Reforming Minnesota's Property Tax System

1989 Law Changes

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Minnesota Department of Revenue
Minnesota Department of Finance

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Minnesota tax reform since 1984

Since the mid-1980s, Minnesota has focused much thought and effort on reforming its major taxes:

1983 Governor Perpich establishes the Minnesota Tax Study Commission; report issued in 1984.

1984 10 percent income tax surtax repealed.

1985 Income tax simplified; rates lowered.

Estate tax simplified; becomes a "pick-up" tax equal to the Federal credit for state tax.

1987 Major individual and corporate income tax reform accomplished through increased conformity to federal tax laws, including the 1986 federal tax reform; tax base broadened, rates lowered and forms greatly simplified.

Sales tax base broadened and made more fair through the elimination of several special exemptions.

1988 Disparities in property tax rates between communities reduced.

Number of property tax classes cut from 68 to 29.

Property tax system changed; tax equals a percent of the property's value.

1989 Sales tax on capital equipment purchases for new or expanding manufacturing operations eliminated, which will encourage the expansion of businesses in Minnesota.

Income tax on insurance companies updated to accord with current federal law, which will ease administration and improve compliance.

1989 Property Tax Reform for Minnesota

Introduction

The property tax reform just passed by a special session of the Minnesota Legislature and signed into law by Governor Perpich marks the latest step in the state's commitment to a tax system that is fair, efficient, stable, competitive, and understandable, both in structure and in operation. The reform includes:

- reducing or eliminating projected increases in 1990 property taxes for all property owners;
- increasing fairness by reducing tax rates on heavily taxed classes of property;
- beginning the process of untangling the financing of local government services to ensure that property tax revenues are spent primarily on local services, and state aids are spent primarily for state-required programs.
- encouraging more citizen participation in local government spending and taxing decisions by making the system easier to understand, and by requiring notice to each property owner of proposed tax increases and budget hearings.

Holding down property tax increases for 1990

Without the tax relief provided in the reform, total property taxes would have increased about 14 percent in 1990.

The tax relief included in the reform will hold the increase in the total property tax to about 1.5 percent in 1990, which is less than the annual rate of inflation.

Because property taxes on newly constructed buildings account for about 3 percent of the growth in tax revenues, the total property tax on existing properties will actually decrease about 1 percent.

Since the property tax is a local tax affected by local spending and taxing decisions and by changes in property values, the actual change in tax from 1989 to 1990 will vary from property to property, with some decreases and some increases from 1989 levels. All property owners, however, will pay far less property tax in 1990 than they would have without this tax relief.

Percent change in taxes from 1989 to 1990 before and after reform

Existing properties only

Property class	before reform	after reform
Farms	13.0%	3.8%
Cabins	7.6	2.5
Homes	12.1	-2.7
Rental housing	9.0	-11.5
Businesses	10.9	1.0

All properties (including new construction)

Property class	before reform	after reform
Farms	13.0%	3.8%
Cabins	10.6	5.5
Homes	15.1	0.3
Rental housing	13.0	-7.5
Businesses	14.9	5.0

Improving fairness of the system

Besides holding down property tax increases for all classes of property, the reform concentrates property tax relief on rental housing and mid- to high-value homes, reducing property taxes in 1990 for these two heavily taxed classes of property.

The reduction in property taxes on rental housing will help promote an adequate supply of affordable, well-maintained rental housing. The reduction in property taxes on homes mitigates the effects of recent substantial inflation of home values, which results in pushing lower-value homes into the middle-value range and middle-value homes into the high-value range.

Owners of business property–another heavily taxed class of property–are also targeted to receive property tax relief in 1990. Failure to provide this tax relief would have allowed the total property tax on business property to rise approximately 15 percent in 1990.

But with it, the total property tax payable by business property owners will increase by only 5 percent in 1990. About 80 percent of this increase will be due to growth in newly constructed buildings. The owners of existing business properties will experience an average increase of about 1 percent in 1990.

In 1990, owners of business property located in communities with relatively high property tax rates will be eligible for a refund of a portion of the tax on the amount of the property's value over $100,000.

Tax rates for businesses are scheduled to be reduced again in 1991, 1992, and 1993. However, the phasing down of the tax rate on the portion of a business's property value over $100,000 after 1991 will depend on the legislature's response to recommendations that the governor makes for lowering the tax rate.

The cut in tax rates on business property, which are among the highest in the nation on office, retail and storage facilities, will enable Minnesota businesses to compete more effectively with businesses in other states, and will encourage businesses from other states to locate facilities in Minnesota.

Tax Rates for Property Classes

Specifically, the new law reduces property tax rates on the following classes of property:

Homes, especially mid- to high-value homes:

from 2.5 percent to 2.0 percent on the portion of the home's value between $68,000 to $100,000;

from 3.3 percent to 3.0 percent on the portion of the home's value over $100,000.

Apartment buildings and rental homes:

from 4.1 percent to 3.6 percent for apartment buildings;

from 3.5 percent to 3.0 percent for single-family homes, duplexes and triplexes.

The law requires the owners of rental housing to comply with local health, safety and building maintenance codes in order to qualify for the reduced tax rate on the rental property.

Business property:

from 3.3 percent on the first $100,000 of value to 3.0 percent by 1993;

from 5.25 percent to 5.06 percent in 1990 and to 4.95 percent in 1991 on value over $100,000;

ultimate goal set at 4.0 percent.

For businesses in communities with relatively high taxes, the new law also provides for a special property tax refund of up to $4,000 for taxes payable in 1990 and 1991.

Farms and timberland:

In addition, the new law consolidates several tax rates that applied to farmland into three rates for 1990 and two rates by 1992. Beginning in 1990, farm homes will be taxed at the same class rates that apply to other homes.

For 1990, the tax rates on homesteaded farmland will be:

0.4 percent on the first $100,000;

1.3 percent on the balance of the value of the first 320 acres on a homestead;

1.7 percent on all remaining farmland and on timberland.

Comparing tax rates for 1990

	Before reform	After reform
Homes		
First $68,000	1.0	1.0
$68,000-$100,000	2.5	2.0
Over $100,000	3.3	3.0
Businesses		
First $100,000	3.3	3.3
Over $100,000	5.25	5.06
Rental Housing		
1-3 units	3.5	3.0
Apartments	4.1	3.6

By 1992, the two tax rates on the portion of the farm's value over $100,000 will be consolidated into one tax rate of 1.5 percent. The tax rate on timberland will also be cut to 1.5 percent. County boards of commissioners retain the option of assessing timberland according to its fair market value or on a method based on the annual growth of timber on the property.

Property Tax Refund Changes

In addition to cuts in the tax rates, many Minnesota homeowners, renters, and cabin owners will also benefit from changes in the state's property tax refund programs. The changes include:

For homeowners,

- expanding eligibility for regular property tax refunds in 1990 to homeowners with household incomes of up to $60,000. In 1989, eligibility for the refund was limited to homeowners with household incomes of no more than $35,000.
- increasing the dollar amount of refunds homeowners can receive through the regular property tax refund program.
- removing the limit for 1988 returns (filed in 1989) on the amount of the special property tax refund (targeting) for homeowners who experience an unusually high increase in property taxes; and
- extending the special property tax refund program (targeting) to 1994.

Before the special session, the special (targeting) property tax refund for 1989 was limited to 75 percent of that portion of a property tax increase over 10 percent, up to a maximum refund of $250. Because the new law removes the maximum, the Department of Revenue is recomputing all 1989 special property tax refunds already filed, and will mail an additional refund to homeowners who filed previously and were affected by the refund limit, with no further action needed on their part.

Starting in 1990, the state will pay 75 percent of the first $250 of the tax increase over 10 percent and 90 percent of the balance of the tax increase. The amount of the tax increase over 10 percent to which the 75 percent rate applies is increased after 1991 as follows:

1992: 75 percent of the first $275 of the increase over 10 percent;
1993: 75 percent of the first $300 of the increase over 10 percent;
1994: 75 percent of the first $325 of the increase over 10 percent.

To be eligible for the refund, a homeowner's property tax must increase by at least $40 in 1990 and 1991, $60 in 1992, $80 in 1993 and $100 in 1994.

Another provision of the law directs the Department of Revenue to develop by February 15, 1990, a series of recommendations for:

- changing eligibility for the property tax refund in order to provide additional refund dollars to homeowners in 1991;
- simplifying the program to make applications easier to complete; and
- increasing public awareness and participation in the program.

For renters,

The property tax refund program for renters for 1989 applications filed in 1990 remains essentially the same as this year's program.

However, for 1990 applications filed in 1991, renters will receive greater refunds.

Further, the law directs the Department of Revenue to develop a more generous

schedule to compensate renters for reductions in refund amounts due to cuts in property taxes on rental housing.

For owners of seasonal residential recreational properties (cabins),

A one-time property tax refund program was adopted for the owners of cabins who experience an unusually high increase in their property tax from 1989 to 1990. Under the program, owners of property classified as seasonal residential recreational are eligible for a refund of 75 percent of the first $250 of tax increase over 10 percent.

Reorganizing taxing and spending responsibilities

The new law begins the process of clarifying and restructuring the taxing and spending responsibilities of state and local governments. It establishes the general principle that the state should pay for programs it mandates, and that local governments should pay for local spending decisions. The new law also recognizes that financing of some services should be shared by both state and local government.

In addition, the law establishes the principle that state aid funds may be used to help ensure that certain communities can provide a basic level of services without having to impose excessively high taxes on property owners.

In this first stage, the new law:

- provides $18 million for state takeover of court costs. In 1990, the state assumes the costs for district court administration, public defense services for juvenile and misdemeanor cases in Hennepin and Ramsey counties and operation of the trial court information system;
- provides for the complete state takeover of income maintenance (public assistance) programs in 1991;
- prepares the state for future assumption of the costs of other human service programs; and

- increases state share of K-12 funding by $113 million to allow for a corresponding reduction in local school district levies. The state's share of education spending will rise from 61 percent to 64 percent.

In respect to remaining programs involving state aid to local government, the law stipulates that a joint House-Senate legislative commission will recommend which programs should be paid for by which type of government. The law also requires the governor to review all undesignated state aid programs, as well as all aids that are designated for human services and for elementary and secondary education, and then make recommendations to the commission.

If the governor recommends shifting the financing of a program from state to local resources, the governor must also identify which other state programs are to receive the state revenues.

The new law also directs the commission to recommend changes in financial reporting methods to ensure public oversight of local government expenditures.

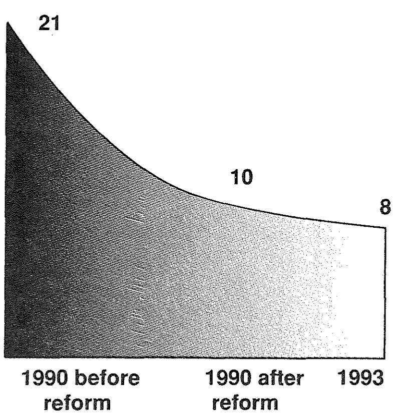
Overall, the reform provides for reducing our reliance on property taxes for the funding of education, human services and other non-property-related programs so that local governments can use property taxes to support locally determined, property-related services.

Encouraging citizen participation, controlling spending

In order to improve taxpayers' understanding of the property tax system and to encourage their participation in and control of the system, the new tax law:

- reduces the number of property tax rates from 21 in 1989 to 10 in 1990 and 8 in 1993 *(see below)*;
- simplifies the terms used to refer to aspects of the property tax system;
- removes state-imposed levy limits on year-to-year increases in property tax collections for cities in 1992 and for counties in 1993;
- requires property tax bills to show a year-to-year comparison of the amount of tax the property owner pays to each local government so citizens can more easily identify which officials are responsible for what taxing decisions;

Number of property tax class rates



- provides for truth-in-taxation notices to give property owners an opportunity to express their opinions on upcoming spending decisions which will affect the amount of property tax they will pay:
  - Hennepin, Ramsey and St. Louis counties will mail each property owner a "proposed property tax statement" showing the amount of property tax the owner would pay to each local government if the local governments adopt the budgets they are considering.
  - All other counties will mail each property owner a statement announcing the total amount of property tax to be collected by their county, by their city or town and by their school district if local governments adopt the budget amounts they are considering.

To encourage fiscal responsibility on the state level, whenever a bill for a new or expanded program is introduced, it must include information about the program's financial impact on both state and local governments.

To help control current and future spending, the law requires the governor to propose ways to cut programs by $50 million in 1990 and $100 million in 1991.

Finally, because the bill helps clarify the relationships between state and local taxing responsibilities, citizens will be better equipped to know which unit of government to hold accountable for decisions. (Future spending increases will be controlled if the government unit that decides to expand a program is required to pay for that decision.)

Conclusion

Reducing anticipated property tax increases, making the tax system more fair, untangling the financing of local government services and encouraging citizen participation in spending and taxing decisions are major elements in the 1989 property tax reform.

Just as the reforms of the income tax and sales tax demonstrated earlier this decade, the property tax reform package passed by the 1989 legislature attests to Minnesota's continued commitment to reforming the state's major taxes as needed to make our tax system–in structure and operation–more fair, efficient, stable, competitive and understandable.

The 1989 reform law commits the governor and legislature to strive for future improvements in the structure of state and local taxing and spending responsibilities. The law also encourages future public debate on the property tax rates for different classes of property by simplifying the rate structure.

Although lawmakers still face some challenges in the decade ahead, the tax reform achieved in the 1980s should be an impetus for future progress.

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