Minnesota 2020
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Property taxes are projected to rise statewide in 2012 by $376 million dollars.
EXECUTIVE SUMMARY

Conservative-crafted fiscal policy enacted at the end of the 2011 special session cut $632 million in property tax aid and credits from Minnesota's local governments. As a result, property taxes are projected to rise statewide by $376 million dollars in 2012, making Minnesota’s tax system more regressive. At the same time, local governments are cutting more public services.

The latest round of aid cuts comes after a near decade of declining state funding in Local Government Aid and other property tax aids and credits. In a time of shrinking state funding and national economic decline, Minnesota’s local government units have shown great fiscal discipline; yet, they’ve become scapegoats for conservatives’ “no-new-taxes” policy.

In shielding the state’s richest from paying an effective tax rate more in proportion with middle-class Minnesotans, conservatives have balanced the state budget by pushing shortfalls off to local governments. Since 2002, local governments have cut services and increased property taxes.

By fiscal year 2013, it’s projected that the state will have cut nearly $3 billion in aid and credits from local governments over the decade, using constant 2011 dollars. As a result, local governments have made deep cuts in the services they provide that include reductions in certain areas of public safety. Just as an example of local cuts, Minnesota cities’ per capita spending is already more than five percent below the national average, based on a 2010 Minnesota 2020 analysis (2007 data).

In order to maintain a base level of public services, there have been increases in property taxes. From 2002 to 2010 (when FY2003-11 taxes are paid) local property taxes had risen by $1.6 billion in inflation-adjusted dollars. Conservative-crafted tax legislation passed in 2011’s special session only worsens local governments budget situation, pressuring leaders to cut more and impose even higher property taxes. This legislation includes about $260 million in direct property tax increases through the elimination of the homestead credit even if local governments do not increase or decrease their property tax levies by a single dime, according to nonpartisan House research staff.

Property taxes are regressive, meaning they fall disproportionately on those least able to pay, versus income taxes, which are based on earnings.
Statewide, 2012 property taxes are projected to increase by 4.6%, according to House research. In some areas of the state, the property tax burden will be even higher. For example, Greater Minnesota cities are projected to see a 6.3% hike, with south central Minnesota cities expecting a 7.3% increase over what they would have paid under existing tax laws—due to the homestead credit elimination and reductions to other property tax aid and credits.

Job-creators that conservatives sought to protect could see their business property taxes rise by 3.7% statewide. Greater Minnesota cities’ businesses are projected to face a 6.6% property tax hike. Farmers will face a likely 5.6% hike. Minnesota’s east central ag producers could see property taxes go up 7.6%, based on nonpartisan House research projections.

The legislation also sets in motion an ongoing erosion of the Minnesota Miracle because it freezes aid levels permanently. As inflation rises, state aid dollars’ purchasing power will decrease, putting more pressure on local taxpayers to make up the difference or on local policymakers to cut more services.

At the beginning of 2011’s legislative session, progressive policymakers, including Governor Dayton, sought to reverse this near decade-long regressive fiscal policy trend and restore Minnesota’s tax fairness. Throughout the legislative session, progressive allies joined the governor in a call for a fair and balanced approach to solving a $5.2 billion state budget deficit. Fiscal policy experts throughout Minnesota recommended state-level progressive revenue increases on the state’s highest income earners along with spending cuts. The governor’s end-of-session proposal included no cuts in aid and credits for local governments.

Conservatives refused this balanced solution, insisting on a cuts-only budget. Actually, the “cuts only” budget is a misnomer, since the budget solution insisted on by House and Senate conservatives will result in property tax increases for homeowners, businesses, farmers, renters, and owners of every other category of property in the state.

Minnesota needs a better way forward. For the past eight years, Minnesota’s middle- and low-income earners have made a disproportionate sacrifice to maintain the state’s economy. A fairer fiscal system that adequately funds 21st century schools, roads, bridges, transit, health care and other public services will ensure that middle-class and working Minnesotans at least share in the state’s future prosperity.
From FY2003-13, the state of Minnesota is expected to have cut nearly $3 billion in aid and credits to local governments in constant 2011 dollars.

Conservative-crafted 2011 tax law cuts $632 million in aid and credits to local governments, compounding local governments’ revenue shortfall.

Over nearly a decade, local governments have made deep community service cuts and increased property taxes to make up for declining state revenue.

Nonpartisan house research projects 2012 property taxes will increase by 4.6% or about $112 for the average $200,000 home, as a result of conservatives’ 2011 state aid and credits cuts.

Conservatives’ phase out of the Homestead Tax Credit will cause a direct $260 million property tax increase, regardless of local action.

Governor Dayton and progressive allies sought to reverse this trend toward regressive fiscal policy.

Conservatives’ insistence on protecting Minnesota’s richest income earners led to a state shutdown with no new progressive revenue.

Increase progressive, state-level revenue

Restore the Homestead Credit

Restore LGA and County Program Aid Cuts

Use a balanced approach to state budgeting that doesn’t shift the state’s fiscal burden to property taxpayers
Literally, Minnesota taxpayers will be paying more and getting less.
During the 2011 legislative session, conservatives insisted on an all cuts approach to solving the state’s budget deficit. Their budget ax’s major target was property tax aids and credits. Deep cuts proposed in this area would have resulted in significant property tax increases based on the Legislature’s own non-partisan staff projections.

Governor Mark Dayton’s end-of-session proposal included no cuts to property tax aids and credits. Instead, his overall budgeting approach called for a fair and balanced solution that included progressive income tax increases on Minnesota’s wealthiest and cuts to other areas of the state budget.

Conservatives refused to negotiate on raising progressive state income taxes; as a result, state government shutdown. Ending the shutdown included $632.6 million in cuts to property tax aids and credits. Still, the governor succeeded in blocking a third of the cuts to local government aids and credits proposed by conservatives.

As a result, statewide 2012 property taxes are projected to increase by 4.6%.

To be clear, this anticipated 2012 property tax increase is not the result of local spending increases. The 4.6% property tax increase in 2012 is not growth from what taxes were in 2011, but growth relative to what property taxes would have been in 2012 had current law been continued (i.e., had the special session tax bill not been enacted). In addition to causing property taxes to increase, the special session tax bill will cause funding for local government services to decline. Literally, Minnesota taxpayers will be paying more and getting less—that is to say, paying higher property taxes and receiving fewer local government services.
I. THE PROCESS THAT PRODUCED THE SPECIAL SESSION
PROPERTY TAX INCREASES

The “no new tax” label frequently affixed to conservative policy is a misnomer, since the various
tax bills the conservative-led caucuses passed during Minnesota’s 2011 regular session would have
resulted in property tax increases through large cuts in property tax aids and credits.

The Governor’s Proposed Budget

The governor made clear his desire to avoid increases in regressive property taxes—which fall
largely on middle and low income households—and instead generate revenue through progressive
income taxes. This plan aimed to reverse Minnesota’s near decade-long regressivity trend.1

The Dayton proposal made absolutely no cuts to property tax aids and credits. The Homestead
Credit, city Local Government Aid, County Program Aid, Property Tax Refunds, and all other
property tax aids and credits were fully funded in FY 2012-13 at their current law levels. As a
result, Governor Dayton’s proposal would have resulted in no local property tax increases in 2012.
However, the governor’s proposal for a state-imposed property tax on the portion of homestead,
non-homestead residential (1 to 3 units), and seasonal recreational property value in excess of $1
million would have resulted in a state property tax increase of $44 million in 2012.2

To balance the state’s budget deficit without cutting property tax aids
and credits, the governor proposed to increase state taxes. The vast
majority of the new revenue in the governor’s initial budget proposal
to the Legislature came from an income tax increase directed at high
income households. Specifically, the governor proposed increasing
the income tax rate that would apply to taxable income in excess
of $150,000 for married joint filers, $130,000 for head-of-household
filers, and $85,000 for single filers.3 (These amounts correspond to a
typical gross income of $202,000 for married joint filers, $165,000 for
head-of-household filers, and $106,000 for single filers).

An analysis from the Minnesota Department of Revenue revealed that Governor Dayton’s decision
to balance the state budget through progressive income tax increases—as opposed to shifting the
state’s budget problems on to property taxpayers through regressive property tax increases—would
have led to a significant reduction in the regressivity of Minnesota’s tax system.4 Under the Dayton

Most of the new revenue in the governor’s initial budget proposal
came from an income tax increase directed at high income households.

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1 The regressivity of Minnesota’s state and local tax system is demonstrated in the “2011 Minnesota Tax Incidence Study,” Minnesota Department of

2 The tax under this proposal would equal 1.05% of taxable market value in excess of $1 million. The portion of seasonal recreational property value in
excess of $1 million would have been exempted from the existing state property tax.

3 The Governor’s initial February budget also proposed a three year (FY 2012-FY 2014) income tax surcharge on income in excess of $500,000.
However, with improvements in the state budget as revealed in the February forecast, the additional revenue from the income tax surcharge was no
longer needed and thus the surcharge was dropped from the Governor’s revised March budget proposal.

4 The Minnesota Department of Revenue’s tax incidence analysis of the Governor’s budget (which was introduced in bill form to the Legislature as
House File 1231 and Senate File 935) can be found on-line at http://taxes.state.mn.us/legal_policy/Revenue_Analyses/HF1231(sf0925)_Incidence_
Analysis_1.pdf.
proposal, state and local taxes would have been more closely aligned with the ability to pay and the
tax advantage of high income households relative to the middle class would have been diminished.

**Conservative-crafted House and Senate Tax Bills**

Legislative conservatives’ budget deficit balancing approach sharply contrasted with Governor
Dayton’s. Conservatives shielded Minnesotans’ wealthiest from a tax increase by making sharp
expenditure reductions—including steep cuts to property tax aids and credits. In doing so,
legislators shifted a disproportionate share of the state’s budget problems on to local governments
and property taxpayers.

The House omnibus tax bill was similar to the Senate’s omnibus tax bill in that both cut deeply into
property tax aids and eliminated the Homestead Credit. However, the two bills did differ in terms
of specifics. The table below compares cuts to property tax aids, credits, and refunds in House and
Senate omnibus tax bills for both years of the FY 2012-13 biennium, which corresponds to property
tax payable years 2011 and 2012.

<table>
<thead>
<tr>
<th>FY 2012-13 (TAX PAYABLE YEAR 2011 AND 2012) CHANGES TO PROPERTY TAX AID, CREDITS, AND REFUNDS</th>
<th>HOUSE OMNIBUS TAX BILL</th>
<th>SENATE OMNIBUS TAX BILL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction to and ultimate elimination of the Homestead Credit</td>
<td>-$360.4 million</td>
<td>-$365.3 million</td>
</tr>
<tr>
<td>Reduction to the Renters’ Property Tax Refund</td>
<td>-$186.1 million</td>
<td>-$105.7 million</td>
</tr>
<tr>
<td>Increase to the Homeowners’ Property Tax Refund</td>
<td>$0</td>
<td>$44.3 million</td>
</tr>
<tr>
<td>Reduction to city Local Government Aid (LGA)</td>
<td>-$247.4 million</td>
<td>-$203.6 million</td>
</tr>
<tr>
<td>Reduction to County Program Aid (CPA)</td>
<td>-$72.7 million</td>
<td>-$72.7 million</td>
</tr>
<tr>
<td>Net change to other prop. tax aids, credits, and refunds</td>
<td>-$10.7 million</td>
<td>-$26.3 million</td>
</tr>
<tr>
<td><strong>TOTAL REDUCTION</strong></td>
<td><strong>-$877.3 million</strong></td>
<td><strong>-$729.3 million</strong></td>
</tr>
</tbody>
</table>

Both omnibus tax bills reduced the county and city portion of Homestead Credit payments in FY
2012 (local budget year 2011)\(^5\) and completely eliminated the Homestead Credit program effective
in FY 2013 (local budget year and tax payable year 2012). In both bills, they replaced the Homestead
Credit with the “homestead value exclusion.”

This exclusion attempted to mitigate the homestead property tax
increase resulting from the elimination of the Homestead Credit by
excluding from taxation a portion of the value of homes that received
the Credit. However, this exclusion causes the tax base of local
governments to shrink, which in turn causes local property tax rates
to increase, even if local governments do not increase their levies. As
a result, the vast majority of homeowners and other property owners
will see property tax increases as a result of the elimination of the
Homestead Credit and the creation of the homestead value exclusion.\(^6\)

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\(^5\) The only difference in regard to the FY 2012 (budget year 2011) Homestead Credit cut between the House and Senate omnibus tax bills is that the House bill eliminated the reduction for townships. Thus, the total FY 2012 Homestead Credit reduction in the House tax bill is $4.9 million less than in the Senate bill.

\(^6\) The Minnesota Department of Revenue has prepared a more extensive explanation of the Homestead Credit elimination and the new homestead value exclusion, which can be found at: http://taxes.state.mn.us/property/Documents/hmve-taxpayers.pdf
Technical explanations aside, there is no way to remove $265 million in property tax relief (the amount of the FY 2013 Homestead Credit payments that would be eliminated by the conservative tax bills) from the system without producing property tax increases. The homestead value exclusion is simply smoke and mirrors that shifts the resulting property tax increases from one class of property to another, but in no way prevents the property tax increases resulting from the elimination of the Homestead Credit from occurring.

As noted in the above table, both omnibus tax bills made deep cuts to nearly every category of property tax aids and credits, including city Local Government Aid (LGA). Going forward it will be frozen at its reduced FY 2013 (paid in 2012) level, with no adjustment for inflation or population growth.

This conservative tax legislation continues a long pattern of decline in real (i.e., inflation-adjusted) per capita LGA extending back to the beginning of the Pawlenty administration. The graph below shows the decline in real per capita LGA from FY 2003 to FY 2012 (aid payable years 2002 to 2011), with the FY 2012 amounts based on the House and Senate tax bills.

Under both the House and Senate tax bills, real per capita LGA in both FY 2012 and FY 2013 would have been less than half of what it was in FY 2003.
Conference Committee Report

Conservative leaders crafted conference committee legislation, working out the differences between their respective tax bills. Given that the House and Senate omnibus tax bills each contained large cuts to property tax aids and credits, it is not surprising that the bill negotiated by House and Senate tax conferees also contained large cuts. What may be surprising is that the level of aid and credit cuts in the tax bill that emerged from the tax conference committee was larger than those in either the House or Senate omnibus bills.

The tax conference committee report cut the county and city portion of the FY 2012 Homestead Credit and entirely eliminated the Credit for FY 2013, as was the case in both the House and Senate omnibus bills. The Homestead Credit’s elimination—in isolation from all other changes in the tax conference committee report—is projected to result in a statewide property tax increase in excess of two percent for homeowners and other property owners in 2012. Approximately one-half of the property tax increases resulting from the tax conference committee report is attributable to the decision to eliminate the Homestead Credit.7

The tax conference committee cut the Renters’ Property Tax Refund by $186 million, adopting the House’s steeper cut. In fact, funding cuts for the Renters’ PTR in the FY 2014-15 biennium were even deeper than those proposed by the House. Funding for the most progressive program in Minnesota’s tax system would be cut nearly in half.

While slashing the Renters’ PTR, the committee increased the Homeowner’s PTR by $30 million. The increase in the Renters’ PTR was projected to offset less than one-sixth of the projected aggregate statewide homestead property tax increase resulting from the tax conference committee report.

From Minnesota cities’ perspective, the tax conference committee report incorporated the worst features of the House and Senate tax bills. It adopted the House tax bill’s LGA phase-out and elimination for Duluth, Minneapolis, and Saint Paul while incorporating the Senate’s LGA cuts for all other cities for both years of the FY 2012-13 biennium.

This $310 million LGA reduction for the FY 2012-13 biennium was $63 million greater than the House’s proposed cut and $106 million greater than the Senate’s reduction proposal. By FY 2013 (aids payable in 2012), the level of real per capita LGA funding would be 60% less than it was a decade earlier.

The cut to County Program Aid in the tax conference committee report for FY 2012-13 was $73 million, the same as in both the House and Senate omnibus tax bills, representing an 18% CPA reduction in the appropriation for the FY 2012-13 biennium.

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7 These observations are based on House Research simulations #11C2 (dated March 11, 2011)—which examined the impact of the homestead credit elimination only—and #11E5 (dated May 17, 2011)—which examined the impact of all property tax provisions in the tax conference committee report, excluding PTR changes. Some caution should be used in comparing these two simulations, since #11C2 is based on 2011 data, while #11E5 is based on projected 2012 data.
The total reduction in property tax aids, credits, and refunds in the tax conference committee report was $925 million, significantly greater than the cuts proposed in either the House and Senate omnibus tax bills. The table below shows changes to property tax aids, credits, and refunds under the tax conference committee report for both years of the FY 2012-13 biennium, which corresponds to property tax payable years 2011 and 2012.

<table>
<thead>
<tr>
<th>FY 2012-13 (Tax Payable Year 2011 and 2012) Changes to Property Tax Aids, Credits, and Refunds</th>
<th>Tax Conference Committee Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction to and ultimate elimination of the Homestead Credit</td>
<td>-$365.3 million</td>
</tr>
<tr>
<td>Reduction to the Renters’ Property Tax Refund</td>
<td>-$186.1 million</td>
</tr>
<tr>
<td>Increase to the Homeowners’ Property Tax Refund</td>
<td>$29.8 million</td>
</tr>
<tr>
<td>Reduction to city Local Government Aid (LGA)</td>
<td>-$310.0 million</td>
</tr>
<tr>
<td>Reduction to County Program Aid (CPA)</td>
<td>-$72.7 million</td>
</tr>
<tr>
<td>Net change to other prop. tax aids, credits, and refunds</td>
<td>-$20.9 million</td>
</tr>
<tr>
<td><strong>Total Reduction</strong></td>
<td><strong>-$925.3 million</strong></td>
</tr>
</tbody>
</table>

Just as the cuts to property tax aids, credits, and refunds were greater under the tax conference committee report than under either the House and Senate omnibus tax bills, so too were the resulting property tax increases. The total 2012 property tax increase resulting from the tax conference committee report was projected to be $393 million—7.5% greater than the increase under the House tax bill and approximately 22% greater than under the Senate tax bill.8

The conference committee report would have increased Minnesota’s state and local tax regressivity, according to a Revenue Department incidence analysis.8

The governor vetoed this bill.

**The Governor’s End-of-Session Offer**

In an attempt to bring the 2011 regular legislative session to a successful conclusion, the governor offered to reduce his proposed income tax increase by raising the income levels above which the fourth tier income tax rate would take effect to $250,000 for married joint filers, $200,000 for head-of-household filers, and $150,000 for single filers (which corresponds to a typical gross income of $305,000 for married joint filers, $268,000 for head-of-household filers, and $179,000 for single filers).

In addition, the governor offered to drop his proposal imposing a state property tax on the portion of homestead, non-homestead residential, and seasonal recreational property in excess of $1 million. With the deletion of this provision, the governor’s offer to the Legislature at the end of the regular legislative session contained no state or local property tax increase.

8 The Revenue Department’s incidence analysis of the tax conference committee report can be found on-line at http://taxes.state.mn.us/legal_policy/Revenue_Analyses/HF0042_Incidence_Analysis_2.pdf.
Legislative conservatives refused to entertain any increase in state taxes, insisting on balancing the state budget entirely through spending reductions. With this, the 2011 regular legislative session ended without a balanced budget.

Negotiations between the governor and Legislature continued after the end of the regular session in an attempt to avoid a state government shutdown. During this period, the governor made several more concessions to House and Senate conservatives, including his offer to increase the income level at which the proposed fourth tier tax rate would take effect all the way to $1 million. By June 30, the Governor had agreed to seek only about $1.4 billion in new tax revenue—or only about one-quarter of what was needed to resolve the $5 billion state budget deficit.

Meanwhile, House and Senate conservatives refused to consider any increase in state revenue. Their only concession of any significance was to offer to forego their demand for additional tax cuts that would have only further swelled the state budget deficit. For example, conservatives agreed to drop their demand to begin a phase-out of the state property tax on business property, which would have expanded the state budget deficit by $50 million in the FY 2012-13 biennium.

Even the governor’s last minute acquiescence to the conservative demand for absolutely no tax increase was not sufficient to avert a government shutdown, as conservatives further insisted that the Governor also concede to them on a variety of social policies (i.e., stem cell research, teacher collective bargaining rights, etc.) unrelated to taxes. When Governor Dayton refused to do this, negotiations reached an impasse and state government shut down on July 1, 2011.

Resolution

The state government shutdown had led to layoffs for tens of thousands of public and private sector workers, halted important public services, resulted in business closings due to the inability to issue appropriate permits, hurt the tourism industry due to the closing of state parks and the inability to issue fishing licenses, and was causing additional losses of state revenue with each passing day.

The Governor compromised on conservatives’ demand for no new state tax increases and accepted a proposal to generate one-time revenue through the sale of tobacco bonds, as well as through additional K-12 school funding shifts. When conservatives dropped their social policy demands, the pieces were in place for a compromise that resolved the FY 2012-13 budget and ended the state government shutdown.

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9 Both of these measures fall into the category of “accounting gimmicks.” The sale of tobacco bonds was initially proposed by the Pawlenty administration in 2009 and resurrected by House and Senate Republicans in 2011 to generate one-time revenue to balance the FY 2012-13 budget without raising state taxes. Both the sale of tobacco bonds and the K-12 funding shift do nothing to solve the state’s long-term structural deficit, since no new permanent revenue is acquired. For this reason, these measures damage the state bond rating and could lead to higher state borrowing costs in the future.
The compromise included cuts to the Homestead Credit in FY 2012 and elimination of the Credit in FY 2013 (corresponding to tax payable year 2012). The elimination of the Homestead Credit alone will produce a $272 million—or 3.4%—statewide property tax increase, assuming no change in local levies. Because of homestead value exclusion enacted along with elimination of the Homestead Credit, this property tax increase will not be borne by homeowners alone, but will be spread among all types of property. The table below shows the estimated statewide impact of the Homestead Credit elimination in isolation from all other provisions of the special session tax bill.

<table>
<thead>
<tr>
<th>INCREASE IN PROPERTY TAXES RESULTING FROM HOMESTEAD CREDIT ELIMINATION &amp; REPLACEMENT WITH HOMESTEAD VALUE EXCLUSION</th>
<th>DOLLAR PROPERTY TAX INCREASE</th>
<th>PERCENT PROPERTY TAX INCREASE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential Homestead</td>
<td>$111.9 million</td>
<td>3.2%</td>
</tr>
<tr>
<td>1 to 3 Unit Rental</td>
<td>$25 million</td>
<td>4.6%</td>
</tr>
<tr>
<td>Apartments</td>
<td>$15.6 million</td>
<td>4.7%</td>
</tr>
<tr>
<td>Seasonal-Recreational</td>
<td>$8.8 million</td>
<td>3.8%</td>
</tr>
<tr>
<td>Business</td>
<td>$72.3 million</td>
<td>2.6%</td>
</tr>
<tr>
<td>Agricultural</td>
<td>$37.8 million</td>
<td>6.6%</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>$0.8 million</td>
<td>5.3%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$272.2 million</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

This compromise prevented dramatic cuts in certain areas of the aid and credit system and the elimination of LGA for Duluth, Minneapolis, and Saint Paul. Ultimately, the special session tax bill that was enacted into law cut city LGA for FY 2012-13 by $204 million or nearly two-thirds of the $310 million cut sought in the conservative-crafted tax conference committee report.

Real per capita LGA payable to cities in 2013 will be less than half of what it was in 2002 and 26% less than it was in 1972—the first year of the LGA program.

The cut to County Program Aid (CPA) in the special session tax bill was the same as that contained in the tax conference committee report. Total CPA received by Minnesota counties for FY 2012-13 was reduced by $73 million or 18%.

The special session tax bill also increased funding for the homeowners’ property tax refund by $30 million. However, on a statewide basis, the increase in the refund will be sufficient to offset only about one-sixth of the anticipated $168 million homeowner tax increase resulting from the elimination of the Homestead Credit and other provisions of the special session tax bill. Overall, the special session tax bill that was enacted into law was not a good deal for Minnesota homeowners.

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10 The property tax increases resulting from the elimination of the Homestead Credit and creation of a homestead exclusion presented in this paragraph and in the table are based on House Research simulation #11F1 [http://www.house.leg.state.mn.us/hrd/issinfo/csim11F1.pdf]. This simulation is not directly comparable to other simulations presented in this report because it (1) assumes that local governments do not change their levies in response to the Homestead Credit elimination and (2) is based on data for taxes payable in 2011 instead of 2012.
Governor Dayton blocked most of the property tax increases that would have resulted from cutting the Renters’ Property Tax Refund. The tax conference committee report would have reduced funding for the credit in FY 2012-13 by $186 million—nearly half of the entire Renters’ PTR funding for the biennium. However, by the time that the Governor and Legislature began negotiating the final parameters of the tax agreement in mid-July, it was too late to cut the FY 2012 PTR payments, which were already well on the way of being processed and sent out. Thus, the FY 2012 portion of the Republican’s proposed cut to the PTR— which came to $91 million— could not be implemented.

The FY 2013 portion of the Renters’ PTR cut in the tax conference committee report was $95 million. In negotiations with leadership, Governor Dayton whittled the cut down to $26 million. Ultimately, the governor succeeded in reducing by 86% the total FY 2012-13 Renters’ PTR cut proposed by conservatives.

However, the fact that there was any cut to the Renters’ PTR was unfortunate. As a result of other aid and credit cuts proposed by conservative-crafted legislation and incorporated into the special session tax bill, 2012 property taxes on rental properties (including non-homestead residential and apartment properties) are projected to increase by $64 million or 7.0%—prior to factoring in the cut to the Renters’ PTR. According to the 2011 Minnesota Tax Incidence Study, rental property taxes are the most regressive of all property taxes; the cut to the FY 2013 Renters’ PTR will result in a significant increase in rental property tax regressivity and impose an additional $26 million tax burden on low-income renters, many of whom are seniors.

The table below summarizes the cuts to property tax aids, credits, and refunds contained in the special session tax bill that was enacted into law.

<table>
<thead>
<tr>
<th>FY 2012-13 (Tax Payable Year 2011 and 2012) Changes to Property Tax Aid, Credits, and Refunds</th>
<th>Special Session Tax Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction to and ultimate elimination of the Homestead Credit</td>
<td>-$365.3 million</td>
</tr>
<tr>
<td>Reduction to the Renters’ Property Tax Refund</td>
<td>-$26.3 million</td>
</tr>
<tr>
<td>Increase to the Homeowners’ Property Tax Refund</td>
<td>$29.8 million</td>
</tr>
<tr>
<td>Reduction to city Local Government Aid (LGA)</td>
<td>-$203.6 million</td>
</tr>
<tr>
<td>Reduction to County Program Aid (CPA)</td>
<td>-$72.7 million</td>
</tr>
<tr>
<td>Net change to other prop. tax aids, credits, and refunds</td>
<td>$5.5 million</td>
</tr>
<tr>
<td><strong>TOTAL REDUCTION</strong></td>
<td><strong>-$632.6 million</strong></td>
</tr>
</tbody>
</table>

By reducing property tax aid and credit cuts to $633 million, the governor averted about one-third of the $925 million cut the conservative-crafted tax conference committee report proposed. Still, conservatives made steep cuts in the aids and credits system that will have a big impact on property taxes and make Minnesota’s tax system more regressive.
II. COMPARISON OF PROPERTY TAX IMPACTS

In terms of property taxes, the following analysis will attempt to clarify the lines of accountability by comparing the property tax positions of the governor and legislative conservatives at the end of the 2011 regular session to the property tax impacts resulting from the special session tax bill that was ultimately enacted into law.

The Data

The “baseline” for this analysis will be projected 2012 property taxes under state law prior to enactment of the special session tax bill. Projected property taxes under this baseline will be compared to:

1) The final property tax proposal made by Governor Dayton before the end of the 2011 regular legislative session,

2) The conservative-crafted property tax plan as embodied in the 2011 regular session tax conference committee report (House File 42), and

3) The final tax bill that was passed during the 2011 special legislative session in July.

By proposing no cuts to property tax aids and refunds and by maintaining full funding for the Homestead Credit and by avoiding its partial replacement—the homestead value exclusion—Governor Dayton’s end of regular session offer to the House and Senate would have resulted in no property tax increase relative to current law for any class of property in any region of the state.

Most of the 2012 property tax information presented in this section for the baseline (i.e., current law prior to the special session changes), the tax conference committee proposal, and the final special session tax bill that was enacted are from simulations prepared by the Research Department of the Minnesota House of Representatives11 (referred to below as “House Research”).

All of the property tax projections presented below are from the Legislature’s own non-partisan research staff; this fact makes it difficult for legislators of either party to dispute the impartiality or validity of this data.

11 Specifically, the information is from House Research simulation #11E5 [http://www.house.leg.state.mn.us/hrd/issinfo/csim11E5.pdf] and #11E7 [http://www.house.leg.state.mn.us/hrd/issinfo/csim11E7.pdf].
In addition to examining statewide property tax changes, House Research simulations divide the state into multiple regions. Based on this information, an online supplement to this report (http://bit.ly/homesteads) shows property tax impacts for the following regions.12

12 The “metropolitan area” includes the counties of Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington. “Greater Minnesota” includes the remaining 80 Minnesota counties. All other regions referred to in this list are described in a House Research map [http://www.house.leg.state.mn.us/hrd/issinfo/regmap.pdf].
The House Research simulations from which most of following information is derived divide properties into 13 categories. For ease of presentation, these 13 categories are condensed into seven categories in this report, grouped as indicated below.

<table>
<thead>
<tr>
<th>CATEGORIES IN THIS REPORT</th>
<th>…CORRESPOND TO THE FOLLOWING CATEGORIES FROM HOUSE RESEARCH SIMULATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential Homestead</td>
<td>Residential Homestead</td>
</tr>
<tr>
<td>1-3 Unit Rental</td>
<td>Residential Non-Homestead</td>
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<tr>
<td>Apartments</td>
<td>Apartments</td>
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<tr>
<td></td>
<td>Low-Income Apartments</td>
</tr>
<tr>
<td>Seasonal Recreational</td>
<td>Seasonal-Recreational</td>
</tr>
<tr>
<td>Business</td>
<td>Commercial/Industrial Low Tier</td>
</tr>
<tr>
<td></td>
<td>Commercial/Industrial High Tier</td>
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<tr>
<td></td>
<td>Public Utility: Electric Generation</td>
</tr>
<tr>
<td></td>
<td>Public Utility: Other</td>
</tr>
<tr>
<td>Agricultural</td>
<td>Agricultural Homestead: House</td>
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<tr>
<td></td>
<td>Agricultural Homestead: Land</td>
</tr>
<tr>
<td></td>
<td>Agricultural Non-Homestead</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>Miscellaneous Properties</td>
</tr>
</tbody>
</table>

In addition to showing growth in aggregate property taxes, the following analysis and the online supplement to the report shows growth in the average value homestead. The average value homestead property taxes are determined by applying the various tax rates and, if applicable, credit amounts to the average value homestead. For example, the tax on the average value home in greater Minnesota is determined by applying the aggregate greater Minnesota tax rates to the average value greater Minnesota homestead ($158,000) and subtracting, when applicable, the Homestead Credit amount that this home would receive. The percent growth is then calculated by comparing the baseline tax on the average value home to the tax under the Governor’s end-of-session proposal, the conservative-crafted tax conference committee proposal, and the final special session tax law.

Average value homestead property tax projections for 2012 cited below and in the online supplement are from the House Research simulations, except for statewide average value homestead property tax projections, which are from the Office of Senate Counsel, Research, and Fiscal Analysis. (The House Research simulation does not present projections for the statewide average value homestead.)

The House Research and the Senate Counsel property tax simulations cited here and in the online supplement to this report do not include the impact of changes to either Renters’ or Homeowners’ Property Tax Refund programs. For example, the property tax increase resulting from the cut to the Renters’ PTR in the tax conference committee report is not reflected in the information shown here or in the online supplement.

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Statewide Property Tax Increases by Property Type

Residential homesteads would have seen no property tax increase under Governor Dayton’s end-of-session proposal. However, statewide property taxes would have gone up by a projected 5.1% under the conservative-crafted tax conference committee report. The special session compromise restored some of the cuts to city LGA and other property tax programs, thereby reducing projected homestead property tax increases to 4.5%.

The 2012 special session tax bill will exacerbate the long-term trend of rising homeowner property taxes.

Under current law prior to the passage of the special session tax bill, the projected 2012 tax on an average value Minnesota residential homestead ($198,200) was $2,358. Under the tax conference committee report, the tax would have increased by $127 or 5.4% to $2,485. The tax increase under the final compromise will be somewhat smaller ($112 or 4.7%). Nonetheless, the 2012 special session tax law will exacerbate the long term trend of rising homeowner property taxes.

The projected property tax increase on 1 to 3 unit rental properties (often referred to as “non-homestead residential”) under the tax conference committee report was 7.8%, while the apartment property tax increase was 8.6%. By negotiating for smaller cuts to LGA and other property tax aids, the governor reduced the tax increase in the special session tax bill for these two classes of property to 6.8% and 7.4% respectively. However, the increase in rental property taxes under the special session tax bill was greater than for any other major category of property.
To add insult to injury, the large increase in rental property taxes resulting from conservative cuts to property tax aids and credits is compounded by cuts to the Renters’ Property Tax Refund. (The impact of the Renters’ PTR cuts is not reflected in this analysis.) Given that rental property taxes are already among the most regressive of property taxes and the important role played by the Renters’ PTR in reducing that regressivity, any cut to the Renters’ PTR adds to the regressivity of Minnesota’s tax system.

Any cut to the Renters’ PTR adds to the regressivity of Minnesota’s tax system.

Seasonal-recreational property, which includes cabins, would have seen no property tax increase under the governor’s end-of-session proposal, but under the conservative-crafted tax conference committee report there would have been a 4.3% property tax increase. The special session tax bill produced a 3.9% increase.

Businesses are the only class of property that experience greater projected property tax increases under the special session tax bill (3.7%) than under the tax conference committee report (3.1%). This is due to the fact that the conservatives dropped the proposal to reduce the state levy on business property fairly early in the negotiation process and thus it was not included in the final special session tax bill. The absence of the reduction in the state levy in the special session tax bill caused the business property tax increases in this bill to be greater than the increases under the tax conference committee report.
The property tax is the single largest tax that Minnesota state and local governments impose on businesses, exceeding sales and corporate and individual income taxes combined. Property taxes are particularly onerous to many businesses because they can rise even if profits remain flat or fall. None of the governor’s tax proposals would have resulted in any business property tax increases.

On a statewide basis, projected property tax increases for agricultural property is 6.0% under the conservative-crafted tax conference committee report and 5.6% under the final special session tax bill. The tax increases for agricultural properties under these two scenarios are somewhat greater than statewide average.

This fact is likely attributable in part to the homestead value exclusion conservatives pushed to replace the Homestead Credit. As described above, this exclusion partially protects homeowners from the impact of the Homestead Credit elimination by shifting the resulting tax increases on to other classes of property. The impact of this value exclusion is sensitive to the mix of property types within a taxing jurisdiction and generally leads to above average tax increases for agricultural property relative to other types of property. House Research simulations that model the impact of the Homestead Credit elimination and homestead value exclusion in isolation from other changes to the property tax system confirm this premise; these simulations show that agricultural properties generally experience greater property tax increase than other types of property.

As is the case for other classes of property, the governor’s tax proposal would have resulted in no agricultural property tax increases.

Projected 2012 statewide property tax increase under the conservatives’ tax conference committee report was $393 million or 4.8%, while the projected tax increase under the special session tax bill was $376 million or 4.6% — a mere 0.2% difference. However, the reduction in the property tax increase from the tax conference committee report to the special session tax bill is somewhat greater for non-business properties. The projected non-business property tax increase under the tax conference committee report was 5.7%, but 5.0% under the special session tax bill — a 0.7% reduction. Governor Dayton’s success in reducing property tax aid and credit cuts proposed by conservatives helped limit non-business property tax increases.

Nonetheless, a 5.0% property tax increase is still significant, especially in light of a decade of property tax increases that generally exceeded the rate of inflation. The growth in real per capita statewide property taxes over the last decade was driven primarily by large real per capita reductions in funding for property tax relief programs. Governor Dayton proposed no reductions in property tax aids and credits in his budget. Unfortunately, while the Governor succeeded in reducing the cuts in this area, he could not eliminate them. The result will be yet more property tax increases for homeowners, businesses, farmers, and other property owners in Minnesota.


15 For example, see House Research simulations #11C8[http://www.house.leg.state.mn.us/hrd/issinfo/csim11C8.pdf] and #11C2.
Property Tax Increases by Region

There is significant regional variation when it comes to the special session’s property tax impact, as illustrated in the graph on page 25. The regional graph shows a comparison of percent increase in property tax under the conservative-crafted tax conference committee report and the final special session tax bill. As is the case throughout this section, the change is shown relative to the 2012 current law prior to the special session changes. The governor’s end-of-regular-session proposal is not shown in this graph because it produced no property tax increases.

Under both the tax conference committee report and special session tax bill, the percentage increase in total property taxes in greater Minnesota is about 1.5 times greater than in the seven county metropolitan area. The contrast is even more stark when comparing the suburban metropolitan area (i.e., excluding Minneapolis and Saint Paul) to greater Minnesota. Under both the tax conference committee report and the special session tax bill, the percentage increase in total property taxes in greater Minnesota is approximately double that of the seven county metropolitan area.

The higher rate of growth in property taxes in greater Minnesota is attributable to provisions that are common to both the tax conference committee report and the final special session tax bill, including:

- **Large cuts in LGA.** Greater Minnesota is more dependent on city LGA than metro communities. (This is especially true if we examine only the suburban metro area.) Thus, the large LGA cuts in both the tax conference committee report and the final special session tax bill had a more severe impact on property taxes in greater Minnesota than in the metro area.

- **The elimination of Homestead Credit.** Homestead Credit payments are larger for low and moderate value homes. Because low and moderate value homes are more prevalent in greater Minnesota than in the metro area, average Homestead Credit payments are significantly higher in greater Minnesota. Thus, the elimination of the Homestead Credit in both the tax conference committee report and the final special session tax bills leads to higher property tax increases in greater Minnesota.

- **Cuts to County Program Aid and other property tax relief programs.** Greater Minnesota communities are generally more dependent on CPA, Disparity Reduction Aid, and PILT payments, which are cut in either the tax conference committee report or the special session tax bill or both. Because of the greater dependence on these programs in greater Minnesota, cuts to these programs lead to larger property tax increases in greater Minnesota.
Property tax increases also tend to be greater in Minnesota cities than in Minnesota towns under both the tax conference committee report and the final special session tax bill. For example, property tax increases under the tax conference committee report and the special session tax bill in greater Minnesota cities are 6.8% and 6.3% respectively, compared to 5.4% and 5.1% increases in greater Minnesota towns. The difference is largely due to cuts in LGA; cities receive LGA, whereas townships do not. Thus, city property taxes increase more when LGA is cut.

For most of the regions examined in this report, property tax increases are lower under the final special session tax bill than under the conservative-crafted tax conference committee report.

As noted above, Governor Dayton also succeeded in reducing the magnitude of the cut to the Renters’ PTR in the final special session tax bill relative to what conservatives proposed in the tax conference committee report. However, the resulting reduction in the level of property tax increases is not reflected in this analysis, since it is based on House Research simulations that do not include the impact of property tax refund programs.

**Local Government “Budget Adjustments”**

Up to this point, this report has focused on the property tax increases resulting from the 2011 tax proposals. In addition to the property tax increases described above, non-partisan staff with the House Research Department, Senate Counsel and Research, and the Minnesota Revenue Department also anticipate that the special session tax law will also result in hundreds of millions of dollars in local government budget cuts and other “budget adjustments” (i.e., spending down of reserves, fee increases, etc.) Projected budget adjustments for calendar years (CY) 2011 and 2012 for counties and cities under the special session tax bill are summarized below.

Total budget adjustments in CY 2011 and 2012 resulting from the special session tax bill are anticipated to be $125 million for counties and $189.6 million for cities. Including the projected $5.7 million in township adjustments, the CY 2011 and CY 2012 budget adjustments for all non-school local governments resulting from the special session tax bill is expected to be $320 million.

It is important to remember that property tax increases are not the only effects of the property tax aid and credit cuts. Real per capita local government revenue has already declined sharply over the last decade and the outcomes of the 2011 special session tax bill will only exacerbate this trend. This reduction in funding will result in fewer resources for public safety, libraries, roads and streets, and other local infrastructure and services.

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16 Based on information from the February forecast “Price of Government” report, real per capita county revenue has declined by 10% from 2002 to 2011, while real per capita city revenue has declined by 17%. The inflation adjustment here is based on the implicit price deflator for state and local government purchases, which is the appropriate measure of inflation for state and local governments [http://www.mn2020.org/issues-that-matter/fiscal-policy/taking-the-spin-out-of-inflation-estimates].
Rebutting the Claim that Aid Cuts Do Not Cause Property Tax Increases

Conservatives have often argued that the hundreds of millions of dollars in cuts to property tax aids and credits will not result in property tax increases. Such claims ignore common sense, the lessons of history, and the conclusions of non-partisan experts.

For the last decade, the state of Minnesota has repeatedly cut aids to local governments in order to address recurring state budget deficits. Over this period, the aid reductions have translated into a combination of property tax increases and cuts in funding for local governments. To claim that this trend will discontinue now is more wishful thinking than a serious policy argument.

Furthermore, the fact that real per capita local government revenues have already declined sharply is a further indication that a portion of future aid and credit losses will translate into property tax increases. For example, Minnesota cities’ per capita spending is already five percent below the national average based on the most recent data available. Given the budget reductions already made by cities over the last ten years, some portion of the $300 million plus aid and credit cuts imposed on cities in the FY 2012-13 through the special session tax bill will need to be recouped through a property tax increase.

Finally, the projections of future property tax increases presented in this report are based the work of the House and Senate’s own non-partisan researchers, whose skill, expertise, and impartiality have been recognized by legislators of all parties and ideological persuasions. These professionals analyze trends in how local governments have responded to past aid reductions and contact local tax administrators for additional current information. This systematic approach results in the best and most reasonable property tax projections currently available. For this reason, the property tax analysis of these respected experts has been relied on for decades. Conservatives should not attempt to disparage or deny the analysis of their own research staff simply because it is politically inconvenient.

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<table>
<thead>
<tr>
<th>Region</th>
<th>Committee Report</th>
<th>Special Session Tax Bill</th>
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</thead>
<tbody>
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<td>Metropolitan</td>
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<tr>
<td>Greater MN</td>
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<tr>
<td>Greater MN city</td>
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</tr>
<tr>
<td>Greater MN town</td>
<td>5.1% 5.4%</td>
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<tr>
<td>Northwest MN city</td>
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<tr>
<td>Northwest MN town</td>
<td>4.5% 4.7%</td>
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<td>North Central MN city</td>
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<td>Taconite town</td>
<td>6.0% 5.1%</td>
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<td>Duluth area</td>
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<tr>
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<tr>
<td>East central MN town</td>
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<td></td>
</tr>
<tr>
<td>Central Minnesota city</td>
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<td></td>
</tr>
<tr>
<td>Central MN Town</td>
<td>5.4% 5.6%</td>
<td></td>
</tr>
<tr>
<td>Southwest MN city</td>
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</tr>
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<tr>
<td>South central MN city</td>
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<tr>
<td>Saint Paul</td>
<td>9.0% 6.1%</td>
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From the outset, cuts to property tax aids and credits— including the elimination of the Homestead Credit— were a conservative initiative.
III. CONCLUSION: A CHOICE TO BE MADE

From 2003 to 2011, real per capita local government budgets fell, but real per capita local property taxes increased. The reason for this is that state policymakers chose to balance a disproportionate share of recurring state budget problems on the backs of local governments and local property taxpayers through cuts in state aid to local governments. Conservative-crafted tax proposals of 2011— which culminated in the 2011 special session tax act— continue this trend.

To Governor Mark Dayton’s credit, the special session tax bill trimmed nearly $300 million from $925 million in cuts to FY 2012-13 property tax aids and credits proposed by the tax conference committee report. However, the 2011 special session tax bill, which became law, still contained over $600 million in cuts, including the Homestead Credit elimination, massive reductions to city LGA and County Program Aid, another cut to the Renters’ Property Tax Refund, as well as cuts to other smaller programs.

Legislature’s own non-partisan staff projects a 4.6% statewide property tax increase in 2012 as a result. This increase is not spread uniformly around the state. For example, the owner of an average value home in rural southwest Minnesota can expect to see a property tax increase of 7.7% due to the special session tax bill. A rental property owner in Minneapolis can expect an 8.3% property tax increase. A cabin owner in northwest Minnesota can expect a 3.3% increase. A farmer in central Minnesota can expect a 6.4% increase. A businessman in the Duluth area can expect a 6.7% property tax increase.

Funding for local government services will decline at the same time that property taxes continue to climb. Funding for Minnesota counties, cities, and towns is projected to fall by over $300 million as a result of the special session tax bill. For Minnesota residents, it will be another case of pay more (in higher property taxes) and get less (in reduced funding for public services).

And what do we have to show for this dismal outcome? The state’s wealthiest residents have been shielded from the income tax increase proposed by Governor Dayton and as a result will continue to pay a smaller share of their income in state and local taxes than will middle income Minnesotans. In fact, as a result of the regressive property tax increases resulting from conservative tax policies, the tax disparity between high income households and other Minnesotans will increase.

From the outset, cuts to property tax aids and credits—including the elimination of the Homestead Credit—were a conservative initiative, inserted into several bills and promoted vigorously by House and Senate conservatives. Governor Dayton acquiesced to conservative demands only as a means of ending a destructive government shutdown which had caused tens of thousands of layoffs, interrupted important public services, hurt Minnesota businesses and tourism, inconvenienced countless state residents and visitors, and was causing additional state revenue losses the longer it continued.
An examination of the data presented in this report answers the question of who is responsible for the property tax increases resulting from the 2011 special session tax bill. For every type of property in every region of the state, the projected property tax increases under the special session tax bill are much closer to those proposed by House and Senate conservatives than to the zero property tax increase proposed by Governor Dayton.

The elimination of the Homestead Credit and reduction to other property tax relief programs were policies that were conceived, proposed, and aggressively pushed by House and Senate conservatives.

Going forward, Minnesotans have a decision to make. The state budget deficit has not been solved, but only pushed down the road through accounting gimmicks proposed by conservatives. New revenue will ultimately be needed to address this deficit. This revenue can be generated either through regressive tax policies that shift more of the burden on to middle income Minnesotans—such as the property tax increases in the 2011 special session tax bill—or through a progressive solution that will ask all Minnesotans to pay their fair share.

In a democratic government, elected officials must be held accountable for the policies they support.

Going forward, Minnesotans have a decision to make.
Minnesota 2020 is a progressive, non-partisan think tank, focused on what really matters.

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