



MINNESOTA

ILLUSTRATED

A VISUAL GUIDE TO TAXES & THE ECONOMY





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A photograph of the Split Rock Lighthouse, a historic yellow and white structure with a black lantern room, perched on a rugged, grey rock cliff. The cliff is partially covered with green trees and shrubs. The lighthouse overlooks a body of water, likely Silver Bay, under a blue sky with scattered white clouds. The foreground shows more of the rocky shoreline and dense green foliage.

Introduction

Taxes are complicated. Each state's tax code is a multifaceted system with many moving parts, and Minnesota is no exception. This chart book aims to help readers understand Minnesota's overall economy and tax system from a broad perspective. It also provides detailed illustrations to each of Minnesota's major taxes—individual income taxes, business taxes, sales and excise taxes, and property taxes—to help make the complicated task of understanding the state's tax code a bit easier.

These charts were compiled by Tax Foundation staff and edited by Nicole Kaeding and Morgan Scarboro.

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Split Rock Lighthouse, Silver Bay

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CHAPTER 1

An Overview of the Minnesota Economy

The following charts illustrate the current and past performance of Minnesota's economy. We show how various economic indicators, such as personal income per capita, state gross domestic product, employment composition, migration, and unemployment, have changed over time. We compare Minnesota to six other states – Illinois, Indiana, Iowa, South Dakota, Texas, and Wisconsin – which compete with Minnesota for jobs and opportunity.

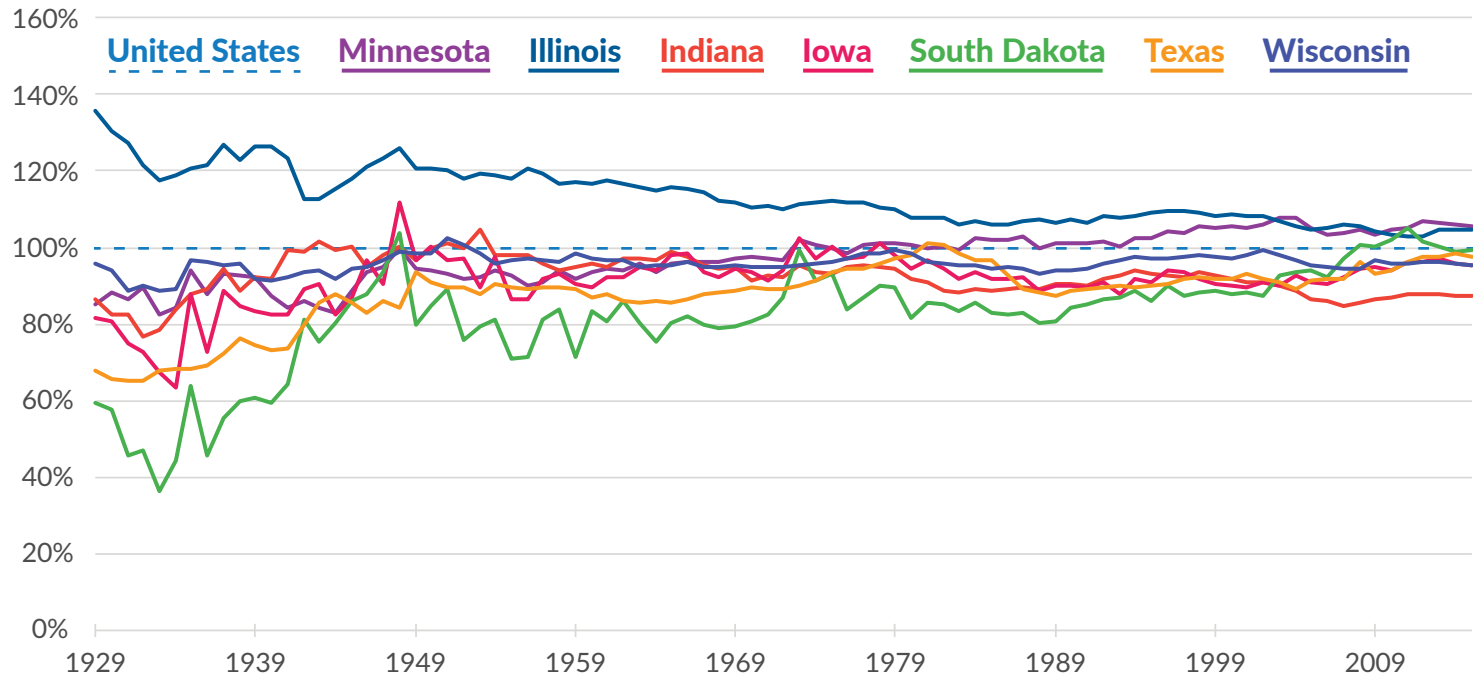
Minnesota's economy has been strong compared to other states for decades, but trends for many variables, such as employment growth and migration, are falling behind, suggesting Minnesota's competitiveness is being challenged.



Shore of Lake Superior

Minnesota's Income per Person is Higher than the U.S. Average

Personal Income per Capita as a Percent of the U.S. Level, Minnesota and Selected States (1929-2015)

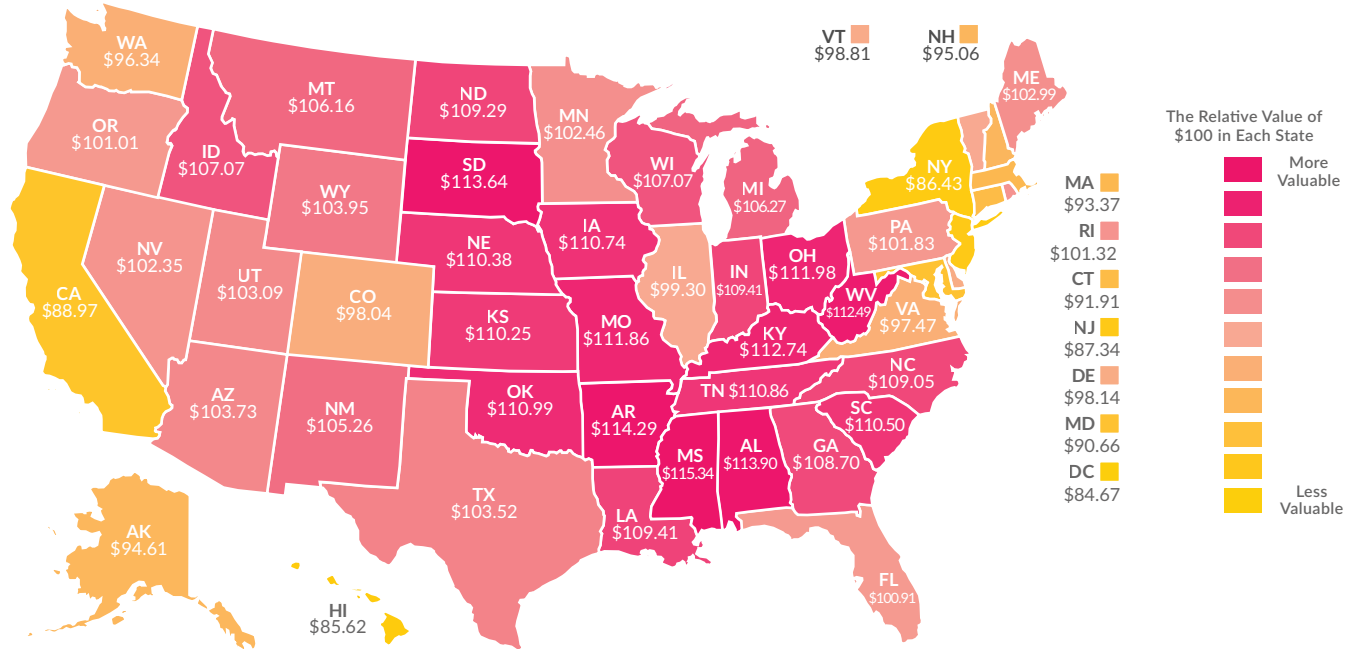


For many years, Minnesota's income per capita was lower than the U.S. average, and several of its peer states. In 1929, personal income per capita in Minnesota was 85 percent of the national average, and below the incomes of Illinois, Wisconsin, and Indiana. Minnesota has now closed the gap. Since the 1970s, Minnesota's income has risen above the average U.S. per person level and above similar states. Today, Minnesota's income per person has grown to 106 percent of the national average, exceeding the per person income of its peer states.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Annual State Personal Income and Employment."

The Cost of Living in Minnesota is Higher than its Peer States

Regional Price Parity (2014)

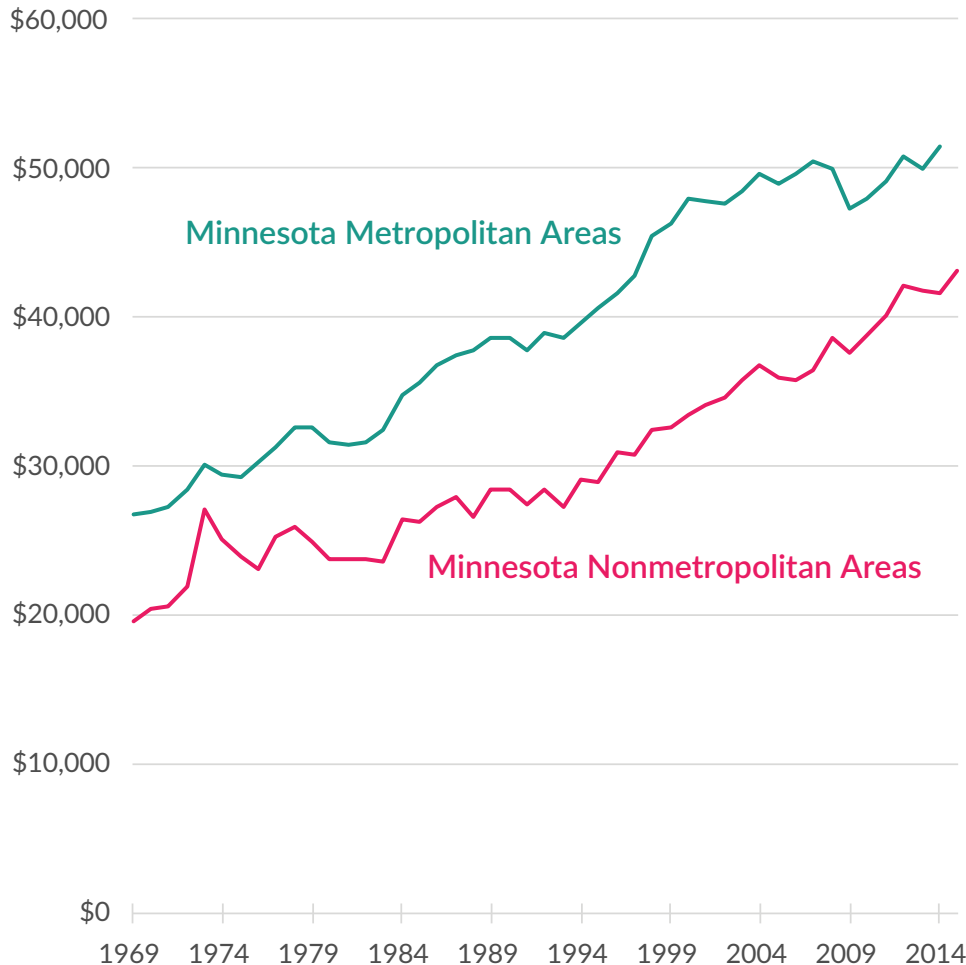


The real value of a dollar varies among states, as the costs of everyday items, such as food and housing, differs by geographic area. This information, known informally as a state's cost of living, tells us where an individual's buying power is stronger. Using regional price parity data, this map is adjusted to show the value of \$100 in each state. Though money in Minnesota goes a bit further with the real value of \$100 being \$102 in the state, its value is lower than most of its peer states – Indiana (\$109), Iowa (\$111), South Dakota (\$114), Texas (\$104), and Wisconsin (\$107). The only peer state that has a lower cost of living than Minnesota is Illinois (\$99). The cost of living is important to take into consideration when comparing different regional incomes.

Source: Bureau of Economic Analysis, *Regional Price Parities*.

Income is Higher in Metropolitan Areas

Personal Income per Capita, Metro and Nonmetro Minnesota (1969–2015)

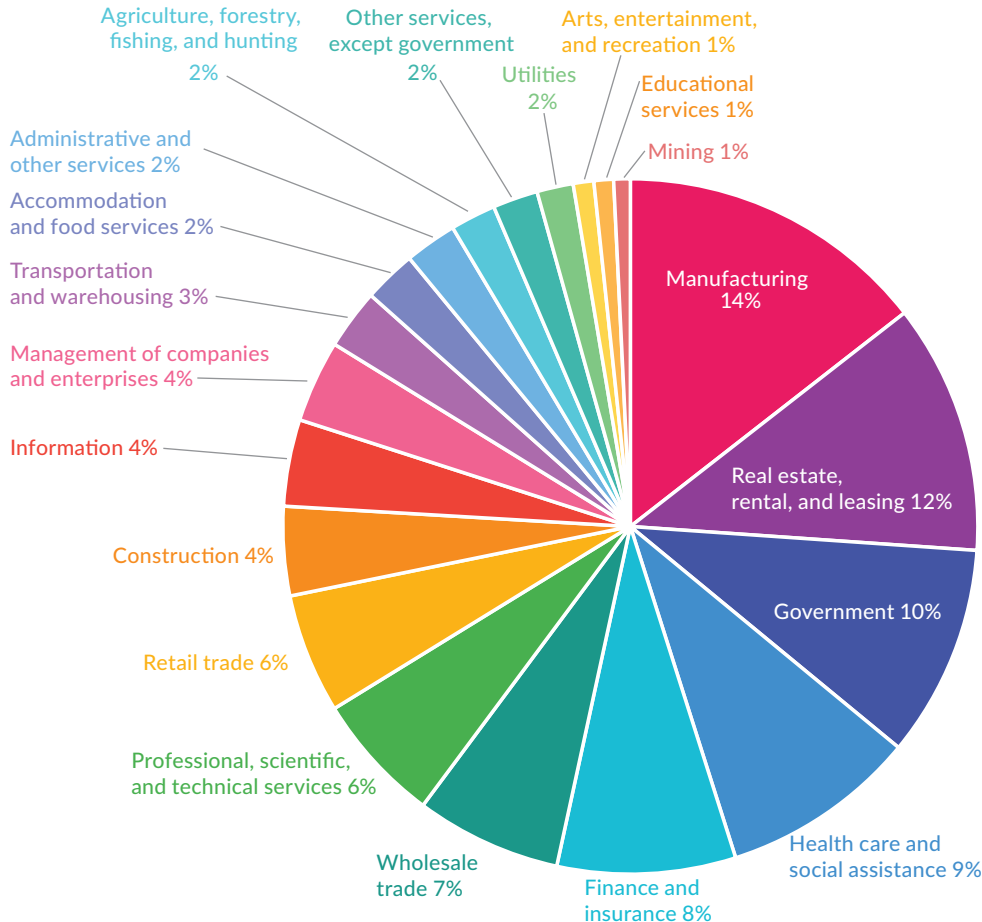


Similar to other states, personal income per capita varies throughout Minnesota. Personal income tends to concentrate in metropolitan areas, such as the Twin Cities. Income lags in the nonmetro areas of Greater Minnesota. In 1969, personal income per capita in metro areas was \$26,763, compared to \$19,594 in nonmetro areas. Despite metro areas having a higher per capita personal income, nonmetro per capita income is growing faster, reducing the gap with metropolitan areas. Since 1969, it has grown 120 percent, faster than metro-area growth of 98 percent. In 2015, Minnesota income per capita in metro areas was \$53,121 while nonmetro income per capita was \$43,141.

Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year.
Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Local Area Personal Income and Employment."

Manufacturing Comprises the Largest Portion of Minnesota's Economy

Percent of State GDP by Sector, Minnesota Statewide (2015)

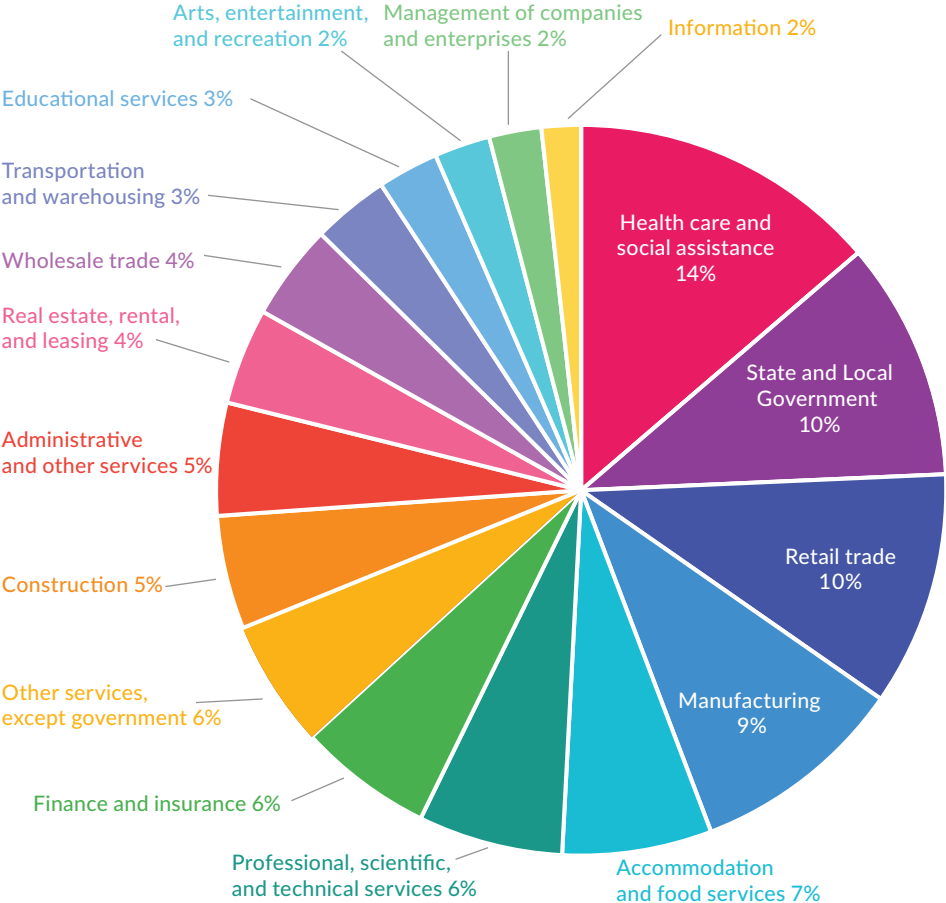


Manufacturing comprises 14 percent of Minnesota's economy. The next biggest industries include real estate, rental, and leasing (12 percent), government (10 percent), and health care and social assistance (9 percent). Together, these four sectors total almost 45 percent of the state's economy. However, because each sector has distinct differences, policymakers must work to create an environment that's conducive to growth for all industries.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Gross Domestic Product (GDP) by State - GDP in current dollars."

Health Care, Government, and Manufacturing Employ the Most People in Minnesota

Percent of Total Nonfarm Employment by Sector, Minnesota (2015)

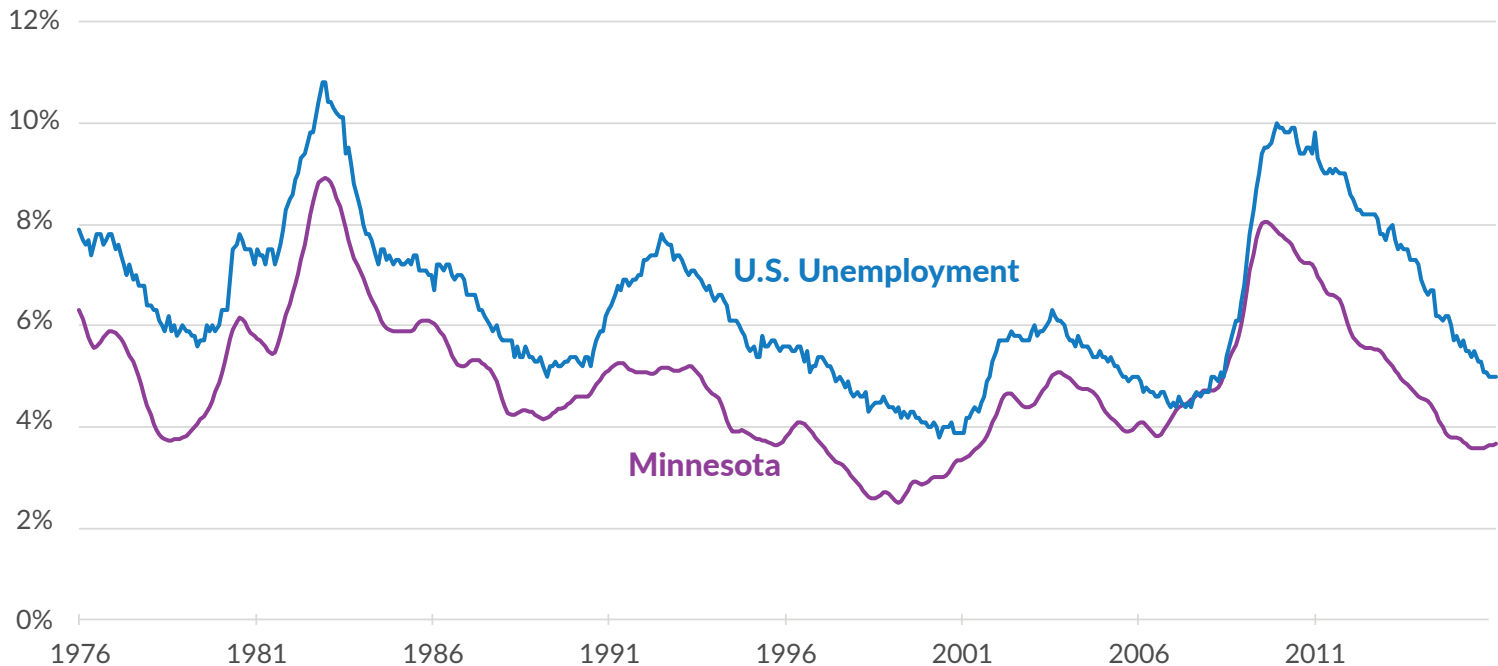


The majority of Minnesota employees work in service-providing sectors. Health care and social assistance employs the greatest percentage of workers at 14 percent, followed by state and local government (10 percent), and retail trade (10 percent). This measure differs from state GDP produced by sector, due to some industries requiring more labor than others. For instance, health care employs 14 percent of the Minnesota workforce, but comprises 9 percent of the state's gross domestic product.

Note: Percentages may not add to 100 due to rounding.
 Source: Bureau of Labor Statistics, *Quarterly Census of Employment and Wages* (Minnesota Statewide for Private, NAICS Sectors, All establishment sizes).

Minnesota's Unemployment Rate is Consistently Lower than the U.S. Average

Monthly Seasonally-Adjusted Unemployment Rate, Minnesota and U.S. (1976-2015)

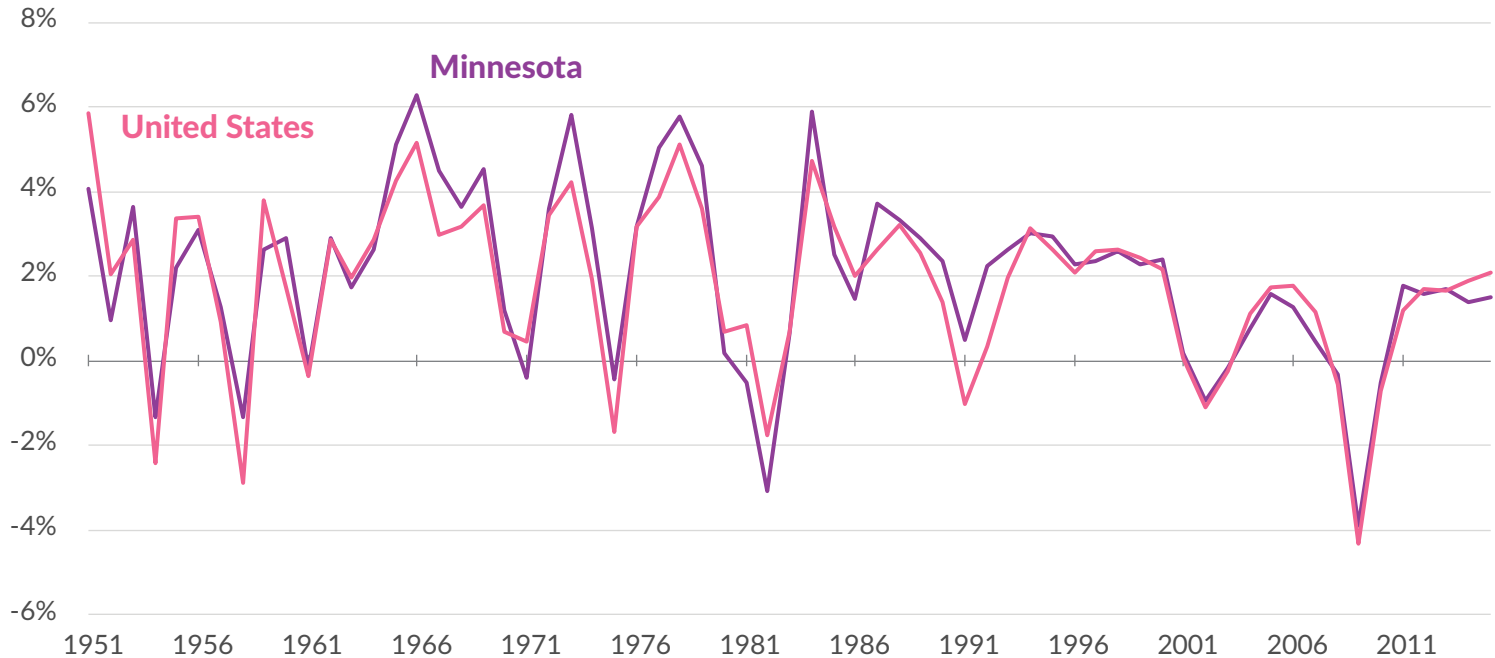


For nearly four decades, Minnesota's unemployment rate has been lower than the national average. Minnesota's unemployment rate peaked in 1982 when it reached 8.9 percent, followed closely in 2009 when it reached 8.1 percent. From 1974-2015, Minnesota's average unemployment rate was 4.9 percent, outperforming the U.S. average of 6.4 percent. The only year the rates converged was 2007, when Minnesota and the U.S. had monthly unemployment rates of both 4.6 and 4.7 percent respectively.

Source: Bureau of Labor Statistics, *Local Area Unemployment Statistics*.

Minnesota's Pace of Job Growth is Slowing

Annual Average Percent Change in Employment, Minnesota and United States (1951-2015)

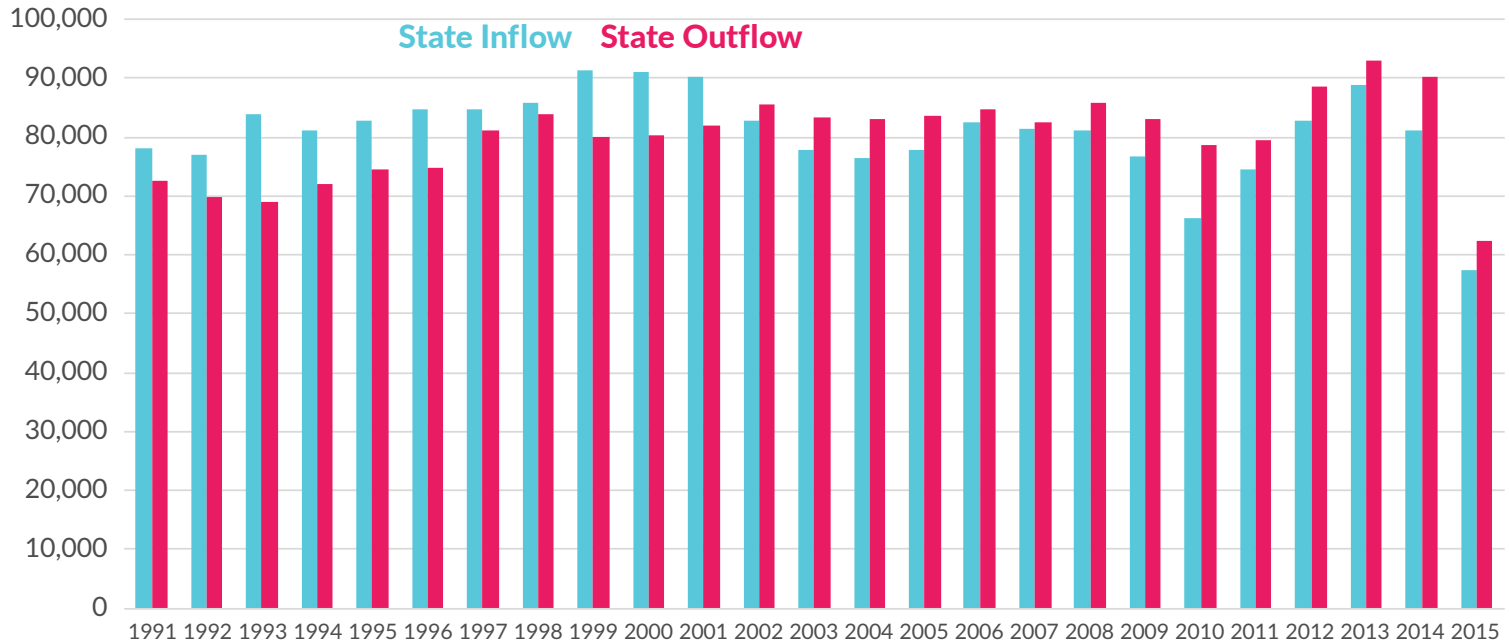


For 36 of the last 64 years, Minnesota's job creation has outpaced national job creation. During much of the second half of the 20th century, Minnesota's job growth was rapid. Particularly during times of economic booms, Minnesota created jobs faster than the national average and didn't lose them as quickly during downturns. However, since 2000, that trend seems to be changing. In the recoveries following recessions in 2001 and 2007-2009, Minnesota's job growth has trailed the national average, suggesting Minnesota's employment fundamentals are less robust than they used to be.

Source: Bureau of Labor Statistics, *Current Employment Statistics*.

Minnesota Has Seen Consistent Out-Migration over the Last Decade

Migration to and from Minnesota Based on the Number of Federal Tax Exemptions Claimed (1991-2015)

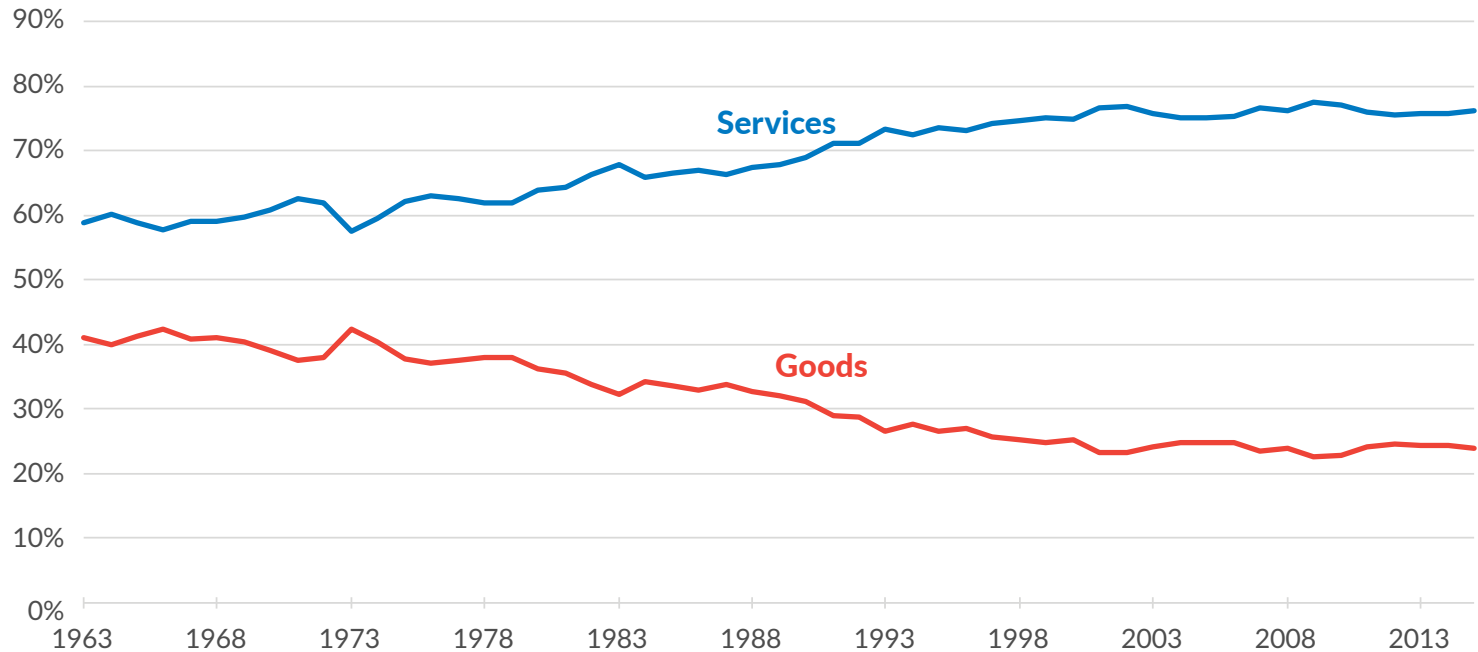


Throughout the 1990s, Minnesota consistently saw an inflow of people moving to the state. That trend, however, has since reversed. Since the early 2000s, Minnesota has seen a net of 76,176 people leave the state, with net out-migration occurring every year since 2002. Since 2000, Minnesota has lost approximately 58,000 people to Texas and gained 11,000 people from North Dakota.

Source: Internal Revenue Service, *Statistics of Income Tax Stats*, "State-to-State Migration Data."

Minnesota's Economy is Shifting from Goods toward Services

Goods and Services as a Percent of Total Private State GDP, Minnesota Statewide (1963–2015)



The composition of Minnesota's economy has changed dramatically over the past 50 years. In 1963, the goods-producing sectors of the economy, like manufacturing, construction, and mining, comprised 41 percent of the state's economy. That share of the economy has shrunk to just 24 percent, while the services-producing sectors have increased from 59 percent to 76 percent of Minnesota's economy.

Source: Bureau of Economic Analysis, *Regional Economic Accounts*, "Gross Domestic Product (GDP) by State - "GDP in current dollars."

CHAPTER 2

Minnesota's Tax Code: An Overview

State and local governments in Minnesota rely on a variety of taxes to fund operations. Some taxes are well-known, such as individual income, property, and corporate income taxes. Minnesota also relies on more targeted taxes, such as excise taxes on gasoline and alcohol, and the state's estate tax. Like every state, Minnesota also receives revenue transfers from the federal government, but the amount received, as a percent of general revenue, is low in comparison to other states.

In general, Minnesota residents face a high state and local tax burden. Minnesota's residents paid 10.8 percent of their income to state and local taxes in fiscal year 2012, above the national average of 9.9 percent. In addition, inflation-adjusted state collections are up 69 percent over the past 20 years.

Tax rates contribute to a state's competitiveness, but other factors matter as well. Tax bases and tax structures play an essential role in determining the strength of a state's tax climate. For instance, Minnesota's property and individual income taxes are not competitive with those of its peer states.



Carleton College, Northfield

Minnesota Taxes at a Glance

This page provides a brief overview of tax rates, tax collections, and other basic structural features of Minnesota's tax code.

General Info

		Rank	Nat. Avg.
Income per capita	\$48,998	13th	\$46,049
Federal aid as % of gen. revenue	26.40%	39th	30.03%
State debt per capita	\$2,504	33rd	\$3,594

Tax Freedom Day April 30th 45th April 24

Individual Income Tax

Number of brackets	4
Tax Rate	9.85%
Tax Rate Rank	3rd
Collections per capita (2014)	\$1,651
Collections rank (2014)	6th

Corporate Income Tax

Number of brackets	1
Tax rate	9.80%
Tax rate rank	3rd
Collections per capita	\$241
Collections rank	9th

Property Tax

Collections per capita	\$1,547
Collections rank	15th
Effective residential property tax rate	1.19%

Sales Tax

State rate	6.875%
State + average local rate	7.31%
State + average local rank	17th
Collections per capita	\$946
Collections rank	24th

Excise Taxes

	Rate	Rank
Gasoline taxes and fees	28.8¢ per gallon	25th
Cigarette taxes	\$3.00 per pack	8th
Spirits taxes	\$8.67 per gallon	13th
Beer taxes	\$0.47 per gallon	11th
Cell phone taxes	10%	28th

Other Taxes

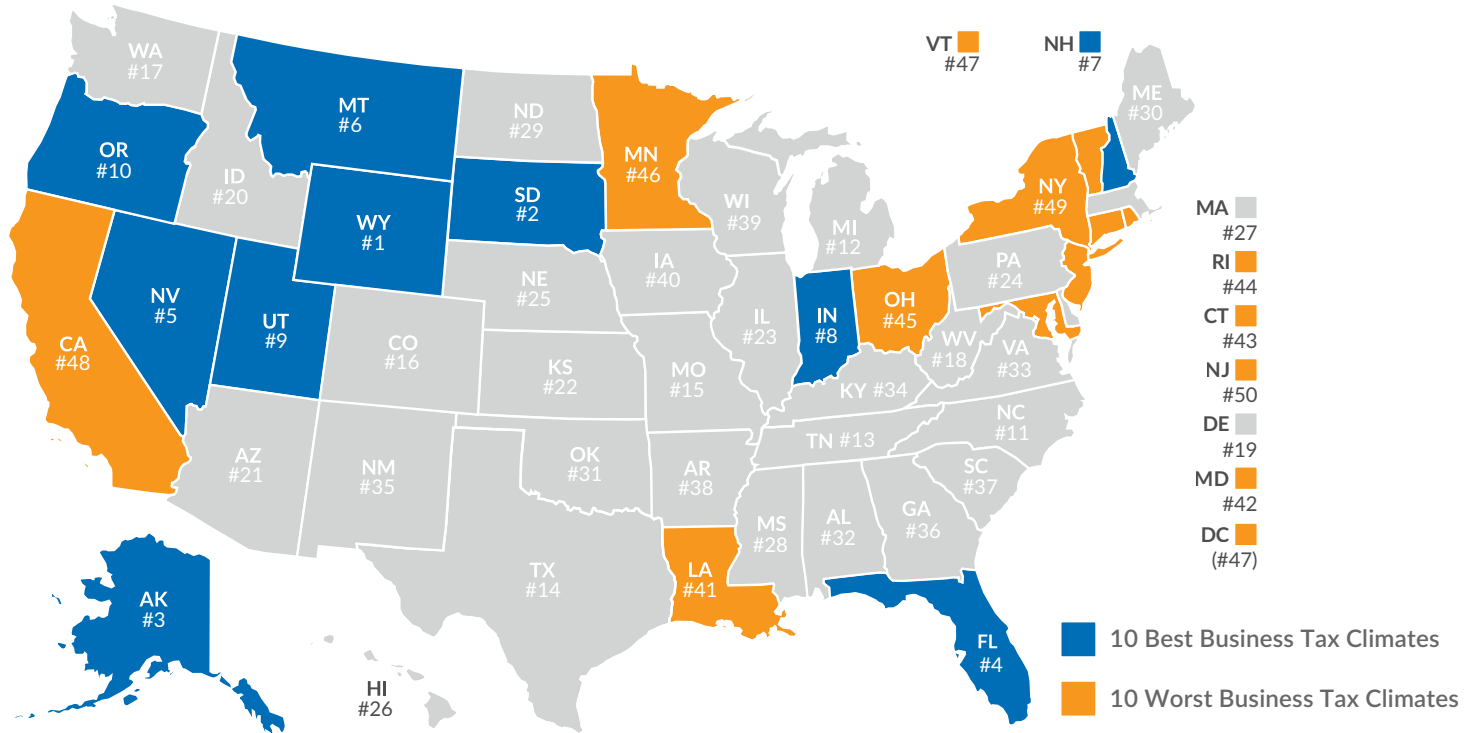
Capital Stock Tax	None
Inheritance Tax	None
Estate Tax	9-16%

Note: All collections listed on this page are state and local per capita collections for the 2013 fiscal year. Federal aid and state debt figures are also for the 2013 fiscal year. Income per capita is for the 2014 calendar year. Individual and corporate income tax rates are ranked according to the top rate if the state has a graduated-rate individual or corporate income tax. These rates and ranks are as of January 1, 2016. "State debt" is defined as the outstanding debt at the end of the fiscal year, as calculated by the Census Bureau. Ranks are sorted from highest to lowest.

Source: Tax Foundation, *Facts & Figures 2016: How Does Your State Compare?*; Tax Foundation, "State and Local Sales Tax Rates, Midyear 2016."

Minnesota Has One of the Worst Business Tax Climates in the Country

Minnesota Ranks 46th out of 50 in the State Business Tax Climate Index (2017)



The *State Business Tax Climate Index* measures the structure of each state's tax code by reviewing more than 100 variables. States with low rates, broad bases, and simple structures score the highest. Minnesota's rank suffers from its relatively high corporate and individual income tax rates and an estate tax, among other things. Minnesota currently ranks 46th on our *Index*.

Note: A rank of 1 indicates the state's tax system is more favorable to business; a rank of 50 indicates the state's tax system is less favorable for business. The snapshot date is July 1, 2016. Component rankings do not average to the overall rank. States without a given tax rank equally as number 1 in that component. Texas does not have an individual income tax, but its Margin Tax affects its individual income tax component ranking. Source: Tax Foundation, 2017 *State Business Tax Climate Index*.

Minnesota's Business Tax Climate Trails Its Peers'

State Business Tax Climate Index Rankings, Minnesota and Selected States (2017)

	Overall	Corporate Tax Rank	Individual Income Tax Rank	Sales Tax Rank	Unemployment Insurance Tax Rank	Property Tax Rank
Illinois	23	26	10	35	38	46
Indiana	8	23	11	10	10	4
Iowa	40	47	33	21	34	40
Minnesota	46	43	45	25	28	33
South Dakota	2	1	1	32	40	23
Texas	14	49	6	37	12	37
Wisconsin	39	30	43	7	36	34

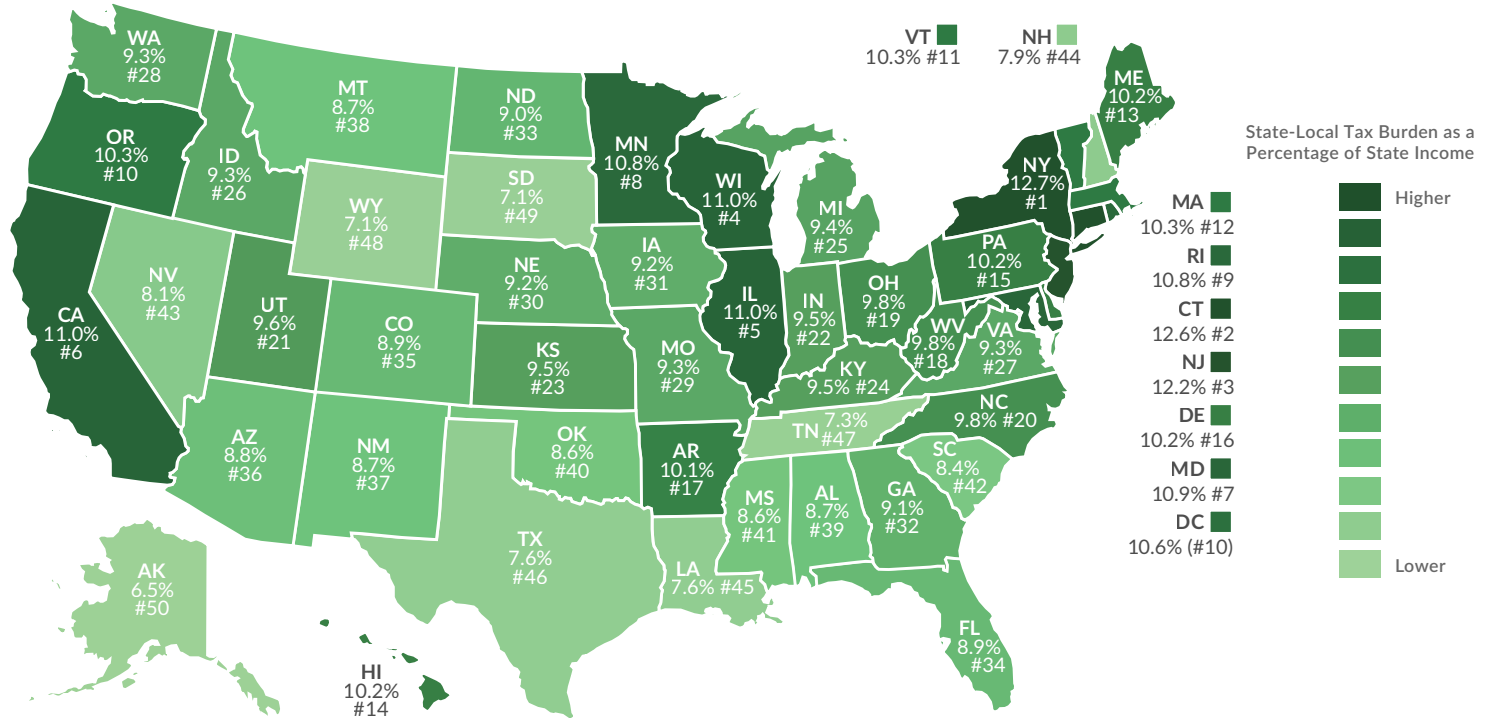
All of Minnesota's peer states have better structured tax codes, hurting Minnesota's competitiveness. A poor tax structure is more likely to stifle economic growth. Neighboring South Dakota ranks 2nd in the country, as the state does not impose a corporate tax or an individual income tax and therefore receives a perfect score in both of those categories. Indiana also ranks in the top ten, and still uses all major tax instruments, showing that a good tax structure doesn't require eliminating a tax.

Note: A rank of 1 indicates the state's tax system is more favorable to business; a rank of 50 indicates the state's tax system is less favorable for business. The snapshot date is July 1, 2016. Component rankings do not average to the overall rank. States without a given tax rank equally as number 1 in that component. Texas does not have an individual income tax, but its Margin Tax affects its individual income tax component ranking.

Source: Tax Foundation, 2017 *State Business Tax Climate Index*.

Minnesota Has the 8th Highest Tax Burden in the Nation

State-Local Tax Burdens as a Percent of State Residents' Income (FY 2012)



A state's tax burden measures the amount of personal income residents pay in state and local tax, both to in-state and out-of-state governments. Minnesota residents pay taxes to other states in multiple ways, such as sales taxes paid while traveling, out-of-state gasoline purchases, and property taxes on vacation homes.

Minnesota residents paid 10.8 percent of personal income, or \$5,185 per capita, to state and local taxes in fiscal year 2012. This ranks 8th highest nationally and well above the national average of 9.9 percent.

Note: This data does not include any tax changes made in 2013.

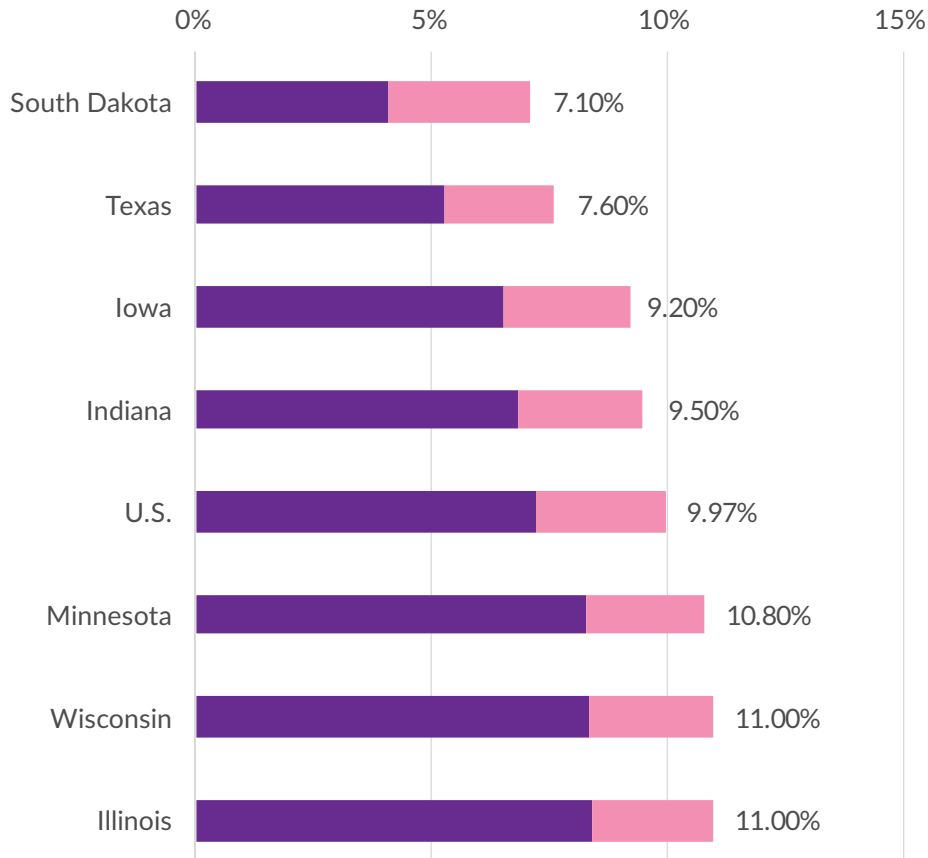
Source: Tax Foundation, *State-Local Tax Burden Rankings FY 2012* (most recent data).

Minnesota's Tax Burden Ranks Higher than Most Other States' Burdens

Total State-Local Tax Burden as a Percent of State Residents' Income, Minnesota and Peer States (FY 2012)

Share of income paid to own state

Share of income paid to other states

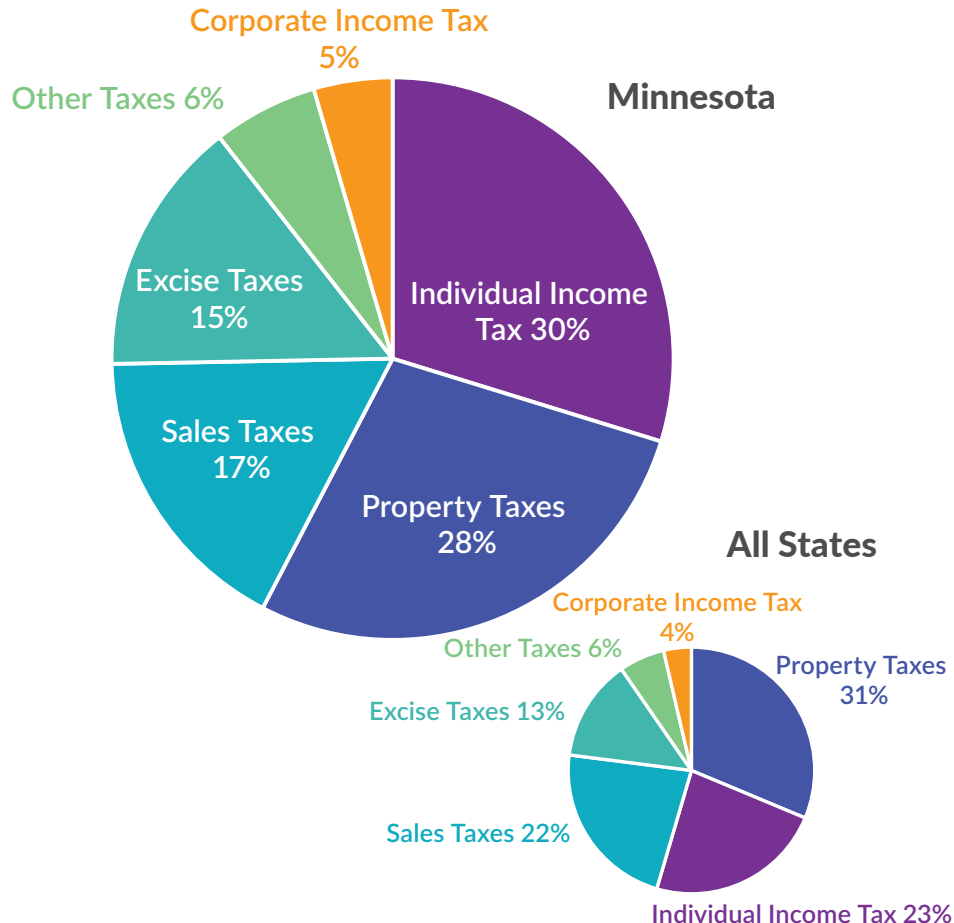


Minnesota's total state-local tax burden is ranked 8th highest in the country and above most of its peer states. The average Minnesota taxpayer paid \$5,185 in state and local taxes in 2012, amounting to 10.8 percent of state residents' total income. Minnesotans pay approximately 77 percent of their total state and local tax burden to governments in Minnesota and pay the remaining 23 percent to out-of-state taxing authorities.

Source: Tax Foundation, *State-Local Tax Burden Rankings* FY 2012.

Compared to the Entire U.S., Minnesota Relies More on Individual Income Tax, Less on Sales Taxes

Percent of Total Combined State and Local Tax Collections by Tax Type, Minnesota and U.S. (2013)



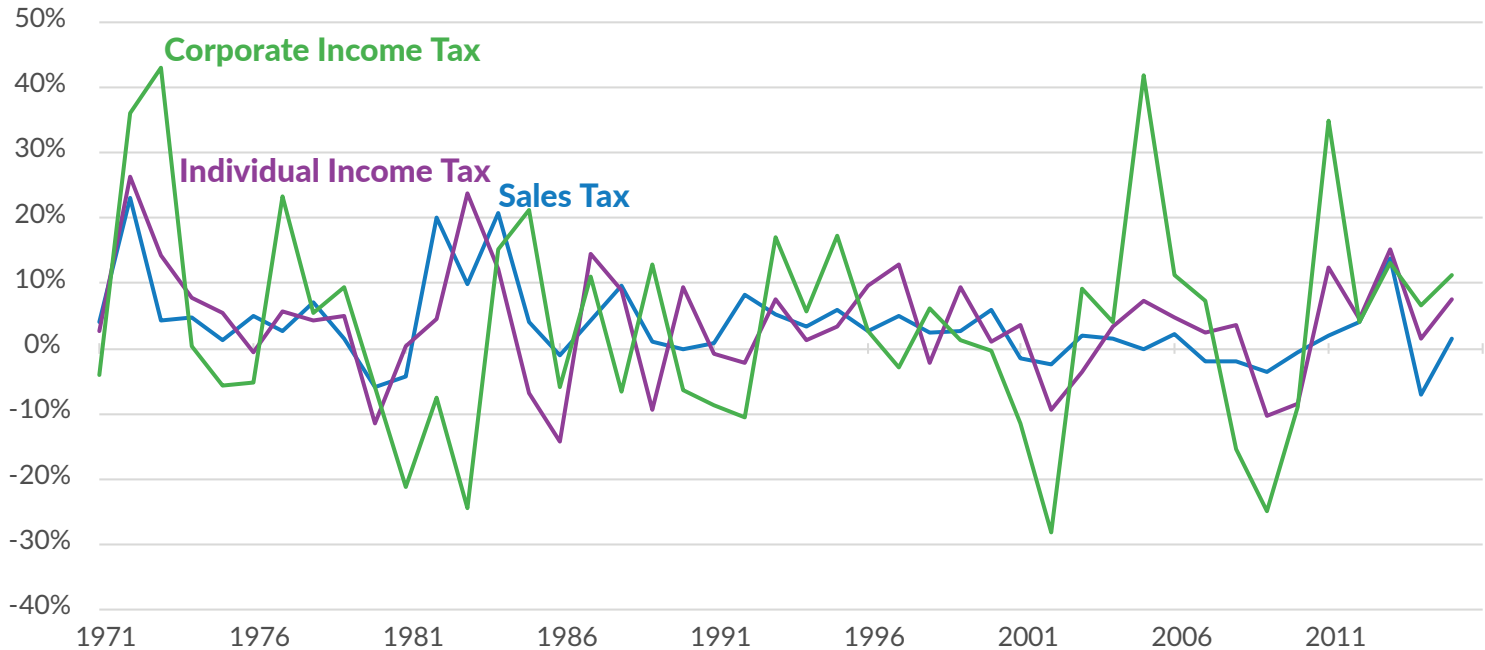
Minnesota obtained the largest share of state and local combined collections in 2013 from individual income taxes (30 percent of total), followed by property taxes (28 percent) and sales taxes (17 percent). Minnesota relies more on individual income taxes than the U.S. average (23 percent), and therefore, less heavily on sales and property taxes—23 and 31 percent respectively. Corporate income taxes make up the smallest share of collections in both Minnesota and the U.S. as a whole, but Minnesota relies on them slightly more than other states (5 percent).

Note: Percentages may not add to 100% due to rounding.

Source: Census Bureau, *State and Local Government Finances*.

Corporate Income Taxes Do Not Provide Stable Revenue

Annual Percent Change in Minnesota State Tax Collections by Tax Type (1971-2015)



Revenue stability over the business cycle is an important component of sound tax policy. Different types of revenues react differently to changes in the economy. Minnesota's corporate income tax revenue has varied by as much as 42 percent year-over-year, making it difficult to properly budget when revenues are unpredictable. In contrast, sales tax revenue is more reliable since consumption stays relatively steady even during economic downturns.

Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year.
Source: Census Bureau, *State and Local Government Finances*.

CHAPTER 3

Individual Income Taxes

Forty-one states tax wage income, with the majority (33 states) using graduated-rate structures. Minnesota is one of those 33 states, but stands out for two reasons: its high top marginal rate and its low rate threshold. Among the states that levy income taxes on wages and salaries, Minnesota has the 3rd highest top marginal individual income tax rate in the country at 9.85 percent, trailing only California and Oregon. In comparison with other states, the top rate kicks in at the relatively low income level of \$155,650. California's rate does not exceed 9.85 percent until \$263,222 in income. This has implications for both individual and business taxpayers as many businesses file taxes under the individual income tax.

Minnesota's individual income tax collections per capita are 89 percent higher than the average for all states and continue to increase.

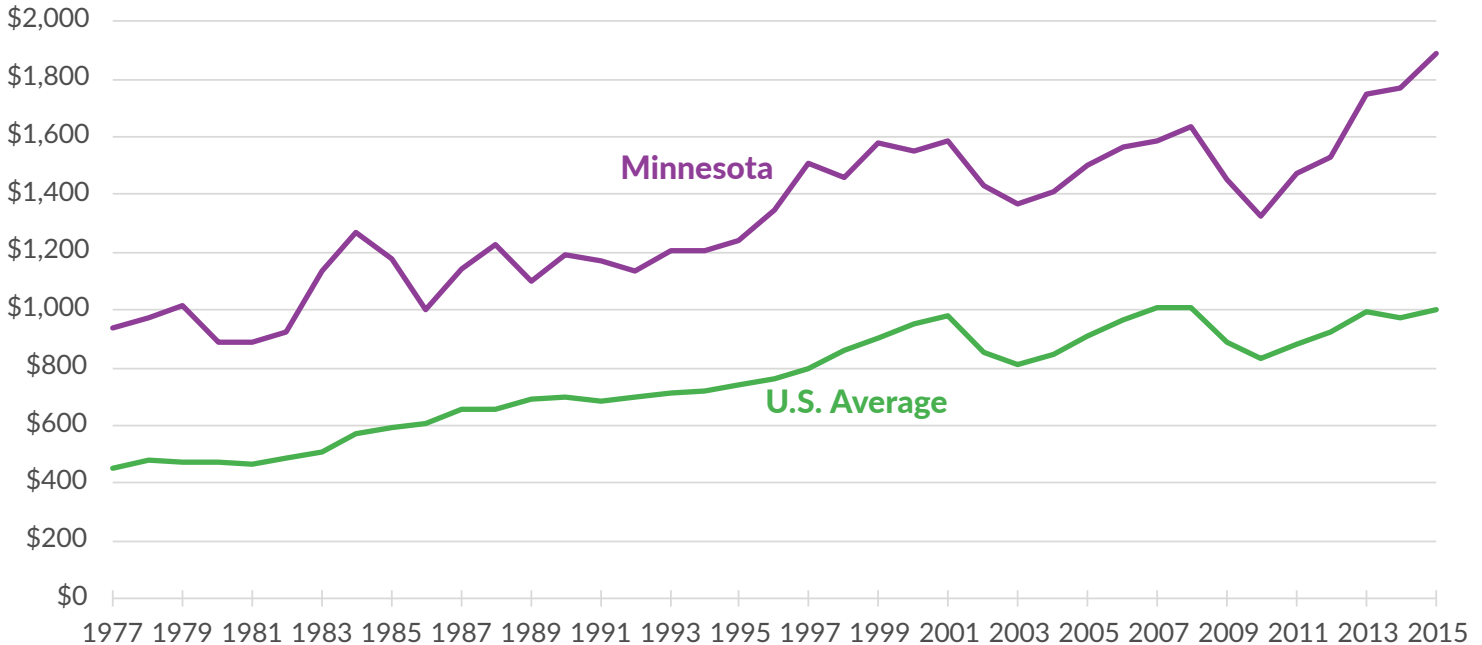
One bright spot of Minnesota's individual income tax code is that it has limited tax expenditures, beyond those that exist in federal statute.



Stone Arch Bridge, Minneapolis

Minnesota Individual Income Tax Collections Have Increased

Total State Individual Income Tax Collections per Capita, Minnesota and the U.S.
(1977-2015, in 2015 dollars)



Since 1977, Minnesota's per capita individual income tax collections have doubled to \$1,889 in inflation-adjusted terms. Collections per capita in Minnesota have exceeded the national average since 1977, but have actually grown at a slower rate than the national average during that time period. The national average grew by 120 percent from 1977 to 2015. Collections are subject to business cycle fluctuations. For instance, collections fell in 2002 and 2003 and again in 2009 and 2010, following the national trend.

Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year.

Source: Census Bureau, *State and Local Government Finances*; Census Bureau, *American Community Survey*; Bureau of Labor Statistics, *Consumer Price Indexes*.

Individual Income Tax Expenditures Total \$470 Million for Fiscal Year 2016

Individual Income Tax Expenditures, Minnesota (FY 2016)

Economic Development 9%

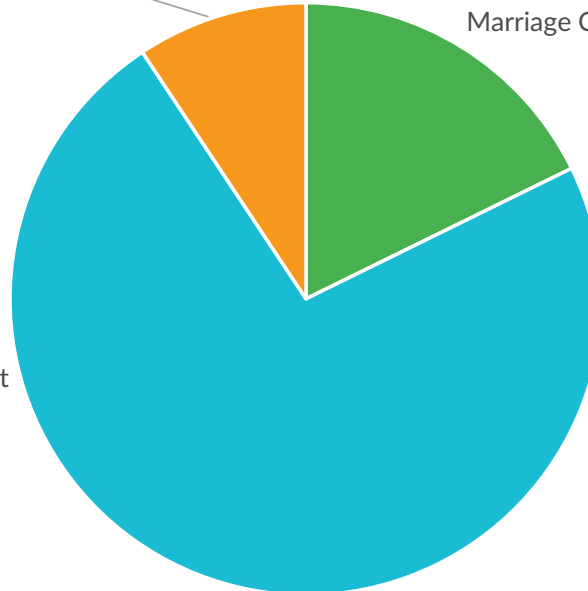
Research & Development Credit
Angel Investment Credit

Structural 18%

Marriage Credit

Policy 73%

Working Family Credit
K-12 Education Expenses Credit
Child and Dependent Care Credit



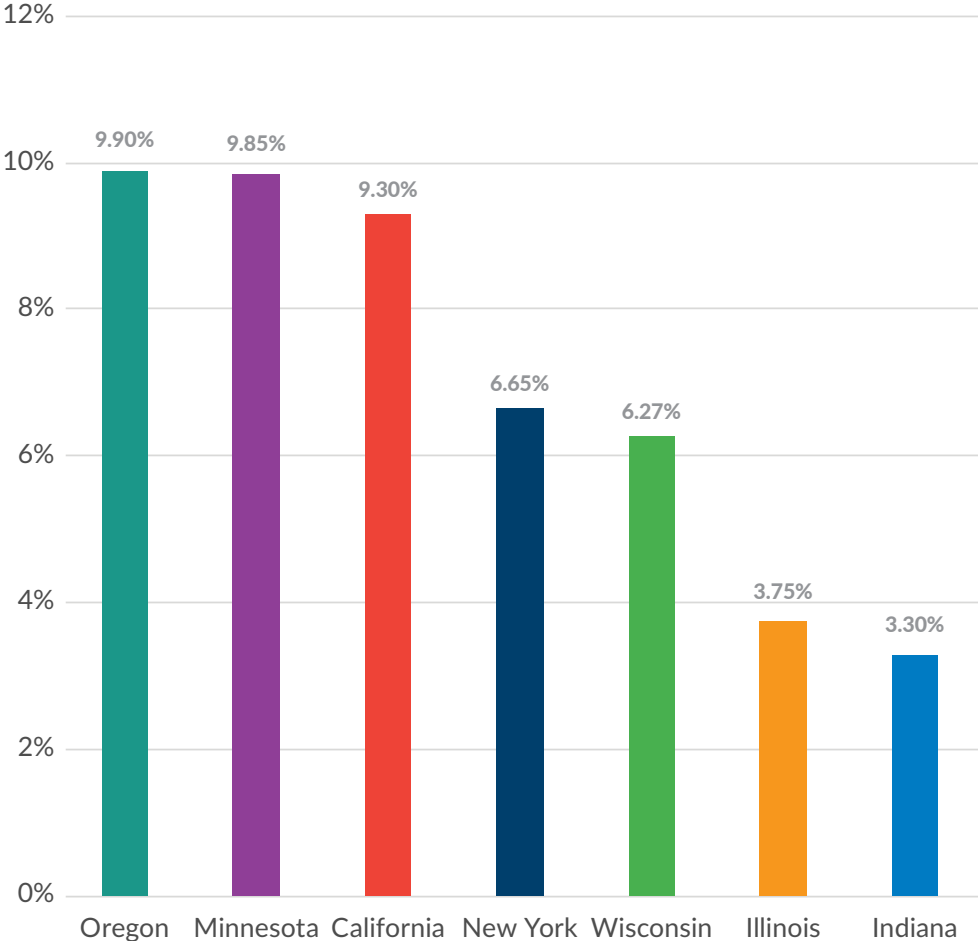
Minnesota's individual income tax expenditures can be split into three categories: policy, structural, and economic development. The largest expenditure category is policy, with the Working Family Credit making up the single largest expenditure (\$260 million). The second largest expenditure is the Marriage Credit. The credit is a structural expenditure which compensates married couples that faced a marriage penalty when filing their taxes (\$83 million). Approximately 414,000 returns claimed the credit for the tax year 2014. The largest expenditure in the economic development category is the nonrefundable Research & Development Credit (\$17 million).

Note: The listed expenditures are selected from each category's full list.

Source: Minnesota Revenue Tax Research Division, *Tax Expenditure Budget* (Fiscal Years 2016–2019).

Minnesota's Top Marginal Individual Income Tax Rate Kicks in Lower than in Other States

Top Marginal Individual Income Tax Rate at \$155,560 in Income, Minnesota and Selected States (2016)



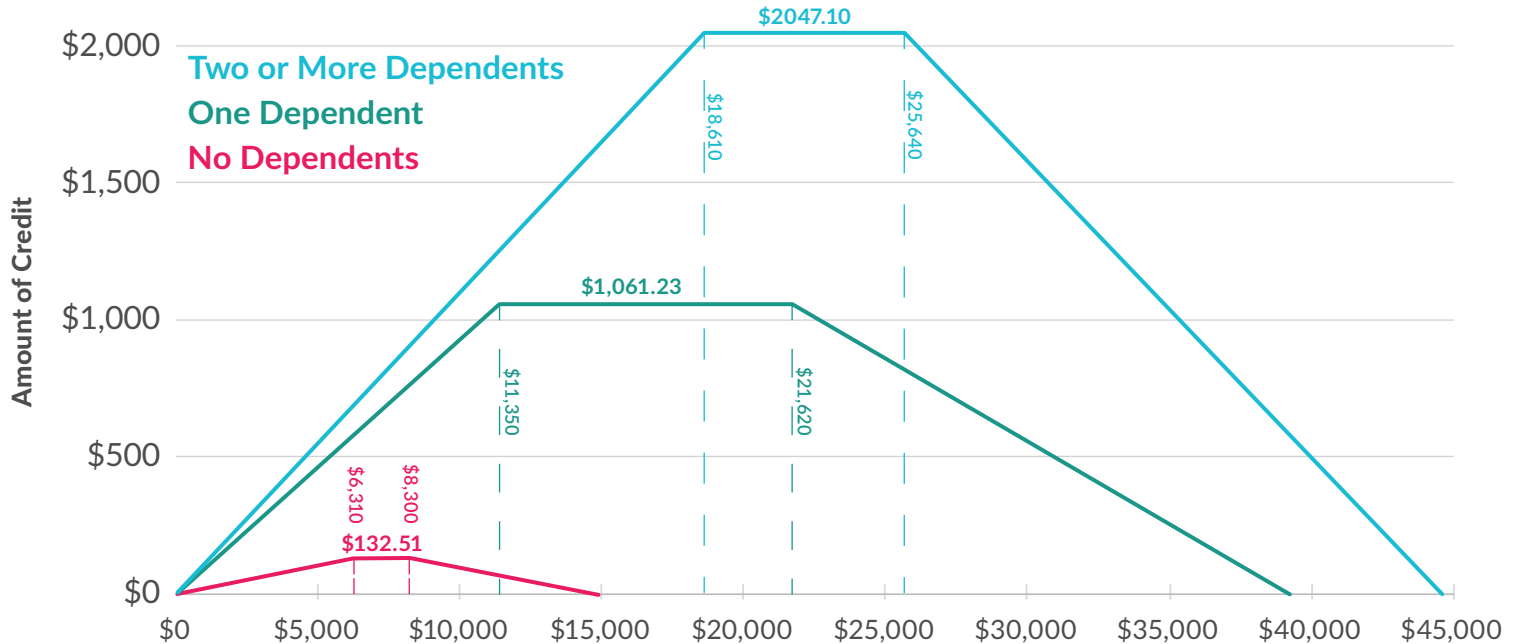
Not only is Minnesota's top marginal individual income tax rate the 3rd highest in the country, but the top rate of 9.85 percent kicks in at a relatively low income level of \$155,650. Only Oregon's 9.9 percent rate kicks in at a lower level of income than Minnesota's, starting at \$125,000. California's income tax rate doesn't surpass Minnesota's until its 10.3 percent rate at \$263,222 in income. (The state's top rate of 13.3 percent starts at \$1 million.)

This is problematic for Minnesota residents and businesses, as income is quickly subject to very high tax rates, disincentivizing work and investment in the state.

Source: Tax Foundation, *Facts & Figures 2016: How Does Your State Compare?*

Minnesota's Generous Working Family Credit

Minnesota Working Family Tax Credit Amount, Income Phase-ins, and Phaseouts (2016)



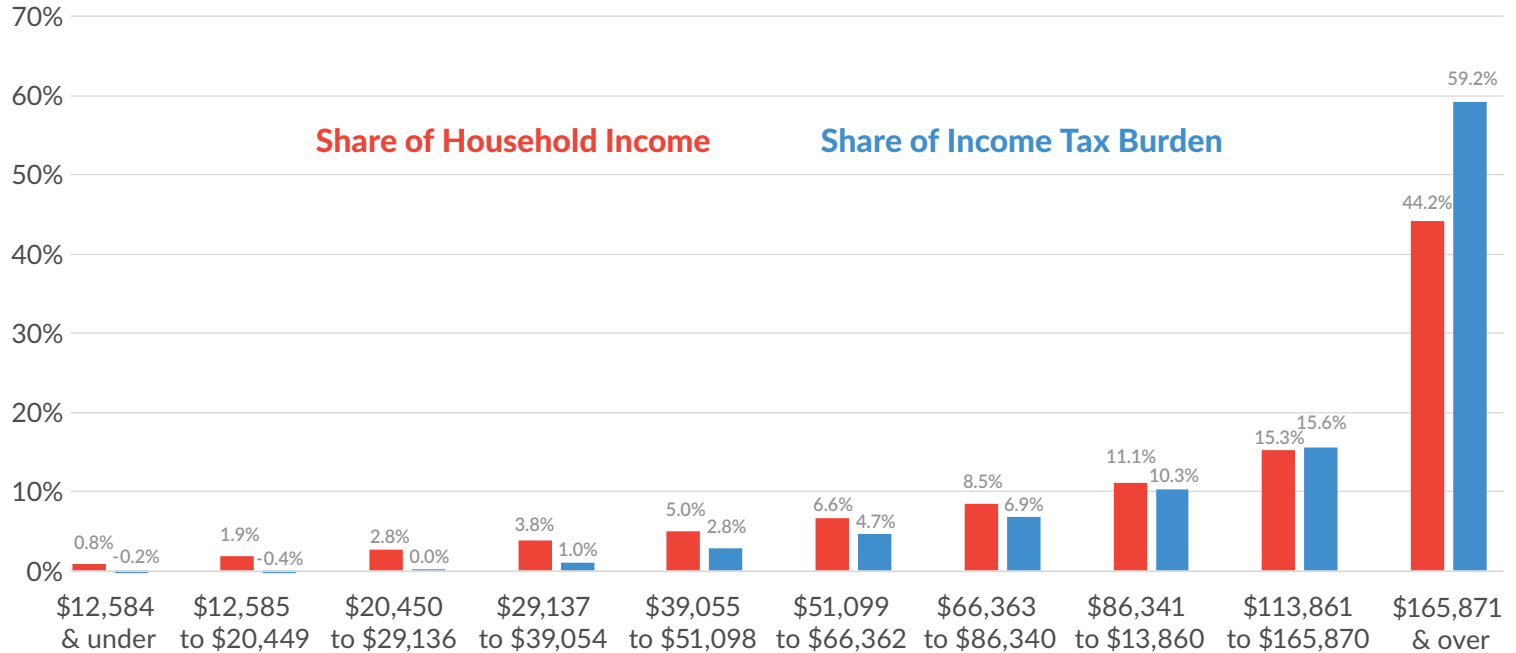
Minnesota is one of 26 states and the District of Columbia to offer an earned income tax credit (EITC), a tax credit for low- and middle-income individuals. The credit increases as more income is earned, subject to a cap. Then, the credit begins to phase out as additional income is earned. A Minnesotan with one dependent earns a credit of \$1,061 after reaching \$11,350 in income, but that begins phasing out at \$21,620 in income. The credit is fully phased out at \$39,248.

Minnesota's credit is quite generous compared to that in other states. In most states, the credit is calculated as a percent of the federal EITC. Illinois provides 10 percent of the federal EITC, while Iowa's is 15 percent. Minnesota has its own EITC calculation, but on average, it is 32 percent of the federal EITC. Only three states, and D.C., have larger credits.

Source: Minnesota Department of Revenue.

Minnesota's Individual Income Tax is Progressive

Distribution of Total Household Income and Tax Liability Among Minnesota Resident Taxpayers (2017)



Minnesota's income tax system is progressive, with lower-income Minnesotans paying a smaller share of taxes than they earn in income. The bottom 20 percent of earners have a negative effective tax rate, meaning they receive a refund each year, in large part due to the state's generous Working Family Credit. Meanwhile, the top 10 percent of earners, or households making over \$165,871 in income, pay nearly 60 percent of the total individual income tax burden.

It is important to note, however, that some other tax types in Minnesota are more regressive than the individual income tax system.

Source: Minnesota Revenue Tax Research Division, 2015 *Minnesota Tax Incidence Study*.

CHAPTER 4

Business Taxes

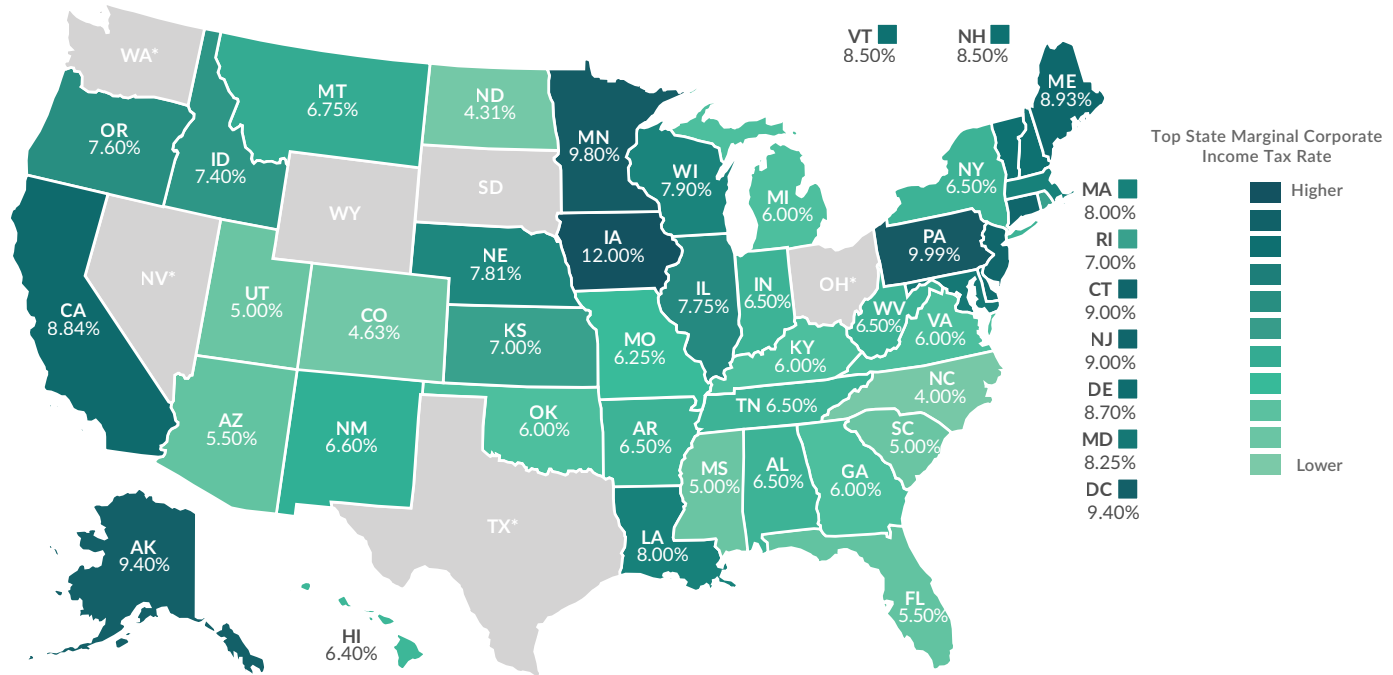
All taxes paid by businesses are ultimately borne by individuals, whether in the form of higher prices, lower wages, or smaller returns on investment. In Minnesota, businesses paid \$13 billion in total taxes in 2014, primarily on taxes other than the corporate income tax, the most recognized type of business tax. In reality, many firms are pass-through entities, such as limited liability corporations (LLCs), S corporations, and sole proprietorships, that pay individual income taxes rather than corporate income taxes. Businesses also pay property, sales, and excise taxes, among others.

Minnesota's corporate income tax structure has flaws. Its 9.8 percent corporate tax rate is the 3rd highest in the country, and the state levies an Alternative Minimum Tax. However, Minnesota's use of single sales factor to apportion income limits the effects of the state's high statutory rate for in-state firms.



Minnesota Has an Extremely High Corporate Income Tax Rate

Corporate Income Tax Rates by State (2016)

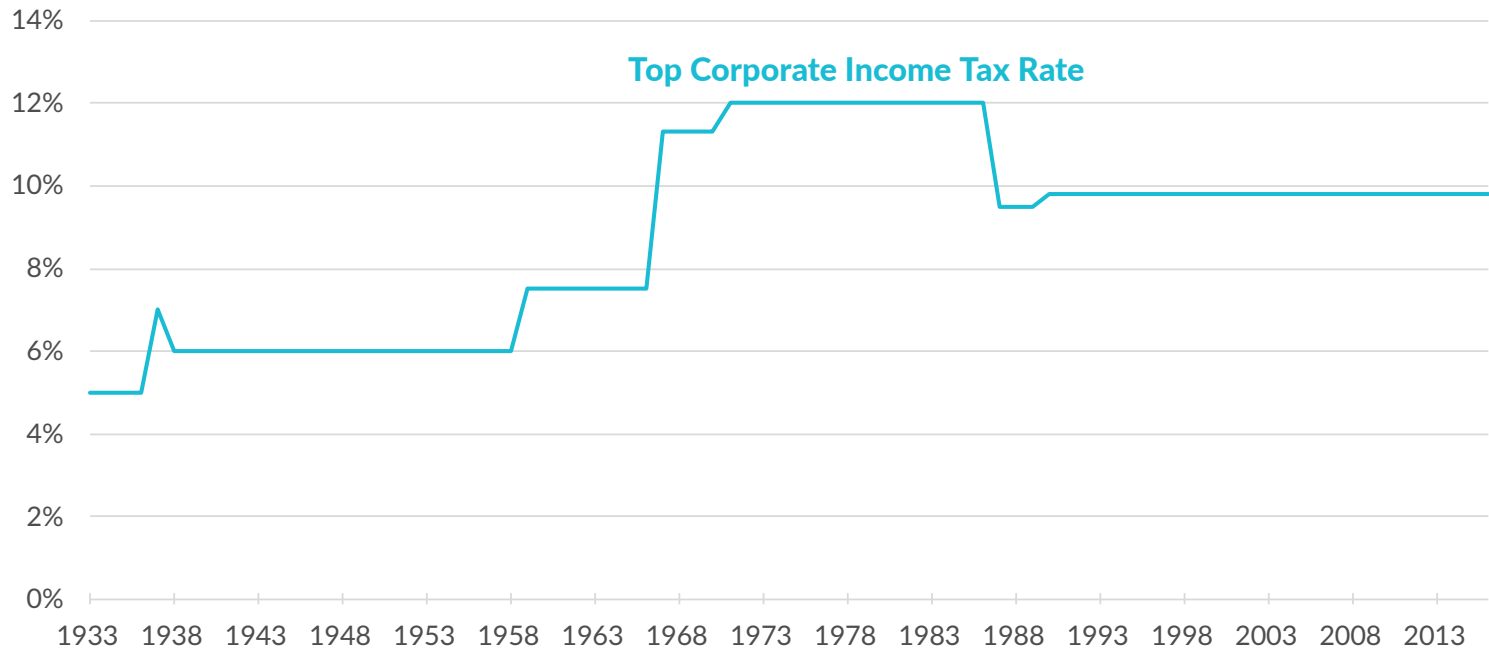


Minnesota’s state corporate income tax rate of 9.8 percent is the 3rd highest in the nation, following only Iowa (12 percent) and Pennsylvania (9.99 percent). Iowa, however, grants a deduction for federal taxes paid, so the effective rate can be lower. Minnesota’s corporate income tax rate is considerably higher than most of its peer states, including Illinois (7.75 percent), Indiana (6.25 percent), and Wisconsin (7.90 percent). South Dakota and Texas do not have corporate income taxes.

Note: Indiana’s corporate income tax decreased from 6.50 percent to 6.25 percent as of July 1, 2016.
 Source: Tax Foundation, “State Corporate Income Tax Rates and Brackets for 2016.”

Minnesota's High Corporate Income Tax Rate over Time

Minnesota's Top Corporate Income Tax Rate (1933-2016)

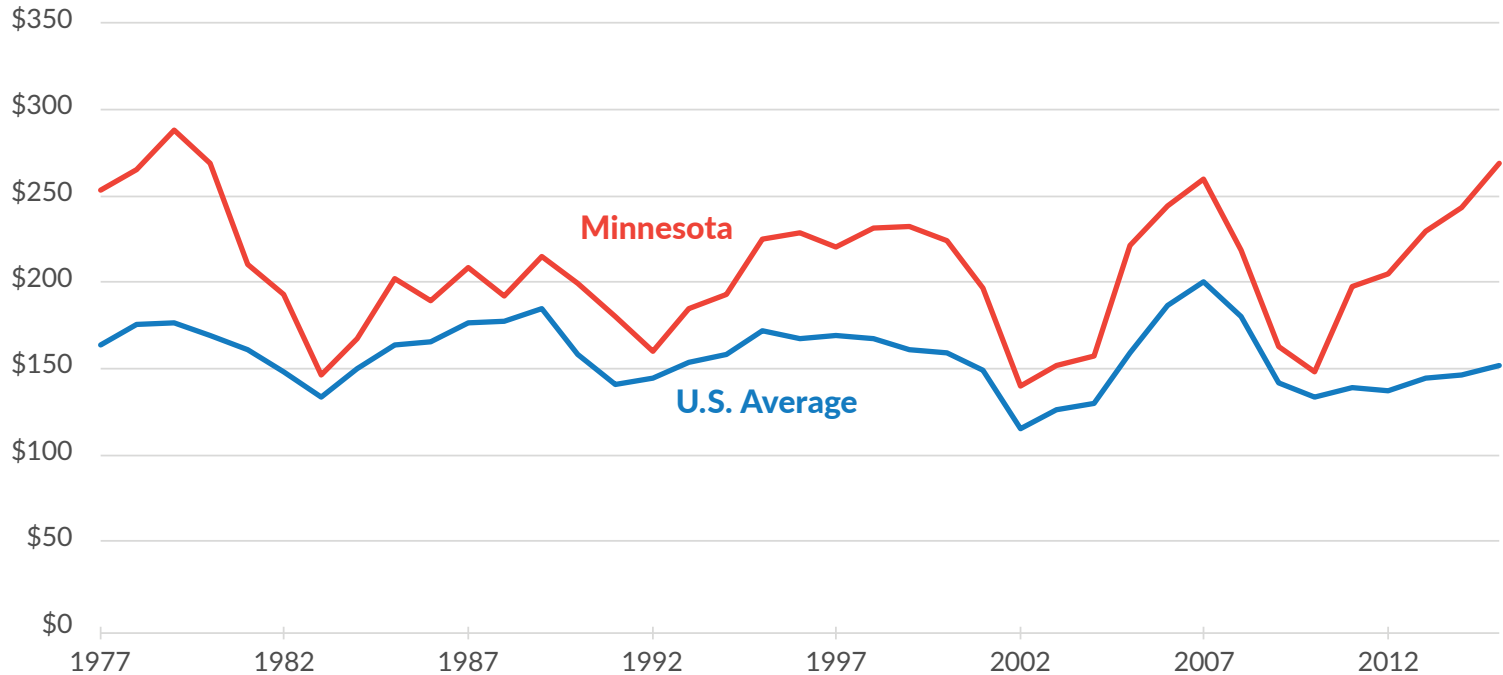


For much of its history, Minnesota's corporate tax rate has been high, remaining above 8 percent since the late 1960s. The rate peaked at 12 percent from 1970-1986, but has remained steady at 9.8 percent since 1990.

Note: This chart includes the base tax rate only. Minnesota occasionally imposed a surtax on top of the base rate, which is not reflected in this chart.
Source: Minnesota Department of Revenue, "Minnesota Tax Rates Since 1933."

Corporate Income Tax Collections Are Higher Than the National Average

Total State Corporate Income Tax Collections, Minnesota and U.S. Average (1977-2015, in 2015 dollars)



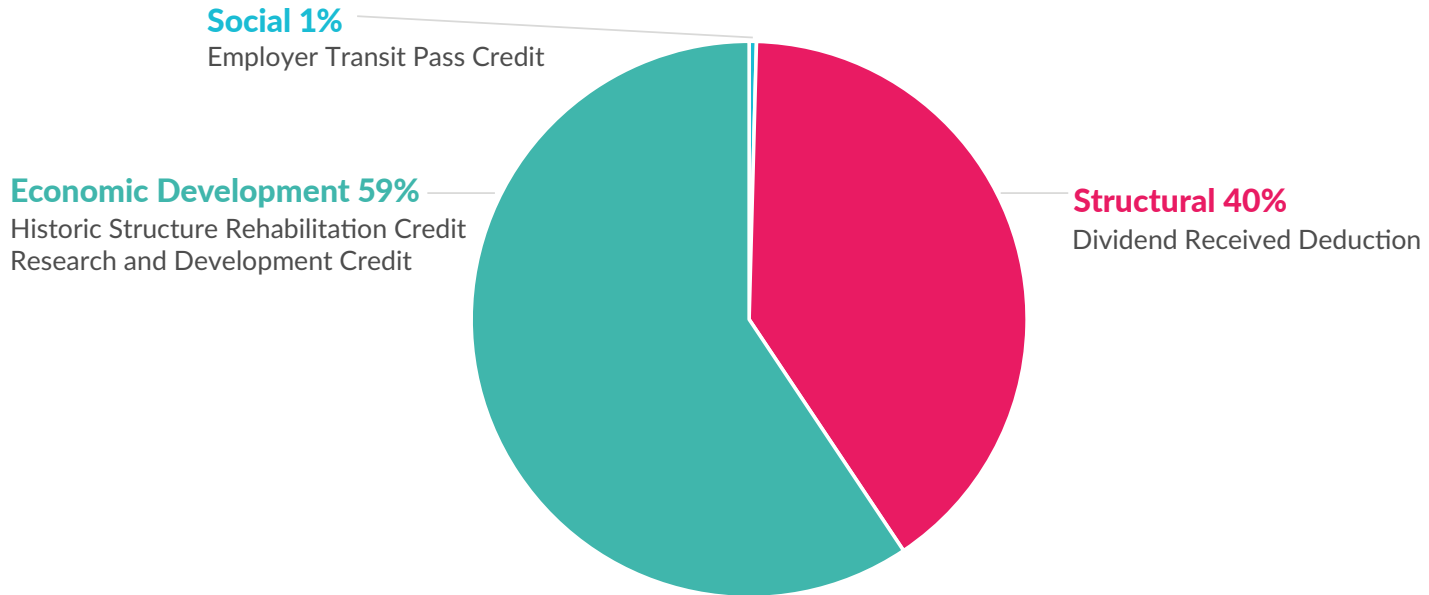
Minnesota corporate income tax collections per person are higher than the U.S. average by more than \$100. Minnesota collects \$268.99 per capita, while the national average is \$151.38, largely due to Minnesota's high corporate income tax rate. Some Minnesotans celebrate that Minnesota's corporate income tax collections are high, but those taxes are passed forward to consumers, workers, and shareholders, meaning that everyday Minnesotans—not corporations—actually pay the tax.

Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year.

Source: Census Bureau, *State and Local Government Finances*; Census Bureau, *American Community Survey*; Bureau of Labor Statistics, *Consumer Price Indexes*.

Minnesota Has a Modest Amount of Corporate Tax Expenditures

Corporate Income Tax Expenditures, by Amount and Percent of Total (FY 2016)

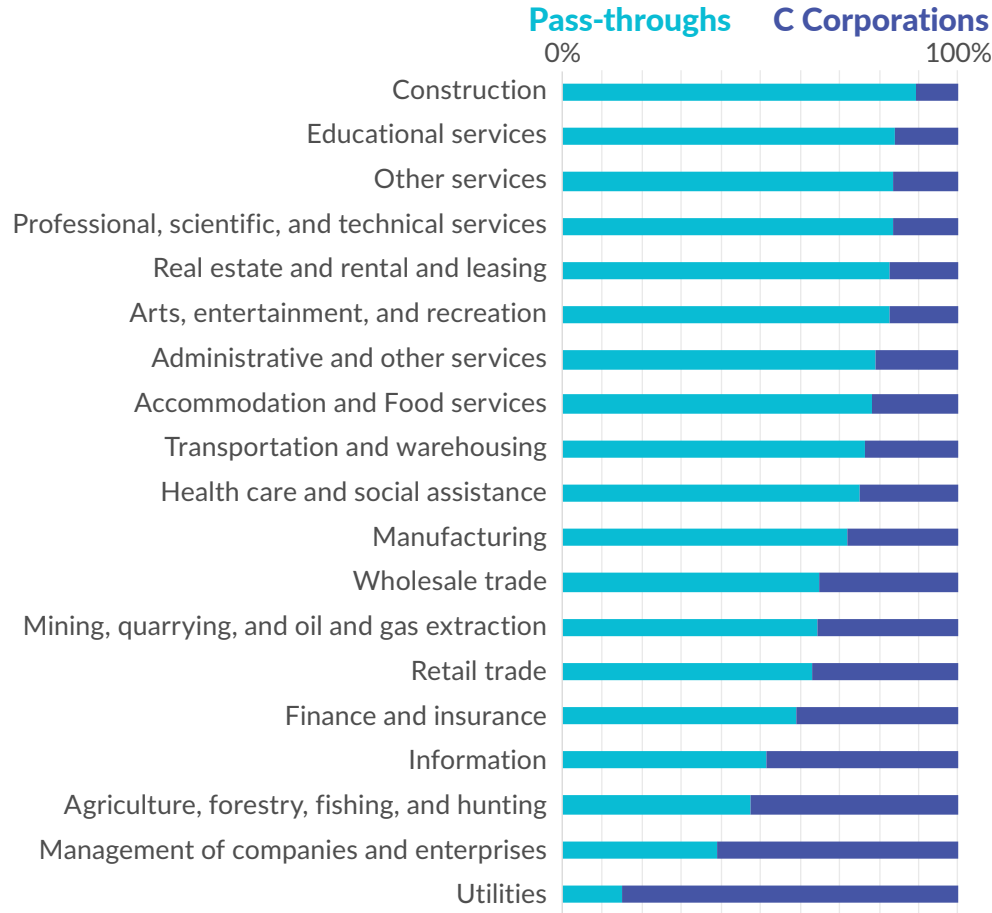


A tax expenditure is an item that has been specifically exempted from taxation via a subtraction, exclusion, deduction, credit, or some other means. Corporate income tax expenditures in Minnesota total approximately \$189.3 million in 2016. The largest expenditure is the Dividend Received deduction. In specific instances, the federal government rightly allows for a 100 percent deduction for dividends received, but Minnesota somewhat limits the deduction. The deduction totals \$76.1 million.

Note: The listed expenditures are selected from each category's full list.
Source: Minnesota Revenue Tax Research Division, *Tax Expenditure Budget* (Fiscal Years 2016–2019).

Businesses Pay Individual Income Taxes Too

Percent of Employer Businesses that are Pass-Through Entities (2014)



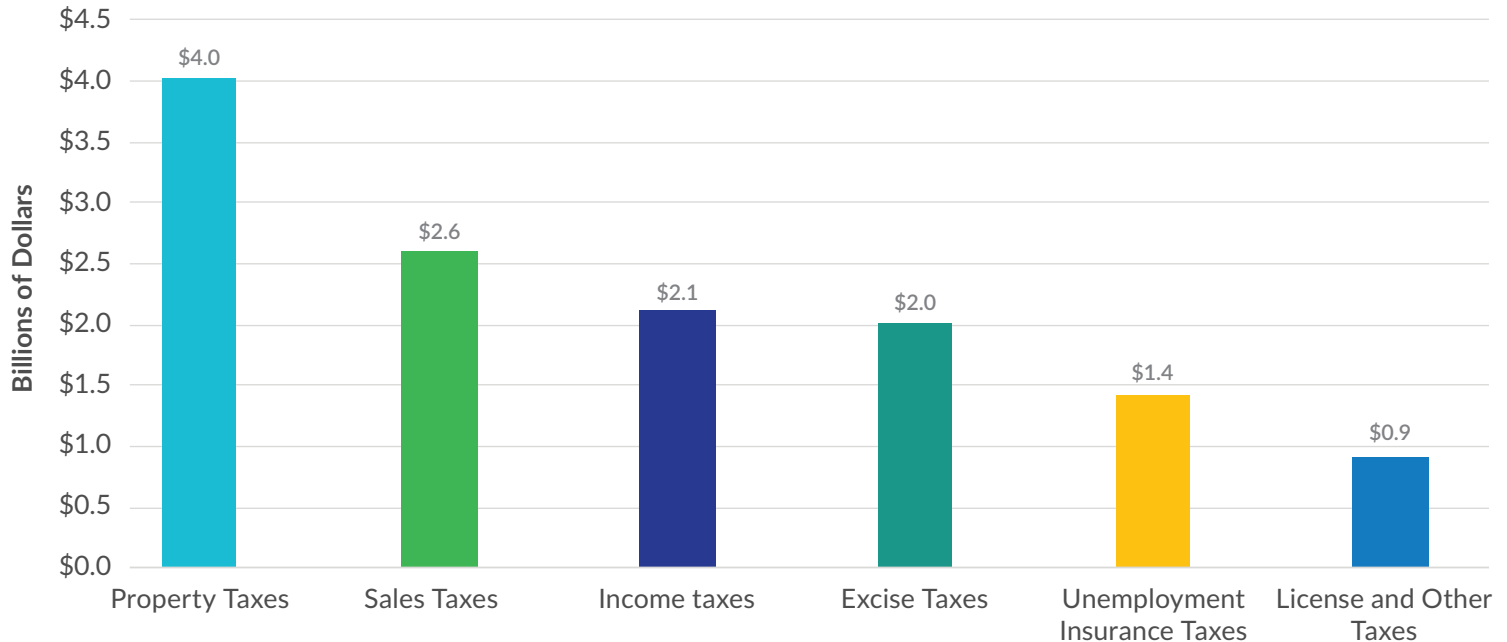
Firms that pay individual income taxes rather than corporate income taxes are known as “pass-through” or “flow-through” entities because business income “flows through” to the owner’s individual income tax return. Sole proprietorships, partnerships, and S corporations are all types of pass-throughs. Pass-through businesses make up 75 percent of all employers in Minnesota. However, while the vast majority of employers are pass-throughs, they represent a small share of total employment. Most employees work at traditional corporations (known as C corporations). In 2014, the industry with the largest percentage of pass-through businesses was construction, and the industry with the largest percentage of traditional C corporations was utilities.

Note: This graph does not include government, nonprofit, or other noncorporate legal forms of organizations. The pass-through category includes S corporations, individual proprietorships, and partnerships.

Source: Census Bureau, *County Business Patterns*.

Minnesota Businesses Pay More than Just Corporate Income Taxes

Minnesota's Total State and Local Business Tax Liability by Tax Type (FY 2014)

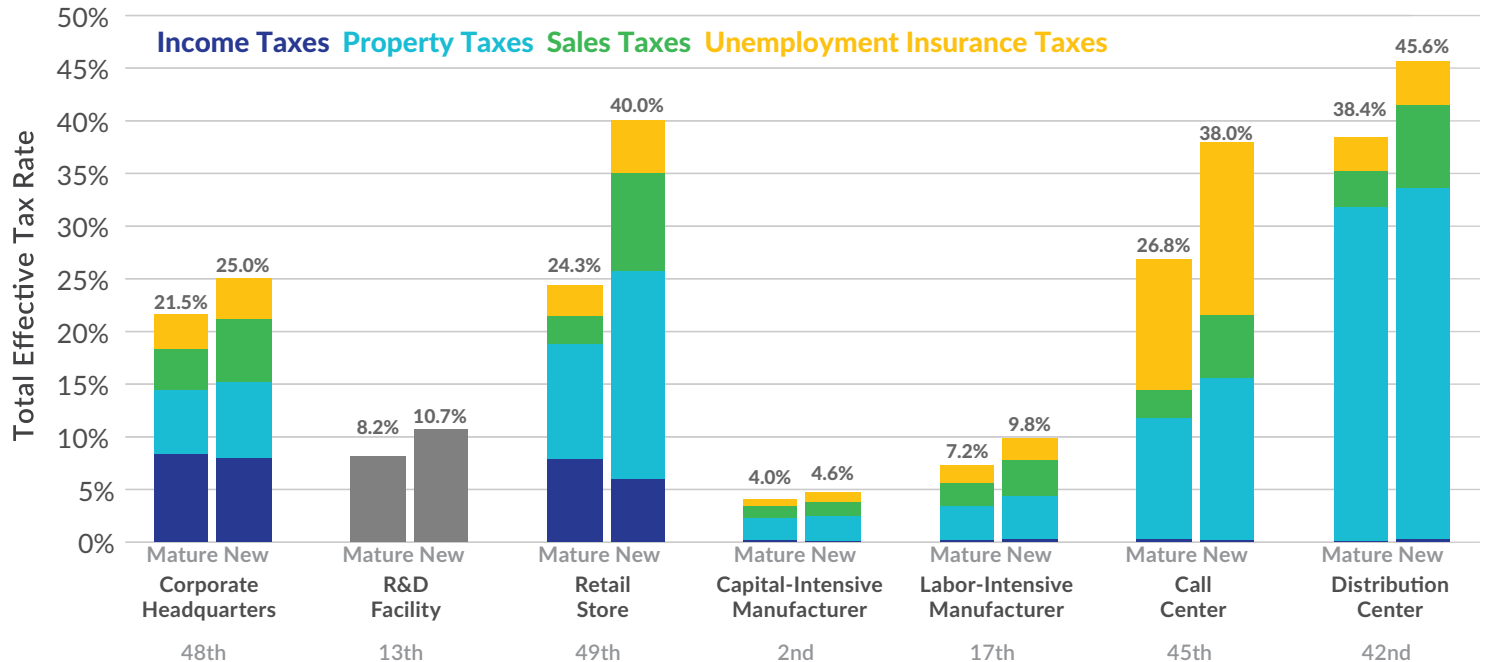


A common misconception is that the corporate income tax is the only tax paid by businesses. However, businesses pay a number of other taxes, including property taxes on real estate, sales taxes on the goods they use, and individual income taxes on business income (if they're pass-through entities that file through the individual tax code rather than the corporate income tax code). In fiscal year 2014, Minnesota businesses paid a total of \$13 billion in taxes, with the largest portion going to property taxes (\$4 billion).

Source: Council on State Taxation and Ernst & Young LLP, *Total state and local business taxes* (FY 2014).

Effective Rates Vary by Industry

Total Effective Tax Rates for Select Minnesota Business Types, New and Mature Firms (2015)



The Tax Foundation's *Location Matters* calculates the tax bills for seven firms in different industries in every state, once as a new firm and once as a long-standing, or "mature," firm. Under the Minnesota tax code, effective tax rates vary widely by industry. Minnesota's mature capital-intensive manufacturers do best in the state, ranking second in the nation. Other types of businesses, like corporate headquarters and call centers, do poorly, ranking 48th and 45th in the country respectively.

Note: Gray bars indicate that tax type breakdowns are unavailable due to negative effective tax rates for one or more tax types. The rank listed under each category on the graph represents Minnesota's rank nationally in that category for mature firms.

Source: Tax Foundation, *Location Matters: The State Tax Costs of Doing Business* (2015).

CHAPTER 5

Sales Taxes

Minnesota's sales tax consists of two parts. The first is the state rate of 6.875 percent, which is uncompetitive among Minnesota's peers. The rate has increased from its original rate of 3 percent in 1967. The second is the local rate, which includes rates charged by both cities and counties in the state. Minnesota's average combined state and local rate is 17th highest in the country at 7.31 percent.

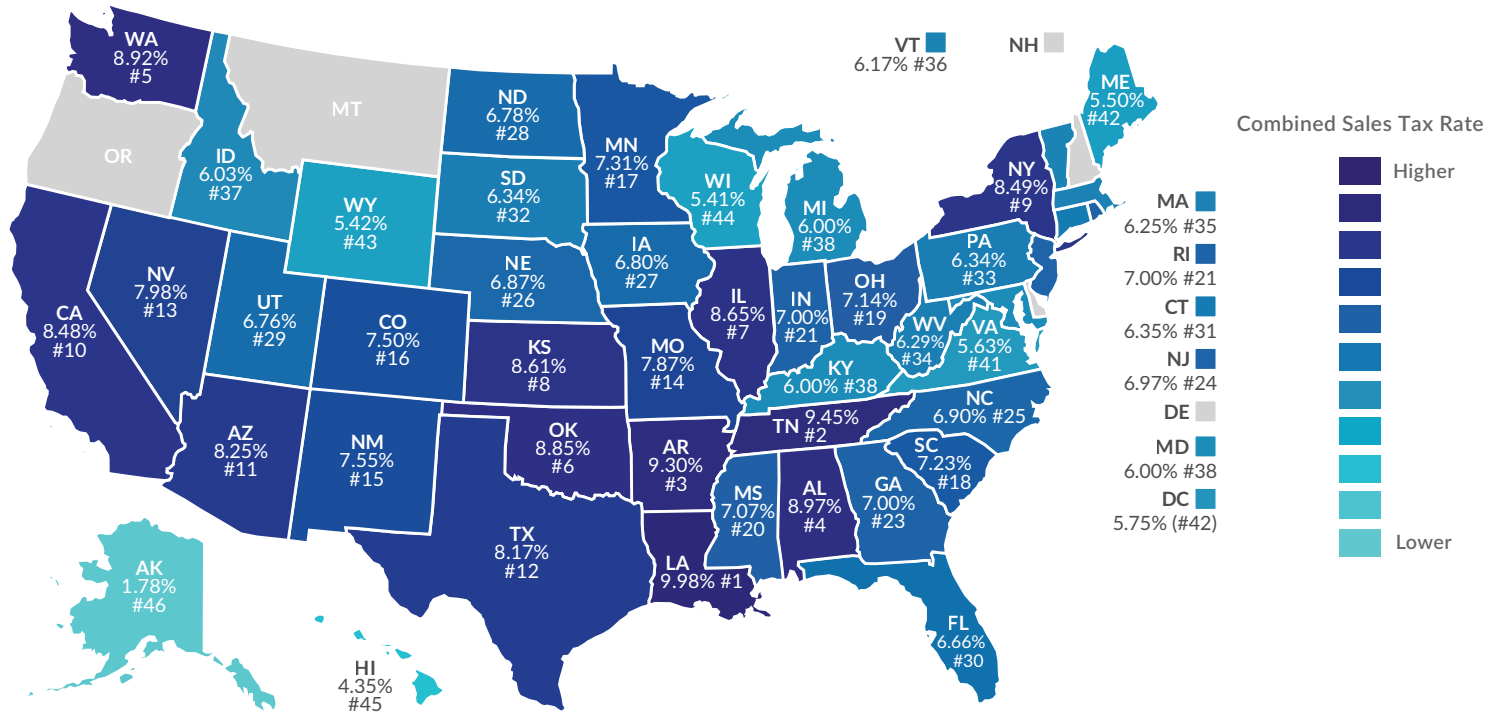
States tend to levy sales taxes on goods, even though the service sector now makes up a much larger share of the economy than when sales tax statutes were written in 1967. Over time, the decreasing tax base has contributed to the stagnation of sales tax collections in Minnesota even as the rate has increased.



The Minneapolis Queen on the Mississippi

Minnesota's Combined State and Local Sales Tax is Higher than Many States

Combined State and Average Local Sales Tax Rates (as of July 1, 2016)



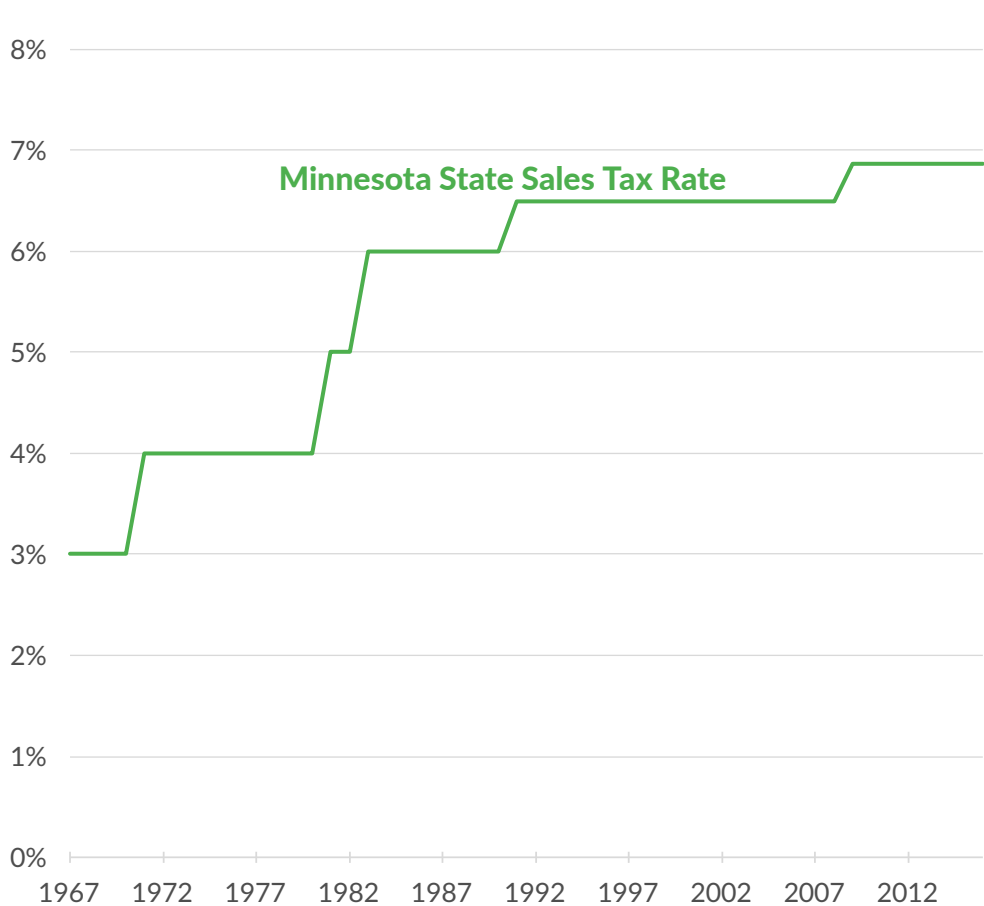
Minnesota's combined state-local sales tax rate is higher than in many other states. It includes a 6.875 percent state rate and an average local rate of 0.43 percent. The combined rate ranks as the 17th highest rate in the country, but the state-only rate is the 7th highest. The high state rate leads to Minnesota's higher-than-average sales tax rate.

It is higher than neighbors Iowa (6.80 percent), South Dakota (6.34 percent), and Wisconsin (5.41 percent).

Note: South Dakota's sales tax is broader than most states by including a number of services.
Source: Tax Foundation, "State and Local Sales Tax Rates, Midyear 2016."

Minnesota's Sales Tax Rate Continues to Climb

Minnesota State Sales Tax Rate (1967-2016)

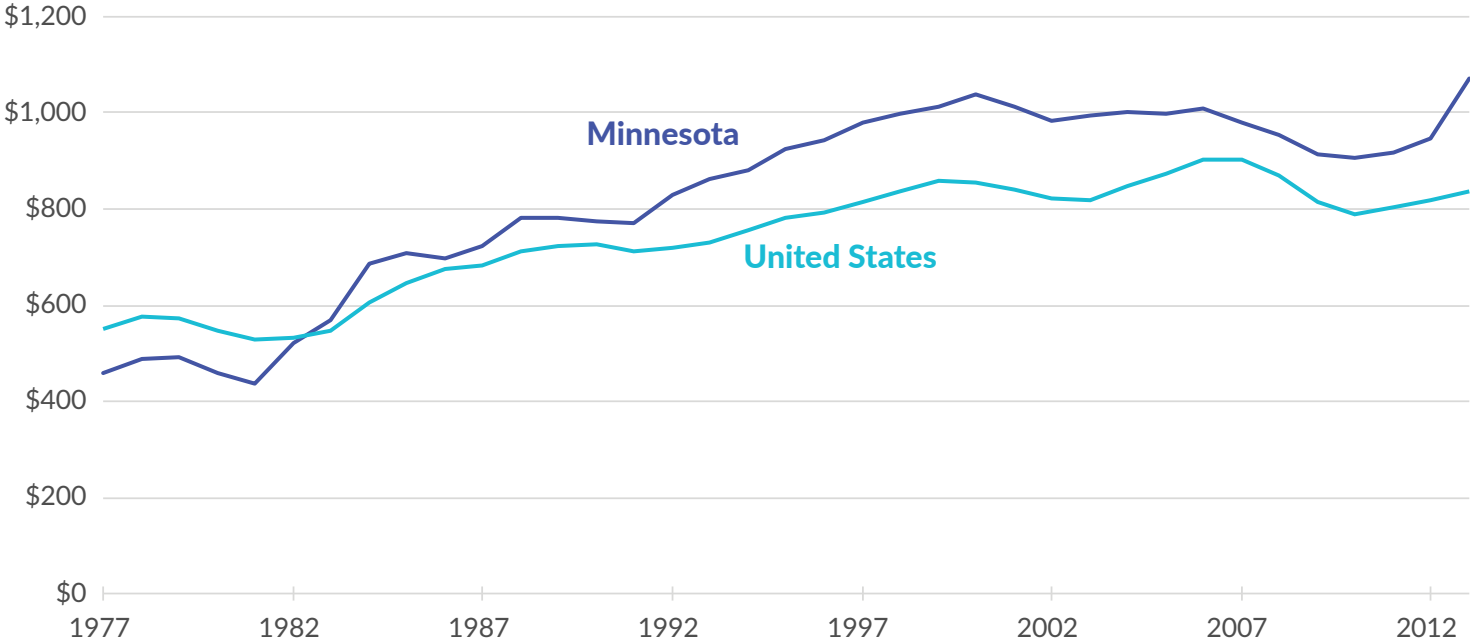


Minnesota passed its first state-level sales tax in 1967, setting it at 3 percent. It increased quickly, reaching 6.0 percent in 1983, and reached 6.875 percent in 2009. The rate has increased five times in the last 40 years. The state rate is now the 7th highest in the country.

Note: These rates do not include local sales tax rates.
Source: Minnesota House Research, "Short Subjects: Minnesota Sales Tax Rate."

Sales Tax Collections per Capita Grew Quickly in Minnesota

State Sales Tax Collections per Capita, Minnesota and U.S. (1977-2013, in 2015 Dollars)



Sales tax collections per capita in Minnesota have grown since the late 1970s. Since 1977, per capita collections have increased 134 percent. The rate of increase far exceeds that of U.S. states as a whole. Nationally, collections have increased 52 percent during the same period. However, the growth of sales tax collections has slowed in recent years. Sales tax collections per capita in Minnesota have only grown 3 percent since 2000.

Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year.
Source: Census Bureau, *State and Local Government Finances*; Census Bureau, *American Community Survey*; Bureau of Labor Statistics, *Consumer Price Indexes*.

All Sales Tax Expenditures Are Not Equal

Minnesota Sales and Use Tax Expenditures, by Type (FY 2016)

Structural 5%

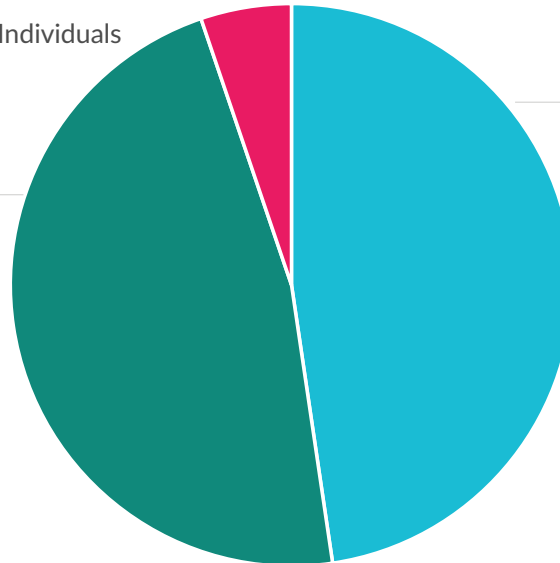
Local Governments Exemption
Isolated or Occasional Sales
De Minimis Use Tax Exemption for Individuals

Social Policy 44%

Food Products
Motor Fuels
Drugs and Medicines

Business Inputs 45%

Business Services
Capital Equipment
Farm Machinery



When states quantify tax expenditures, they often mistakenly lump structural provisions with other carveouts when the two should be distinct. Structural provisions, which includes business inputs, are tools used to ensure the sales tax is correctly structured, and 50 percent of expenditures fall into this category in Minnesota. Other carveouts are often enacted for political purposes, such as exempting food and prescription drugs from the sales tax. These total 44 percent of sales tax expenditures in Minnesota.

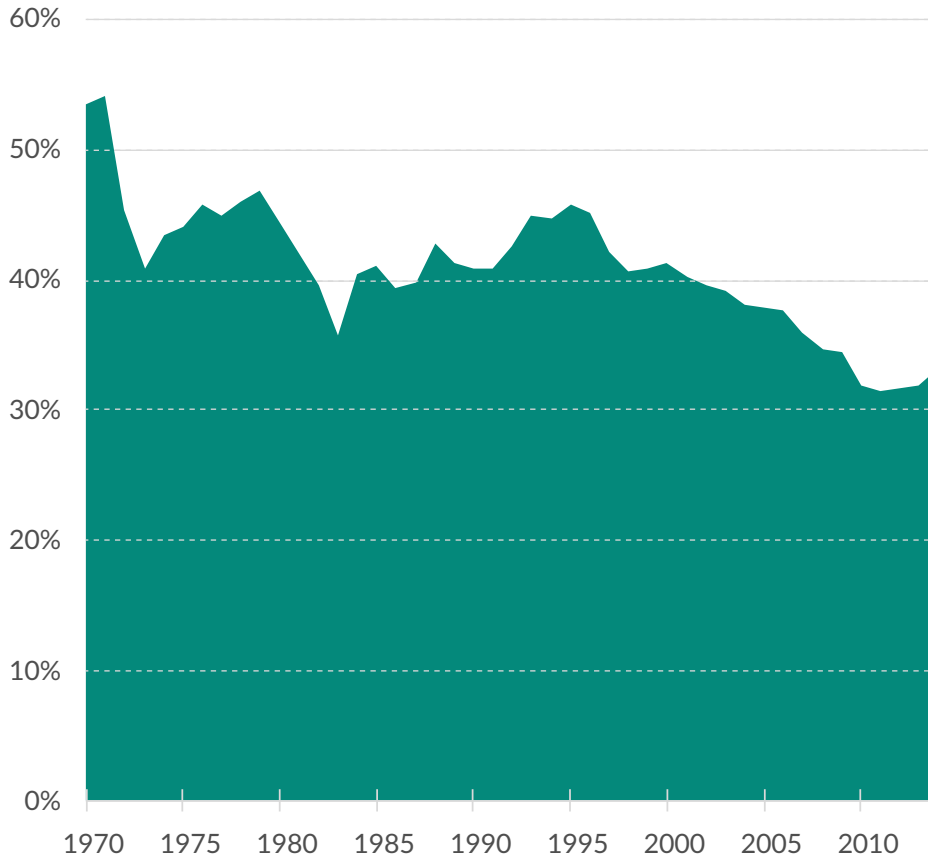
Business inputs should not be taxed in the sales tax, otherwise tax pyramiding occurs. This results in higher prices for consumers.

Notes: This expenditures list does not include personal services, meaning a large portion of the economy is currently left untaxed. The listed expenditures are selected from each category's full list. Percentages may not add to 100 due to rounding.

Source: Minnesota Revenue Tax Research Division, *Tax Expenditure Budget* (Fiscal Years 2016–2019).

Less of Minnesota's Economy is Being Taxed by the Sales Tax

Minnesota Sales Tax Breadth (1970-2014)



An ideal sales tax is one that is levied on all final consumer purchases. By taxing a large number of transactions, the rate can be kept low and still raise sufficient revenue.

When the first American sales tax was created in Mississippi in 1930, it was levied on tangible goods, which was a large part of the overall economy at the time. Most other states followed suit with this model, but the national economy has become more service-based since then. Even though Minnesota did not create its sales tax until 1967, it still copied the Mississippi approach. Now, Minnesota's sales tax only taxes 33 percent of the state's economy. As a result, the sales tax is not nearly as productive as it could be, leading to a higher rate than otherwise necessary.

By failing to tax consumer services, the sales tax inherently favors the services sector over the goods sector.

Note: Sales tax breadth is defined as the ratio of the implicit sales tax base to state personal income.

Source: Professor John Mikesell (Indiana University).

CHAPTER 6

Property Taxes

Property taxes are a major part of Minnesota's revenue toolkit, representing the largest share of total state and local tax collections. For most Minnesotans, this is a local-level tax, but the state also charges a statewide property tax on commercial and industrial property and seasonal recreation properties (cabins).

Minnesota's property tax collections per person, which includes taxes paid by both businesses and individuals, are 15th highest in the nation. When only residential property taxes are considered, Minnesota's effective rate ranks 19th highest nationally.

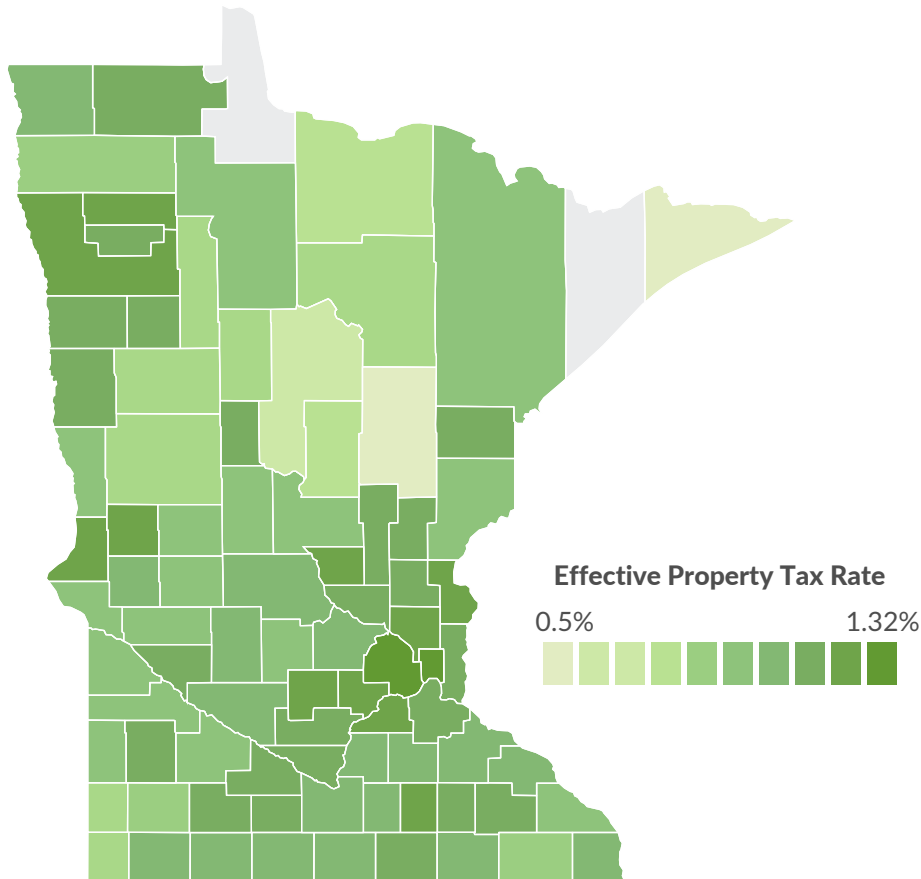
When we discuss property taxes, we're often describing many layers of taxation at the local level—taxes levied by towns, cities, counties, school districts, and even specific-purpose districts such as those dedicated to hospitals. Because of this, effective property tax rates vary widely by county but also exhibit much intra-county variation, as well.



Gooseberry Falls, Silver Creek Township

Residential Effective Property Tax Rates Vary Widely among Counties

Effective Property Tax Rates (5-Year Estimates, 2010–2014)



On average, the residential effective property tax rate in Minnesota was 1.14 percent, though county-specific values vary. The highest effective property tax rate occurred in Ramsey County at 1.32 percent, followed closely by 1.29 percent in Hennepin County. The lowest was in Cook County at 0.5 percent.

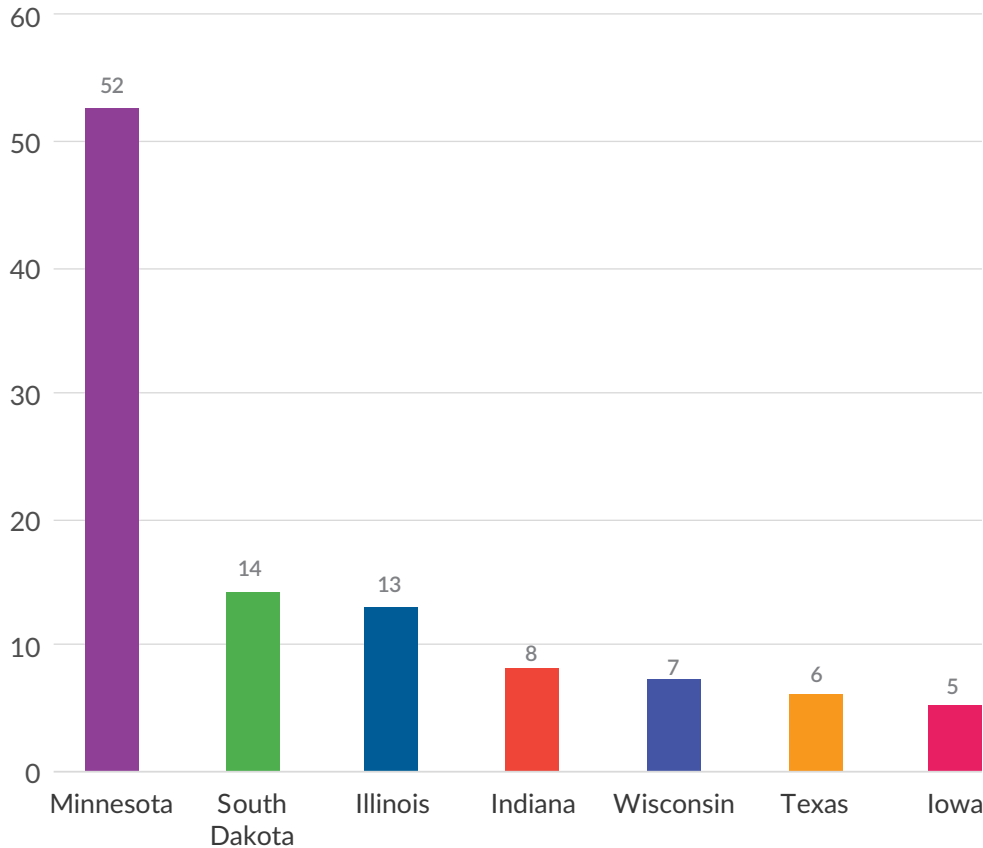
Within a county, individual homeowners' effective rates may differ from these county averages, largely due to the impact of state property tax refunds.

Note: Data for Lake County and Lake of the Woods County was unavailable.

Source: Census Bureau, *American Community Survey*.

Minnesota's Complicated Classification System

Number of Classifications within a State Property Tax



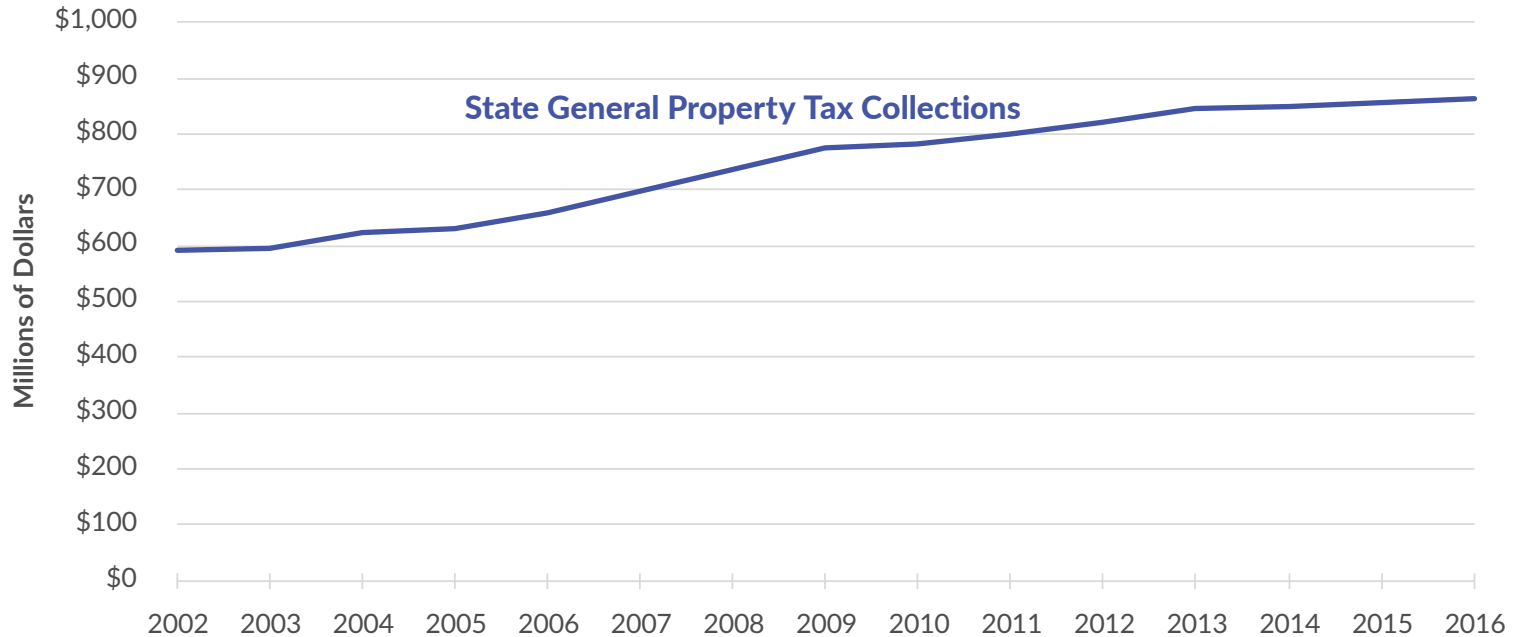
States generally vary their property tax rates by the type of property, such as residential, industrial, or agricultural. On average, states have six classifications for their property tax structure. Minnesota is an extreme outlier with 52 property tax classifications, resulting in immense complexity. South Dakota has the second most nationally with 14.

Note: Illinois's classifications are all within its Cook County. The remainder of the state uses only one property class.

Source: Minnesota Department of Revenue.

Minnesota's Rapidly Growing State Property Tax

State General Property Tax Collections (2002-2016)



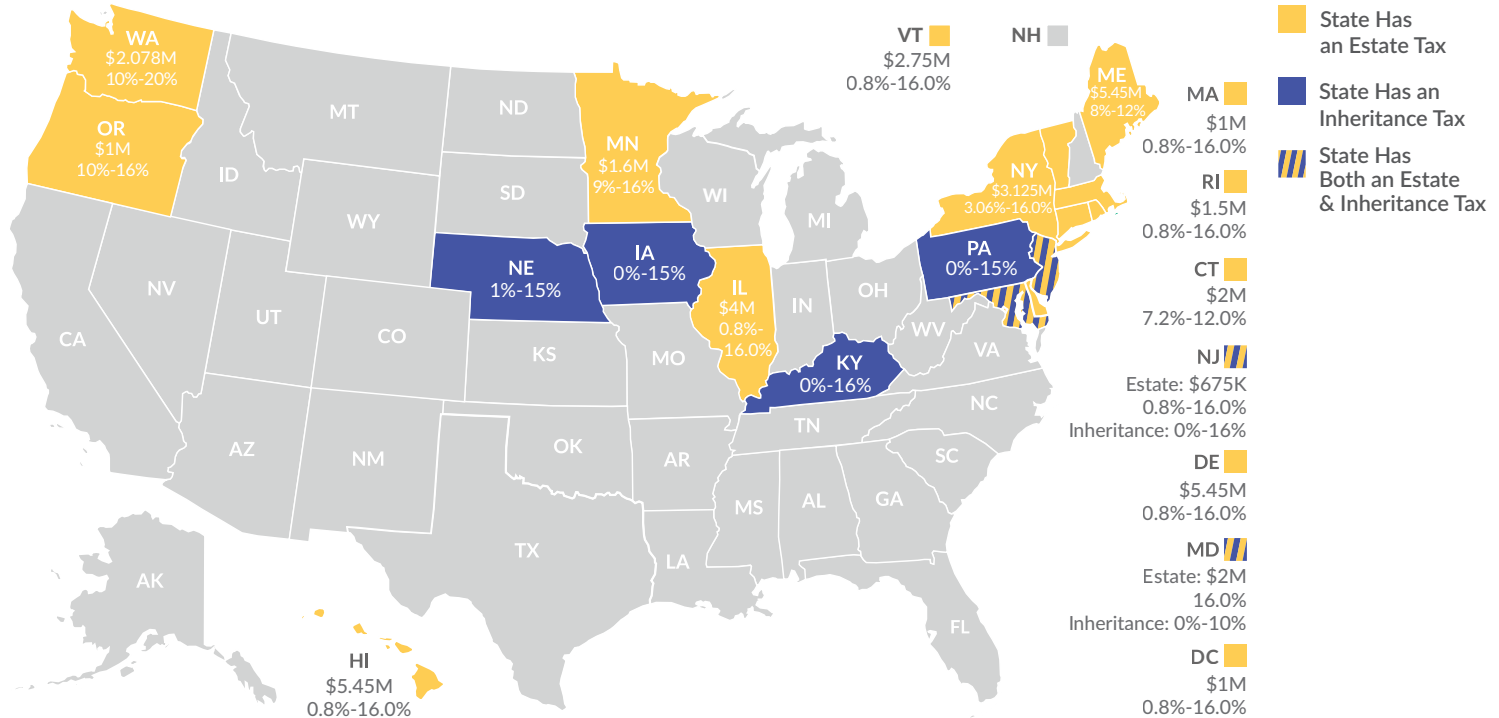
Minnesota charges a statewide property tax on commercial and industrial property, along with cabins. Commercial and industrial properties pay 95 percent of the tax, while cabins pay the remaining 5 percent. The tax mandates an annual increase in the amount of taxes collected and has grown from \$592 million in 2002 to \$863 million in 2016, a 46 percent increase. Revenues are growing more quickly than we would otherwise expect, as it's growing faster than the Consumer Price Index, the most commonly used measure of inflation.

This tax dramatically increases the effective tax rates paid by businesses in the state. The effective tax rate paid for a commercial property of \$1 million in Minneapolis is 3.25 percent, compared to 1.422 percent for a median-priced home in Minneapolis.

Source: Minnesota Department of Revenue, Property Tax Statistics; The Lincoln Institute for Land Policy and Minnesota Center for Fiscal Excellence, *50 State Property Tax Comparison Study*.

Minnesota is One of the Few States with an Estate Tax

State Estate and Inheritance Tax Rates and Exemptions, 2016



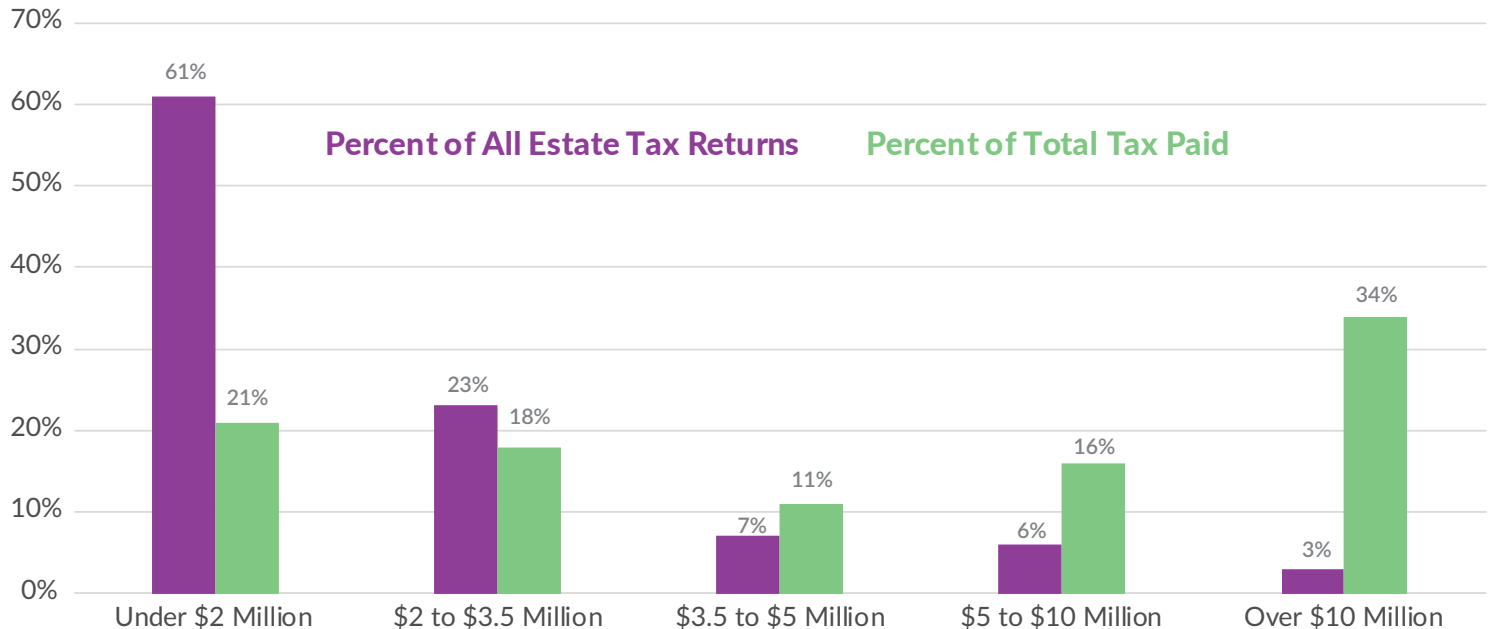
Few states still have an estate tax. Minnesota is one of only 18 states and the District of Columbia that has an estate or inheritance tax. Rates vary from 9 to 16 percent in Minnesota.

Estate taxes tend to burden those with lower levels of wealth, as they are less likely to engage in avoidance techniques. Those with larger estates have a larger incentive to spend resources on estate planning strategies. Family farms and small businesses are particularly hurt by estate taxes, as they tend to have limited liquid capital, limiting estate planning options.

Source: Family Business Coalition; state statutes.

Estate Tax Hits Many that Federal Tax Doesn't

Percent of Estate Tax Returns and Revenues by Size of Estate (FY 2012)



The federal estate tax exempts the first \$5.45 million of an individual's estate in 2016. Minnesota's exemption is much lower, \$1.6 million, meaning many Minnesota families and businesses must pay the state estate tax, even though they are exempt from the federal. In 2012, approximately 90 percent of estates that paid the estate tax were not taxed under the federal estate tax. These 90 percent of estates generated 50 percent of the estate tax revenue in 2012.

Source: Minnesota Department of Revenue, *Estate Tax Report*.

CHAPTER 7

Other Taxes

The previous chapters have covered individual income taxes, corporate income taxes, sales taxes, and property taxes, but Minnesota assesses excise taxes too, which are levies on specific products.

We highlight three types of excise taxes in this chapter: gasoline excise taxes, “sin” taxes on cigarettes and alcohol, and wireless phone services taxes.

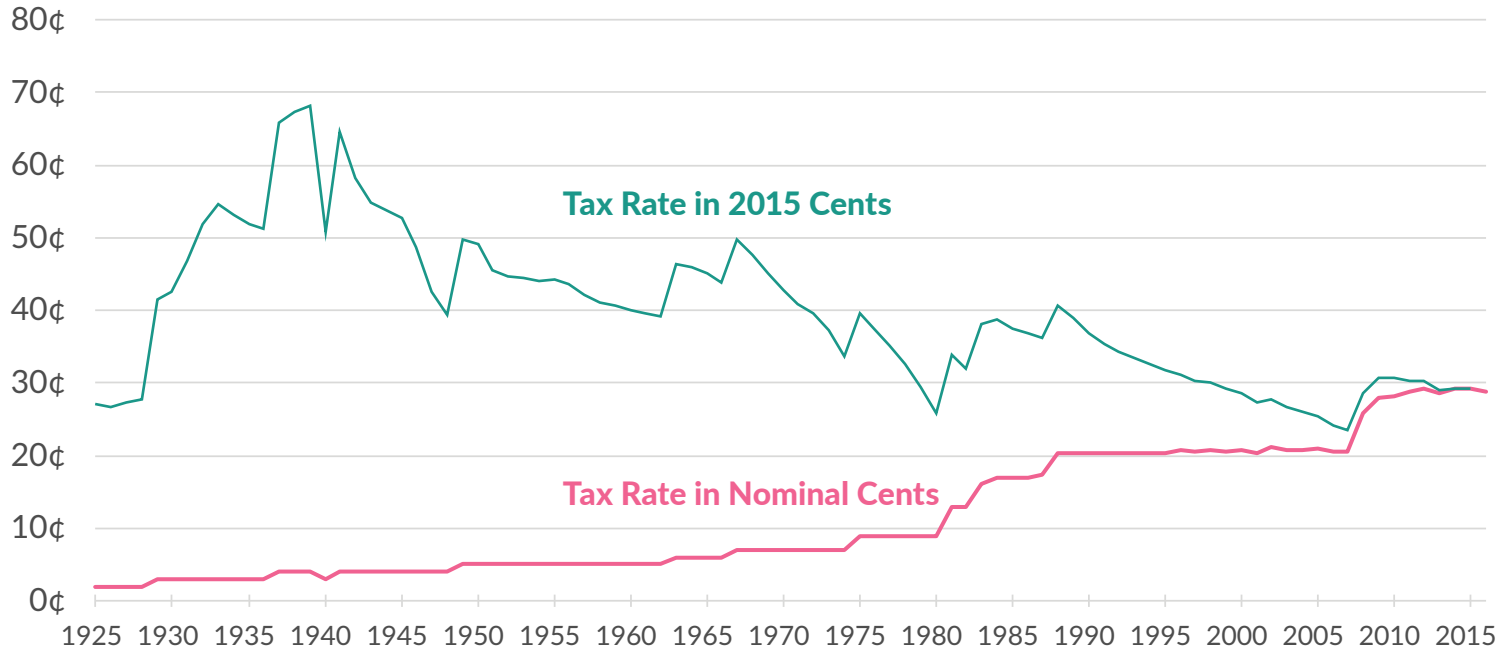
Excise tax collections are higher in Minnesota than in many other states. In fiscal year 2013, per capita state and local excise tax collections were \$817, or 4th highest nationally. Only Vermont, Nevada, and Hawaii collect more per capita from excise taxes.



Minneapolis at Night

The Real Value of Minnesota's Gas Tax Has Fallen over Time

Minnesota Gasoline Tax Rate, Nominal and Real (1925-2015)



Minnesota's first gas tax was passed in 1925 at 2 cents per gallon and has increased periodically, reaching 29.3 cents per gallon in 2015. The green line shows each year's tax rate expressed in today's cents. For instance, the 7 cents per gallon gas tax in 1970 is equivalent to a 42.76 cents per gallon gas tax today.

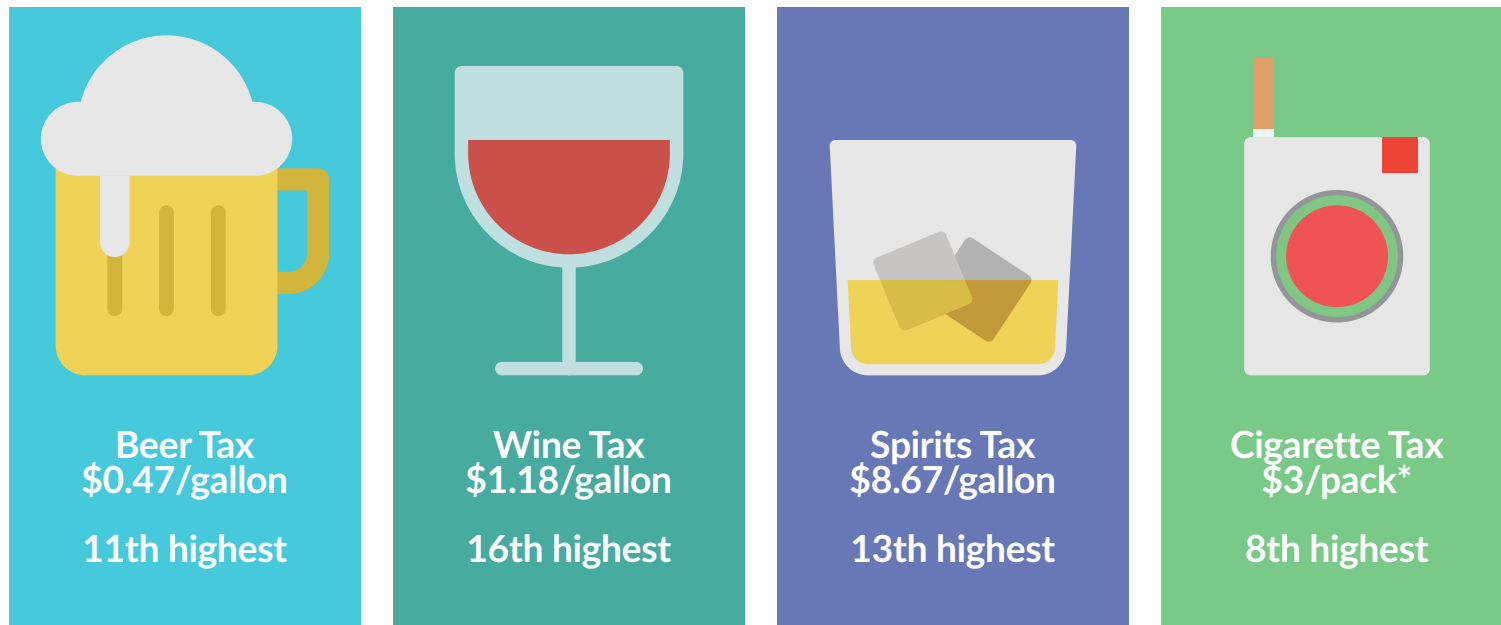
Due to inflation, the value of past gas tax increases eroded over time, with a series of phased-in gas tax changes starting in 2008, in part mitigating the backslide.

Note: Amounts of inflation were adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2015 base year. Rates include the state's gasoline excise tax, inspection fee, and cleanup fee.

Source: Minnesota Department of Transportation, "Motor Fuel Tax Rates per Gallon"; Bureau of Labor Statistics, *Consumer Price Indexes*; state tax forms and statutes.

Minnesota Excise Taxes on Cigarettes and Alcohol

State Excise Tax Rates on Cigarettes, Spirits, Wine, and Beer (as of January 1, 2016)



Taxes on cigarettes and different types of alcohol are often referred to as “sin taxes.” While excise taxes on the sales of these specific types of goods are sometimes promoted as a means of offsetting government costs, such as health issues created by cigarette use, sin taxes should not be used as a means to raise general revenue. The revenues are not sustainable over the long run, and these taxes tend to be regressive.

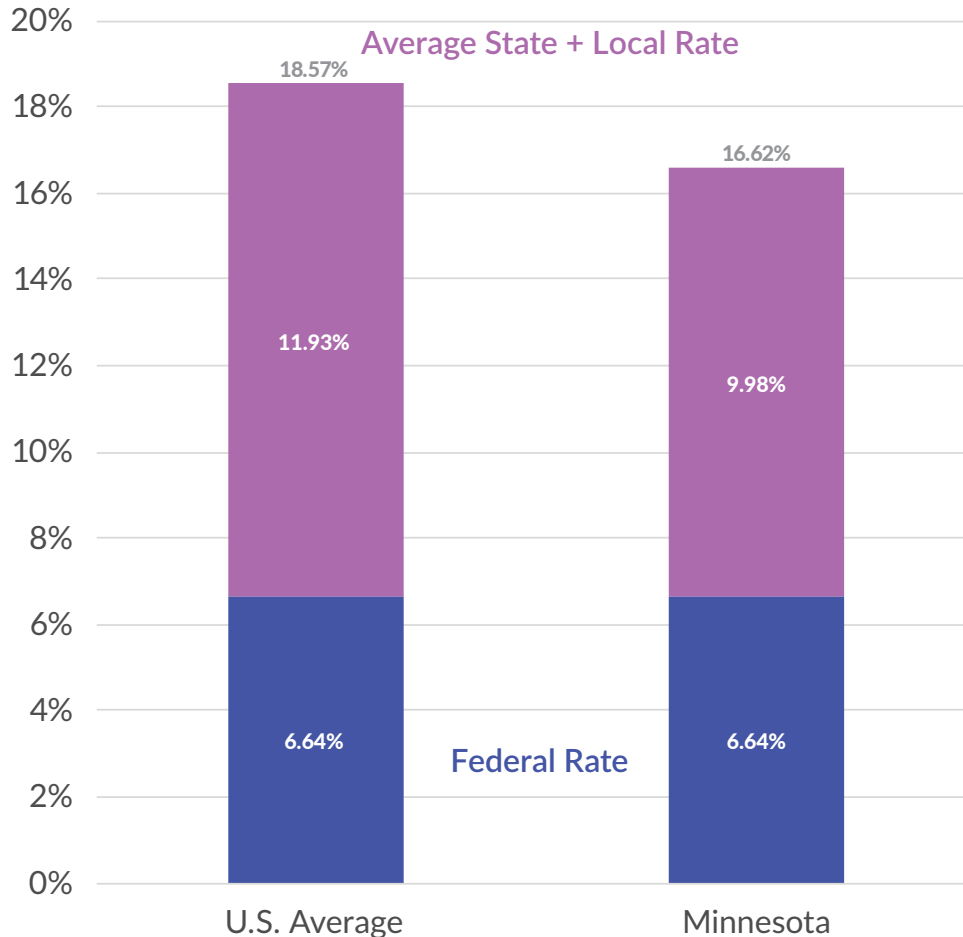
Minnesota’s excise taxes are high on alcohol and cigarettes, ranging between 8th and 16th highest in the country.

Note: * The cigarette tax assumes 20 cigarettes in a pack.

Source: Tax Foundation, *Facts & Figures 2016: How Does Your State Compare?*

Minnesota Taxpayers Face Lower Than Average Wireless Taxes

Charges on Wireless Service, Minnesota and the U.S. Average (as of July 2016)



Wireless taxes in Minnesota are the 28th highest in the country, one of the few taxes where Minnesota is below average. When the various federal, state, and local taxes are combined, Minnesota residents pay an effective tax rate of 16.62 percent, lower than the national average of 18.57 percent.

However, these rates are still much higher than the general sales tax in Minnesota. The average state and local sales tax rate is 7.31 percent, or less than half of the effective wireless tax rate.

Source: Tax Foundation, "Wireless Tax Burdens Rise for the Second Straight Year in 2016."

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About the Minnesota Business Partnership

The Minnesota Business Partnership is comprised of more than 120 CEOs and senior executives from Minnesota's largest employers. These men and women represent a broad range of business interests, political perspectives, and personal philosophies, but they are united by a common mission: Maintain a high quality of life for all Minnesotans by ensuring that the state's economy remains strong and globally competitive.

Taxes are complicated. Each state's tax code is a multifaceted system with many moving parts, and Minnesota is no exception. This chart book aims to help readers understand Minnesota's overall economy and tax system from a broad perspective. It also provides detailed illustrations to each of Minnesota's major taxes—individual income taxes, business taxes, sales and excise taxes, and property taxes—to help make the complicated task of understanding the state's tax code a bit easier.

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