis may show that the deduction would reduce the progressivity of the tax system by giving greater benefits to wealthier families in higher tax brackets who are able to spend more on college expenses.

On the other hand, we may be more inclined to support a college assistance program that utilizes targeted tax credits in place of deductions. The credits could be structured to give greater benefits to lower income families and the cost of the program would be more apparent.

2. "IF deductions, exclusions and credits are granted, they should be determined to be the most cost-effective means of achieving the intended purpose."

Sometimes social policy goals can be funded at less cost via the tax system than through managed government programs. The concurrence gives League lobbyists the opportunity to weigh the cost-effectiveness of using deductions, exclusions and credits instead of direct expenditures to achieve a social policy goal. Use of refundable credits for low-income working households with children (Earned Income Credit) is probably a cost-effective way of providing assistance to working poor households. The credit replaces direct government expenditures to help working poor families and eliminates the need for additional government employees to administer the assistance program. We might conclude that special deductions for homeowners are the best way to accomplish the social goal of encouraging owner-occupied housing, or that investment tax credits are a cost-effective way of stimulating investment in certain items such as housing for people with low income.

3. "IF deductions, exclusions and credits are granted, they should be reviewed periodically to justify continuance."

All government programs should be reviewed on a regular basis. Deductions, exemptions and credits should also receive periodic review. Legislators seem naturally reluctant to shelve unnecessary programs. They are equally reluctant to eliminate outdated deductions, exclusions and tax credits. The effort by the State of Minnesota to quantify the cost of tax expenditures is especially helpful when legislators make this recommended review.

Opponents of these statements might argue that deductions, exclusions and credits are never justifiable. Their cost is too obscure and the potential for abuse is too great. Deductions, exclusions and credits make taxes too complex. They reduce the amount of tax revenue generated by a given tax rate and force legislators to enact higher rates in order to raise needed revenue.

Others might argue that our endorsement of tax expenditures is too limited. The tax code is the best way to accomplish social goals because the government can encourage desirable activities without setting up an extensive bureaucracy.

VIII. State-Local Fiscal Relationship
"The LWVMN supports the distribution of state-collected revenues to local governments based upon the following principles:"

Minnesota tradition allows state government to levy income and sales taxes, reserving revenue from the property tax for local governments and school districts. A departure in recent years has permitted St. Paul, Duluth and Rochester to levy an additional .5% sales tax on retail sales within their communities. Local governments and school districts find themselves unable to raise sufficient revenue without over-burdening property owners. The state has, for many years, passed some of its revenue on to local governments and school districts. In fact state payments to other governmental units are the largest overall category of expenditure in the state budget, representing over 49% of all state expenditures.[35]

The concurrence supports distribution of state-collected revenues to local governments. (Distributions to school districts are covered in the LWVMN Financing Education position.) Such distributions keep the overall revenue system in balance and prevent over-reliance on the property tax. This section of the concurrence establishes **six broad principles** regarding programs which distribute state-collected funds to local governments.

1. "It is appropriate for state and local governments to share in the cost of services provided by local governments that benefit all Minnesotans."

Many local services affect Minnesotans who live beyond the boundaries of the local community that provides the service. The concurrence statement says that it is appropriate for the whole state to share in the cost of services that benefit all Minnesotans even when those services are provided by local governments. For example, we recognize that many major local streets are used by people from outside the community—the state provides aid to build and maintain many major community streets. On the other hand, the state does not specifically support maintenance of less traveled residential side streets. We all bear responsibility for the welfare of all Minnesotans—the state shares in the cost of providing county administered health and human services programs. Other local government services, such as crime control and regional park maintenance, which have clear spillover benefits, are partially financed from general state aid to local governments. The position supports the concept of state-local cost sharing for such services.

Opponents might say that the state should fully fund services that benefit all Minnesotans and that local property taxes are not an appropriate funding source for these services. Others may oppose any state funding of local services.

2. "It is appropriate for local governments to fund local community services."

The concurrence statement indicates that, in general, local governments should fund local community services and the level of these services should be decided locally. The state should not, for example, share the cost of basic local services such as plowing the residential side streets, nor should it help pay for discretionary services like swimming pools etc. [*The Study Committee hopes that League members will avoid spending an excessive amount of time attempting to define which local government services have spillover benefits and which are purely local in nature.*]

3. "If necessary, state funding may be used to assure that local community services are available on an equitable basis."

This exception to the principle of financing local community services with local funds allows for state assistance when the wherewithal of a local community to pay for basic services is severely limited. The state may provide assistance to communities whose ability to raise revenue from the property tax is low relative to the cost of providing basic services.

High-cost, low-valuation communities can provide an adequate level of local services only by charging unusually high property tax rates. Property located in such communities faces an unfair tax burden when compared to similar property in other Minnesota communities. The concurrence statement recognizes that, in some situations, equity requires that the state provide property tax relief by sharing in the cost of basic local community services and that it is in the larger interest to be sure that all communities can provide basic services.

Opponents of redistribution programs will reject this statement. How do we identify communities that are truly needy? How do we determine the extent of their need? What are basic services? What should they cost? Will local authorities be less concerned about cost and value received when they are spending state rather than local money? Current state laws include formulas for determining need and ability to pay, but their use is hotly debated.

4. "The state should not impose statutory limits on local governments' ability to raise and spend revenue for local community services."

By opposing statutory limits on local governments' ability to raise and spend revenue for local community services, the concurrence endorses local autonomy to choose the level of services to be provided. Communities should be allowed to supply the locally preferred level of public services and to tax accordingly. Taxpayers can hold local officials accountable for their service level decisions. Acceptance of this statement allows for disparity in service levels and tax rates. In some cases, wealthy communities will be able to provide a greater array of local services than poor communities even though they charge a lower property tax rate. Such communities have an advantage in attracting new development because they can offer more extensive public services AND lower property tax rates.

5. "Programs which distribute state-collected revenues to local governments should enhance the equity, progressivity, and efficiency of the overall revenue system."

Distribution programs differ in how they redistribute money. The structure of each distribution program determines how funds are redistributed within the state. The state collects revenue from income and sales taxes. The collections come more heavily from wealthy communities and those with a significant retail base. The state then redistributes the funds to local governments via its aid programs. The concurrence states that distribution programs should contribute positively to the achievement of the criteria established to judge the overall revenue system.

Three criteria—**equity, progressivity** and **efficiency**—are emphasized in this section of the statement. If we accept this statement, we envision distribution programs that result in similar tax burdens for households of similar ability to pay (equity), taxes that are a greater percentage of income for wealthier taxpayers (progressivity), and reliance on taxes that have low administration and compliance costs relative to the amount of tax collected (efficiency).

Adoption of the position implies that we would support distribution formulas that provide more state aid to poorer communities than to rich ones in order to equalize taxes paid by similar property for basic services. We would support more aid to poorer communities to reduce their relative reliance on regressive property taxes. This part of the concurrence establishes standards for judging formulas used to distribute state-collected funds which will inevitably redistribute funds from wealthy to poor areas of the state.

Some Minnesotans oppose redistribution programs. Others feel that the political process is unlikely to develop formulas that fairly accomplish the redistribution of funds. No redistribution is preferred to poorly conceived or politically motivated redistribution.

6. "Once enacted, promised distributions of state-collected revenues to local governments should be a reliable source of revenue to local government units."

Local governments should be able to count on revenue promised by state redistribution programs. When the state has a revenue shortfall, legislators may be tempted to balance the state budget by withholding promised distributions to local governments and school districts, forcing a disproportionate share of emergency retrenchment on these governmental units. Long-term budgeting techniques (see section on Budgeting and Expenditures) will improve the reliability of state-aid funding for local governments.

Some political observers would argue that local governments should bear their share of any state revenue shortfall. Local governments must adopt budgets that are flexible enough to cope with unanticipated reductions in state aids.

"The LWVMN supports the principle that state legislation mandating local governments to provide specific services should identify adequate and appropriate revenue sources ."

State legislators have found a way to satisfy constituents asking for additional government services. They mandate that the service be provided by school districts or local governments. Full funding for such mandated services is rarely supplied by the state. School districts and local governments must find some way to carry out the program even though in many cases the taxing authority of the school district or local government is limited by state law.

In this case, the school district or local government cannot raise the funds by increasing local taxes. The only alternative is to reduce other desired, but unmandated programs, in order to fund the mandated service.

The concurrence requires legislators to identify adequate and appropriate funding sources for mandated services as a part of the legislation that establishes the mandate. The appropriate source may be local property taxes, or it may be state-collected revenues. The concurrence assigns the responsibility for fund identification to the legislative body that mandates the service.

Opponents of this statement fear that legislators will be more reluctant to require that school districts and local governments provide services for locally unpopular or traditionally disenfranchised groups such as the disabled, mentally ill, AIDS victims etc. Because legislators are often unwilling to attach their names to bills that explicitly raise taxes, it will be more difficult to expand services to these groups.

IX. Budgeting and Expenditures

1. "The LWVMN supports long-term financial management of all state government funds."

Support of long-range financial planning is a critical element of this concurrence. In its absence legislators scramble to spend surplus revenues that automatically flow into the state coffers during good economic times. They start programs with little thought to their long-range cost. They reduce tax rates during good years, promising a financial windfall to taxpayers. Legislators often face recession deficits with panic, either raising tax rates or precipitously cutting back services and/or promised aids to school districts and local governments.

Employees of the Minnesota Department of Finance have recently received several prestigious awards for effective long-term financial management of the state's capital budget and for improving the budget process and reporting system.[36] The concurrence applauds these efforts and supports use of long-term projections of revenue and expenses in all state government funds.

2. "Long-term projections of revenue and expenditures should be considered when making budget decisions."

Long-term projections should be considered before making any major budget decision. Basic long-term financial planning assures continuance of necessary services during economic downturns. It forces legislators to consider how a program started in good times can be sustained when the economy turns around. It encourages use of a **rainy day fund** built during good times and used during recessions to sustain necessary services.

Perhaps equally important, long-term financial management enables the state to have a positive rather than negative effect on Minnesota's economic cycles. Consider the response of state government to a recession when state finances are not managed on a long-term basis: *Tax revenues fall as the economy falters. With no rainy day fund, balancing the state budget requires either a reduction in expenditures at a time when state programs that serve the poor and unemployed have more needs, or a tax increase, which is likely to further dampen the economy.* It is far better to set aside funds in good times to sustain public services without tax increases during bad times.

On the other hand, during expansions state tax revenues rise. With no long-term planning, legislators are tempted to either quickly add programs or reduce taxes. Additional expenditures and or reductions in taxes are generally assumed to accelerate economic activity further and may spawn inflationary pressures. Programs started under these conditions compete for survival with basic services when the inevitable downturn occurs. The discipline enforced by long-term planning is preferable to on-again, off-again expenditures and variable tax rates.

3. "An adequate budget reserve should be established during good economic times to be used in recession years to sustain expenditures for necessary services."

Support of a rainy day fund is the most controversial part of this section of the concurrence statement. **It contradicts the current LWVMN Financing State Government position** which supports "a flexible Minnesota multi-tax system with emphasis on maintaining state services through a combination of spending cuts and increased taxation when state funds are short and decreased taxation where there is a budget surplus." [37]

Opponents are leery of encouraging the state to build up a reserve fund because they feel that legislators will inevitably spend it on unnecessary items. They do not believe that legislators can restrain themselves from adding programs or making big one-time expenditures once the fund is in place, so having a reserve fund will inevitably rachet up the general level of state spending. Better, opponents say, to give the money back to those who contributed it by reducing state taxes.

For your information: New State Law on Budgeting Reform

The 1994 Legislature passed H.F. 3209 which effectively requires the governor and the legislature to explicitly set "targets" for

(1) *the maximum share of Minnesota personal income to be collected in taxes and other revenues to pay for state andlocal government services;*

(2) *the division of the share between state and local government revenues; and*

(3) *the appropriate mix and rates of income, sales, and other state and local taxes and other revenues, other than property taxes, and the amount of property taxes and the effect of the recommendations on the incidence of the tax burden by income class.*[38]

While forward projections of these items are extremely difficult to do with accuracy, the bill recognizes the importance of considering the impact of state and local financing decisions upon taxpayers. A **LWVMN Financing State Government position** adopted by Minnesota Leagues which establishes basic criteria for evaluating the finance system will allow the League to comment on the targets recommended by the governor and set by the legislature as a part of the budget process.

If you have questions, please call: Mary Emery **Office: 507-646-3155**
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Glossary

Administrative Efficiency relates to the relationship between the collection costs and the revenue generated by a tax or fee. Voluntary compliance by tax or fee payers reduces collection costs as does use of cost-effective processing methods.

Competitiveness Criterion relates to the state's attractiveness as a location for economic activity. In general, lower taxes and more effective public services improve attractiveness. The balance between taxes and public services is important. Evaluating competiveness requires comparison of taxes and public services with other states.

Compliance Efficiency relates to the relationship between the cost of computing and paying a tax and the amount of revenue generated by the tax. Compliance costs include the cost of keeping necessary records and filing tax returns. Lower compliance costs are generally associated with simple tax computations.

Corporation Franchise Tax is levied on profits earned by corporations on their business activities within the state.

Corporation Income Tax - see Corporation Franchise Tax

Deductions are subtractions from taxable income allowed by the tax law. Deductions provide a tax benefit equal to the amount deducted multiplied by the taxpayer's marginal tax rate.

Efficiency Criterion relates to the relationship between the cost of administration and compliance and the revenue generated from a tax. An efficient tax is one with low cost per dollar of revenue generated.

Equity Criterion relates to the amount of tax paid by similar taxpayers. An equitable tax is one that requires taxpayers in like circumstances to pay the same amount.

Exclusions are items that would otherwise be taxed that are exempted from the tax base by law. Examples: Interest received from investments in municipal bonds is excluded from the income tax; the value of certain employer-paid fringe benefits is excluded from the income tax base; the value of property owned by churches is excluded from the property tax.

Horizontal Equity refers to fair taxation of similar taxpayers. Generally this means that similarly situated taxpayers should pay the same amount of tax. In this study the equity criteron refers to horizontal equity.

Individual Income Tax is levied on personal taxable income. In Minnesota, personal taxable income is closely related to Federal taxable income.

Local Community Services are used here to refer to services that provide the vast majority of benefit to local residents only. These services have only minimal spillover benefit to non-residents.

Long-range Financial Planning requires long-term projections of future revenues and expenditures and consideration of the impact of current financial decisions on future budget years.

Mandated Services are programs which one level of government requires another to provide. The Federal Government requires states to provide many services and likewise, the State requires local governments and school districts to supply certain services.

Marginal Tax Rate is the percentage of the last dollar of tax base that is paid in tax. Marginal tax rate indicates how much additional tax will be paid if the tax base increases by $1.00 or how much taxes will be reduced if the tax base falls by $1.00. A marginal tax rate of 28% means that the taxpayer will pay an additional $28 in taxes if the tax base rises by $100 and will save $28 in taxes if the tax base decreases by $100.

Progressivity Criterion requires higher income taxpayers to pay a larger percentage of their income in taxes. The Minnesota individual income tax is an example of a progressive tax.

Property Tax is levied on the market value of real property (land and buildings). In Minnesota, the revenue from the tax is used to fund services provided by local governments and school districts.

Proportional Tax requires all taxpayers to pay the same percentage of their income in tax.

Rainy Day Fund is the accumulation of past and current unspent funds to be used to pay for government services in a future year when it is anticipated that poor economic conditions will cause a revenue shortfall.

Refundable Tax Credits are tax credits (see definition of tax credits) that can reduce the taxpayer's tax liability below zero. The taxpayer can receive a payment for the amount of a refundable tax credit even if no taxes are owed.

Regressivity means that higher income taxpayers pay a lower percentage of their income in taxes. Sales and property taxes are common examples of regressive taxes.

Reliability Criterion refers to the stability of a tax as a source of revenue throughout the economic cycle. In general, collections from the property and sales tax revenues vary less over the economic cycle than collections from the income tax.

Responsiveness Criterion refers to the ability of a revenue source to adjust appropriately to changes in economic conditions.

Retail Sales Tax is levied on the selling price of most purchases. In Minnesota the tax rate is 6.5%. Purchases of food consumed off premises, clothing, and many drugs are exempted or excluded from the tax.

Revenue Burden refers to the amount of tax or user fee paid.

Revenue System refers to all funds collected by state and local governmental units including, but not limited to, tax revenues, fees, assessments, profits from operating state-run enterprises such as the Minnesota lottery.

Simplicity Criterion requires that taxpayers be able to understand how their taxes or fees are calculated. They should know which governmental unit has levied the tax or fee and what services are funded by the tax or fee.

Sin Tax is a tax levied on a specific product or activity in order to discourage its purchase or pursuit. Examples include taxes on tobacco products and alcohol.

Special Assessments are charges made by governmental units for major improvements which benefit specific parcels of property. Examples include assessments for streets, gutter, sanitary sewers, storm drainage, etc.

Tax Avoidance refers to legal methods of reducing the amount of taxes paid. Taxpayers can legally adjust their economic activities to reduce their taxes by engaging in activities that generate tax deductions or are taxed at a lower tax rate.

Tax Credits reduce the tax liability of qualified taxpayers. The amount of the tax benefit equals the amount of the tax credit claimed. Examples include tax credits for the cost of dependent care and the Earned Income Cedit.

Tax Evasion refers to illegal methods of reducing the amount of taxes paid. Tax evaders are prosecuted under the law.

Tax Expenditure refers to tax revenue lost when special deductions, exclusions, or credits are granted to a group of taxpayers. Tax expenditures are often viewed as subsidies to the benefitted taxpayers.

Tax Incidence refers to who eventually pays a tax. Taxes that are levied on one party may be passed on to others, for example, in the form of higher prices.

Tax Rate is the percent of the tax base to be paid in tax.

User Fee: Charge for a specific product or service produced by a governmental unit when an identifiable person or group receives the benefits. The amount of the charge is generally related to the cost of producing the product or service. Examples include tuition charges at state supported college and universities, garbage collection fees, entry fees to parks, etc.

Vertical Equity refers to fair taxation of taxpayers with different abilities to pay.

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