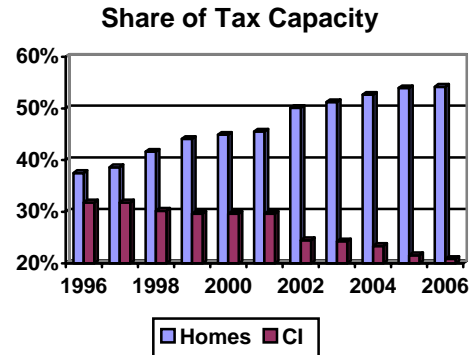


PROPERTY TAX BACKGROUND

The 2001 Legislature passed comprehensive property tax reform legislation that significantly compressed classification rates, eliminated the general education property tax levy and created a new statewide property tax that is assessed on commercial/industrial property (C/I), utility (except electric utility generating equipment), cabin and resort property.

Classification reform. The 2001 legislation completed a multiyear effort to reform Minnesota's classification system. In 1996, C/I classification rates were 3.4 percent on the first \$100,000 of value and 4.6 percent on value over \$100,000. For taxes payable in 2002 and thereafter, the class rates were 1.5 percent on the first \$150,000 and 2.0 percent on value over \$150,000.

The impact of this change is best demonstrated by the change in the share of local property tax burden (tax capacity) facing C/I and homestead property. The chart on the right shows the estimated share of the local tax burden for C/I property fell from 31.8 percent in 1996 to 21.1 percent in 2007. (For taxes payable in 2007, C/I property represents 12.3 percent of the state's taxable market value.) The share of the local tax burden on homestead property increased during this period from 37.5 percent to 53.2 percent. (For taxes payable in 2006, residential homestead property represents 59.3 percent of the taxable market value.) However, that does not mean homeowners experienced tax increases. The Legislature protected homeowners in a variety of ways, most recently by eliminating the general education levy and establishing a market value credit. Between 1996 and the 2007 projection, the statewide effective tax rate for homestead property is expected to drop from 1.69 percent to 1.05 percent while the effective tax rate for C/I property is expected to drop from 5.90 percent to 3.13 percent.



The classification system not only distributes the local property tax burden among property types, but also could affect the growth of the property tax levy and land-use decisions. The Minnesota Taxpayers Association compared the growth in the property tax levy to the share of homeowner property taxes. The analysis shows that the lower the share of homeowners' property taxes, the higher the percent increase in the property tax levy. The analysis did not control for other factors but is consistent with the theory that classification reform (i.e. making the share of property tax closer to the share of the tax base) results in greater accountability and slows levy growth.

Some tax professionals also believe that the classification system could affect land-use decisions. The classification system makes some types of property (commercial/industrial and high-valued homes) more valuable for tax purposes than others. Communities that want to expand their tax base might focus on these property types for development rather than on homes that would be more affordable.

Statewide property tax. To achieve the immediate relief and the classification reform, the Legislature created a new statewide property tax. Commercial/industrial, utility (except for electric utility generating equipment), cabin and resort property pay the tax. This tax is set in statute at a specific dollar amount (\$592 million in 2002) and is indexed to the rate of inflation as measured by the implicit price deflator for government purchases. The growth of the statewide property tax was initially dedicated to K-12 and higher education spending; however, the dedication was eliminated during the 2003 session.

There are risks associated with the statewide property tax. First, since the growth of the tax was initially dedicated to education spending, the tax might be seen as a future source for education funding increases. Second, the base of the tax or the inflationary adjustment could increase. Either of these alternatives would increase the statewide property tax and eliminate some, if not all, of the relief C/I property received from the 2001 legislation. In 2004 and 2005, the Legislature proposed fixing the rate of the statewide property tax at its 2002 level. This would have increased C/I and utility taxes by \$197

million over the FY 2006-2007 biennium. In 2006, the Legislature proposed fixing the rate of the statewide property tax at its 2004 level which would have increased C/I and utility property taxes by \$44 million in FY 2007, \$111 million in FY 2008 and \$173 million in FY 2009.

In 2005, the Legislature also set the share of the statewide property tax paid by C/I and utility property to 95 percent – the level it was at for taxes payable in 2002. Between 2002 and 2005, the share paid by C/I and utility property had declined to about 92 percent since the growth of the C/I tax base slowed.

Industries with special taxes. Certain industries did not benefit from the 2001 property tax reform legislation to the extent that most others did because they have special taxes applied in lieu of local property taxes. The iron mining industry with its taconite production tax is an example. The taconite production tax is based on the number of tons of taconite produced each year. While the production tax also was cut during the 2001 session, it was the first actual rate reduction in the last 15 years. According to the Department of Revenue, when including the taconite production tax, the iron mining industry has the highest effective tax rate of any industry in Minnesota. Future property tax reform efforts should recognize that all industries don't benefit to the same degree and compensate for that accordingly.

Limited market value. The 2001 property tax reform legislation began a six-year phase-out of limited market value. The phase-out was extended for two additional years during the 2005 session. Limited market value caps the increase in a property's market value at a predetermined level. At present, homes, cabins and farms are protected but C/I, apartment and utility property are not. The Legislature adopted a phase-out of limited market value because it does not reduce the overall level of the property tax. It merely changes the distribution of who pays the property tax. Protected properties shift property tax burden on to unprotected ones. In addition, within a community, residential property in areas where valuations are growing more rapidly will shift tax burden on to homes that have slow growing or stagnant valuations.

A recent Department of Revenue study demonstrates the shifting property tax burdens caused by limited market value. If limited market value was eliminated for taxes payable in 2006, the report concludes that 1.1 million homes (78 percent of Minnesota homeowners) would pay \$106 million more property tax; however, 314,000 homes would pay \$86 million less property tax. Statewide, the limited market value law increased net taxes for residential homestead properties by \$17.1 million more than homeowners would have paid without the law. In fact, 2006 was the first year that residential homestead properties received a net increase in property taxes because of limited market value. Non-limited properties (i.e. apartment, commercial/industrial properties, resorts, etc.) paid \$78 million more in property taxes because of limited market value in 2006 (of the \$78 million, commercial/industrial property accounted for \$51.1 million).

State rankings. The Minnesota Taxpayers Association (MTA) conducted five 50-state property tax comparison studies – taxes payable in 1995, 1998, 2000, 2002 and 2004. The MTA also made projections for taxes payable in 2003. The table on the following page summarizes the results.

**Minnesota Taxpayers Association
50-State Property Tax Comparison Study
(National Rankings: 1 = Highest)**

Property Type	1995	1998	2000	2002	2004.	2005
\$1 Million Commercial – Urban	1 st	3 rd	5 th	9 th	14 th	14 th
\$1 million Commercial – Rural	2 nd	2 nd	3 rd	3 rd	7 th	7 th
\$1 Million Industrial – Urban	1 st	7 th	11 th	24 th	18 th	23 rd
\$1 Million Industrial – Rural	3 rd	2 nd	8 th	9 th	17 th	14 th
\$600,000 Apartment – Urban	2 nd	3 rd	7 th	23 rd	26 th	29 th
\$600,000 Apartment – Rural	1 st	1 st	1 st	13 th	29 th	28 th
\$70,000 Home – Urban	27 th	26 th	32 nd	42 nd	37 th	--
\$70,000 Home – Rural	26 th	29 th	29 th	34 th	32 nd	35 th
\$150,000 Home – Urban	14 th	18 th	23 rd	41 st	28 th	29 th
\$150,000 Home – Rural	18 th	20 th	20 th	29 th	28 th	29 th