

April 4, 2017

Senator Roger Chamberlain  
Chair, Senate Taxes  
3225 Minnesota Senate Building  
95 University Avenue W  
Saint Paul, Minnesota 55155

Senator Ann Rest  
Ranking Minority Member, Senate Taxes  
2217 Minnesota Senate Building  
95 University Avenue W  
Saint Paul, Minnesota 55155

Dear Mr. Chairman and Senator Rest:

As the Senate Omnibus tax bill moves forward, I write to express our views on the bill's overall cost and content. As I shared with you in committee, the Senate bill takes a different approach than the Governor's bill which maintains a fiscally responsible budget while investing in our future workforce and providing targeted tax relief for those most in need.

First, I do want to thank you for including several items found in the Governor and Lt. Governor's tax bill. The School Building Bond Agricultural Credit will help farmers by paying 40 percent of their property taxes attributable to that levy. Several other items from the Governor and Lt. Governor's tax bill are also included in the Senate bill:

- Minnesota State High School League Exemption
- Estate Tax Recapture Related to Eminent Domain
- Madelia Rebuild Sales Tax Exemption
- Property tax exemption for St. Paul Soccer stadium
- Numerous Department of Revenue's policy and technical provisions

We also appreciate the inclusion of a number of key provisions for local governments who provide essential services: local government aid, county program aid, debt services equalization, and Indian Child Welfare Act Aid. We do hope, however, that as we move forward we can include these provisions on an ongoing basis at adequate levels so that cities and counties are able to plan and budget for projects for the future rather than one time projects.

A provision added on the floor, however, undermines the LGA and CPA programs for all localities. Despite the fact that Minneapolis has the largest population of any Minnesota city and its services provide value to all Minnesotans that visit and work in the city, this bill arbitrarily cuts its local government aid by \$28 million. There is no policy reason for this targeted cut to the program. And, by making an arbitrary cut outside of the established formula, it threatens the viability of this important funding stream for local governments and the services they provide to Minnesotans.

Unfortunately, the Senate bill does not include a number of priorities in the Governor and Lt. Governor's tax bill. The Governor's tax bill prioritizes tax cuts for middle class families and those

struggling to get into the middle class. Their bill, even given its size, will help over 450,000 people, and ensures significant investment in education, while leaving money for contingencies that are facing our state.

Most importantly, the expansion of the Working Family Credit is not included in the Senate bill. The Governor and Lt. Governor included in their bill the expansion proposed in the Senate last year and carried by the Senate in its 2016 omnibus tax bill. This credit helps working families across Minnesota pay for basic needs and is a proven tool to fight poverty. It will help 370,000 workers across Minnesota. Its absence from the Senate bill is disappointing.

The Governor's and Lt. Governor's bill also proposed expanding the Child and Dependent Care Credit to help more Minnesota families pay for high-quality care for their children. The expansion will mean that 95,000 families across Minnesota will benefit from the credit. It is also unfortunate that two programs to smooth the transition for the buffer requirements in current law – buffer compensation payments and riparian aid to counties and watershed districts – were not included.

Finally, a number of other important provisions from the Governor and Lt. Governor's bill are not included, among them:

- reforms to level the playing field for all businesses by closing loopholes;
- railroad property tax modernization;
- increasing the military service credit for lower income veterans that served for 20 years or have a service-related disability;
- sales tax exemption for a siding facility;
- Angel Investment Credit expansion;
- expanding the sales tax to more nonprofits;
- updates to sustainable forest incentive act; and
- an update to vapor products and tobacco tax provisions.

### **Overall priorities**

When Governor Dayton took office in 2011, Minnesota faced a \$6 billion budget deficit. Now, after six years of making tough, responsible choices, Minnesota is finally on sound fiscal footing. Our state has \$1.65 billion on its bottom line and nearly \$2 billion in reserves to protect Minnesota from future economic downturns. This bill will cost the state \$900 million this biennium and \$1.1 billion in the next and grow in the future, setting the state up for fiscal uncertainty. With its size, this bill prioritizes unsustainable tax cuts now and into the future over investments in prekindergarten, higher education, and economic development that will grow opportunities for hard working Minnesotans in our state.

Upon comparison of several provisions, the composition of the bill is concerning. For example, in the area of property tax: compare the impact of the changes to the commercial-industrial (C/I) levy changes and those to individual taxpayers. In the near term, the C/I levy changes will allow all businesses to reduce their property taxes with the exclusion of the first \$100,000 of



value. The freeze to the levy amount over time however, will disproportionately benefit large building owners like the IDS and the Mall of America.

For income tax changes: it provides significant tax relief to some of the most fortunate in our state with the social security, foundation tax credits, and estate tax changes totaling over \$350 million by the time these provisions are fully in effect. The bill provides little, however, to hard working families across the state, struggling to pay the rent, buy groceries, and raise their kids. While the bill does include an income tax rate cut, this tax cut ends up being less than \$10 a month for most Minnesota families. And, many families who receive even less actually need it more – those earning under about \$30,000 will see a much smaller tax cut than those earning \$150,000-250,000, in both average benefit and as a percentage of income.

The Governor took a more targeted approach, recommending increases to the Working Family Credit and Child and Dependent Care Credit, providing more help to those that need it. The working family credit has proven to reduce poverty – kids who grow up in homes with more economic stability do better in school. This is a place where we should invest to help ensure our future prosperity. The Child and Dependent Care Credit provides assistance to families paying the high cost of childcare, and the Governor's proposal could provide \$1,200 to a family of four earning \$50,000 paying qualifying expenses. Minnesota's economy depends on its most valuable asset – our people – we need to assist those who we know are working hard but could still use some help.

### **Specific areas of concern**

#### *Education*

I would like to convey a number of concerns about the changes being made to existing education related credits and the creation of a new credit for contributions to foundations related to scholarships. The foundation donation credit, in particular, lacks accountability. Two amendments were added on the floor to require recipient schools to comply with laws that prohibit discrimination against, and requires educational opportunities for, students with disabilities and Minnesota's anti-bullying law. These are important steps; however, there are many other requirements placed on public schools whose obligation is to serve all children, including those with special needs. Governor Dayton and Lt. Governor Smith are opposed to this provision that would allow for diversion of public resources to private schools.

Governor Dayton and Lt. Governor Smith, in their budget, prioritized Minnesota's students by investing in our public schools. Their budget expands voluntary pre-K by doubling the enrollees from 3,300 to 8,300 in FY18; invests over \$600 million more dollars to provide better schools for students and families everywhere in Minnesota; and as part of that to increase our investment in special education by \$40 million as well as many other investments that will improve education in Minnesota. These provisions provide direct funding for education in Minnesota, something the Senate tax bill does not accomplish.

### *Estate tax*

Concerns about the estate tax provision are focused on the cost relative to impact and the full cost, which is phased in over time. During Governor Dayton's time in office, Minnesota has already made important changes to the estate tax. The small business and qualified farm deductions passed in 2011 already provide relief to family farms and small businesses being passed down through families. About 300 estates claim the small business and/or farm property subtraction per year. Fewer than ten estates annually claim the maximum subtraction, meaning fewer than ten are paying the estate tax each year.

In 2014, the exemption amount increased from \$1 million to \$2 million over five years. The exemption is already at \$1.8 million and will increase to \$2 million next year. That change cut the number of estate taxpayers by about one half. This provision will cut taxes for about 1,100 annually, most of whom would no longer pay any estate taxes under this provision. Reducing the estate tax will make our tax system more regressive, which means middle and lower income Minnesotans will be paying for a larger share of the services we all depend on.

### *Social Security*

The concerns with the Social Security provision again relate to who is benefited, and cost relative to the number of Minnesotans who benefit. In 2014, only 35 percent of social security benefits received by Minnesotans were taxable. Nearly half of all Minnesota households with Social Security income paid no tax on any of that income. Nevertheless, this provision will provide \$36 million per year to those relatively few seniors. In addition, there are other seniors – who have teachers, police, and nurses pensions – who would not have the same tax benefit available for their retirement income. We appreciate the amendment on the floor to study the issues related to other pensions. However, it would be prudent to have all of the information related to all types of retirement income before making the change proposed in this bill.

### *R&D*

With respect to the R&D credit changes, I would like to thank the committee for bearing in mind the recent Office of Legislative Auditor report, which made several recommendations to the legislature on providing more detail on the purpose and measurement of outcomes of these provisions, particularly in regards to refundability. However, we do believe that if an election to take the simplified calculation for the R&D credit is taken, that election should apply for five years, rather than be subject to change at any time.

### **Implementation costs**

A number of the provisions in this bill have fiscal costs for the Department to implement and administer. Given our current budget, we are currently stretched to our very limit keeping up with increased demands in terms of cost, volume of work, and new threats such as fraud.

If the provisions in this bill were adopted, we would need additional resources to implement these changes well and give them full effect. This would include forms changes; updating our



integrated tax system; education and outreach for customers; work with software vendors; modifying our training materials for employees and customers; updating fact sheets, industry guides and revenue notices; and administering compliance with the provisions.

Of course, the nature of the policy change dictates the level of work involved – as you can imagine there is a significant difference in the amount of work related to an income threshold change relative to an entirely new credit.

We have previously been asked to provide fiscal notes on only a handful of the provisions in the omnibus bill. We have begun the process of gathering the information necessary to provide you with the administrative costs for the remaining provisions.

### **Fiscal responsibility**

This bill will cost the state over \$900 million in this biennium and \$1.1 billion in the next. Costs will go up in the out years and will cost the state over \$6.2 billion over 10 years. That is because items like eliminating the inflator on the C/I levy and the estate tax reduction grow significantly beyond the budget window.

For example, it is important to note that the full impact of the levy freeze cannot be reflected in the window: removing the inflator would not be a significant cost in the first year. However, in five years it will cost \$100 million (by FY2022) and \$247 million per year by FY2027. The freeze will cost over \$1.2 billion over 10 years. Particularly as we look at significant uncertainty in our state's forecast and from federal policy changes, we need to take a cautious approach to our budget outlook and freezing the levy puts Minnesota's fiscal health at risk.

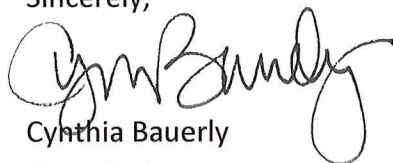
In addition, the full effect of the estate tax cut will not take place until FY2023. In that year, it will cost the state over \$100 million.

The Governor and Lt. Governor are committed to working toward a tax bill as a component of an overall budget that maintains Minnesota's fiscally responsible financial state.

### **Moving Forward**

The Department is eager to continue the conversation about the size and content of a tax bill that the Governor can sign. We look forward to discussing the above provisions and other provisions in the bill that may have limited effectiveness or create unintended consequences. We welcome any opportunity to discuss these issues so that we can best serve Minnesota.

Sincerely,



Cynthia Bauerly  
Commissioner