



# Minnesota's Tax Fairness Retreat: A 50-State Study

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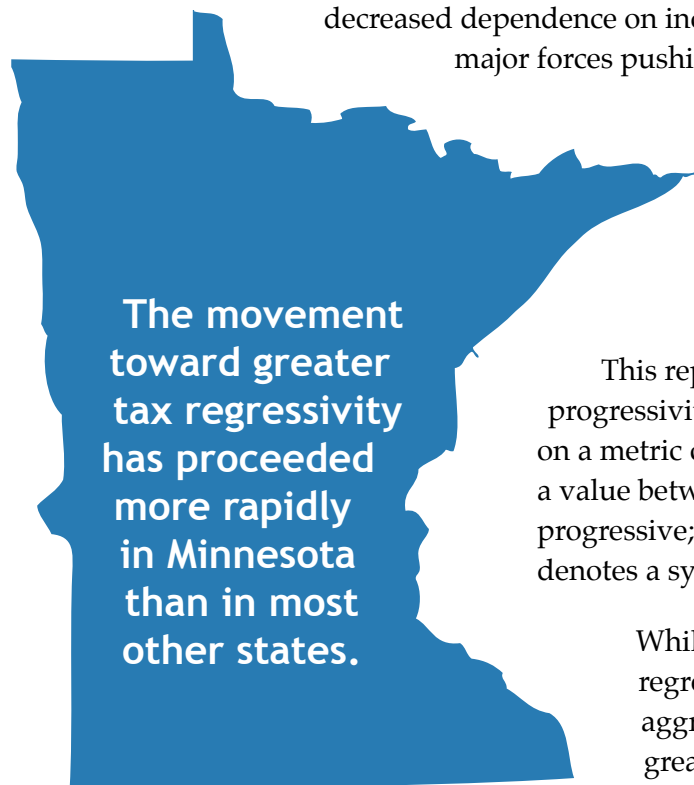


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## EXECUTIVE SUMMARY

In nearly every state, including Minnesota, state and local taxes are regressive, which means that low and moderate income families shoulder a disproportionate share of the tax load. Furthermore, state and local taxes have become more regressive since 2000. Unfortunately, the movement toward greater tax regressivity has proceeded more rapidly in Minnesota than in most other states.



A greater dependence on property taxes—which are regressive—and decreased dependence on income taxes—which are progressive—are major forces pushing Minnesota toward becoming a more regressive tax state. One of the main reasons for this shift is “no new taxes” state policy, which led to reductions in state revenue sharing with local governments, thereby forcing property tax hikes.

This report calculates the regressivity and progressivity of state and local taxes in all 50 states based on a metric called the “Suits index.” A Suits index with a value between 0 and +1 denotes a tax system that is progressive; a Suits index with a value between 0 and -1 denotes a system that is regressive.<sup>1</sup>

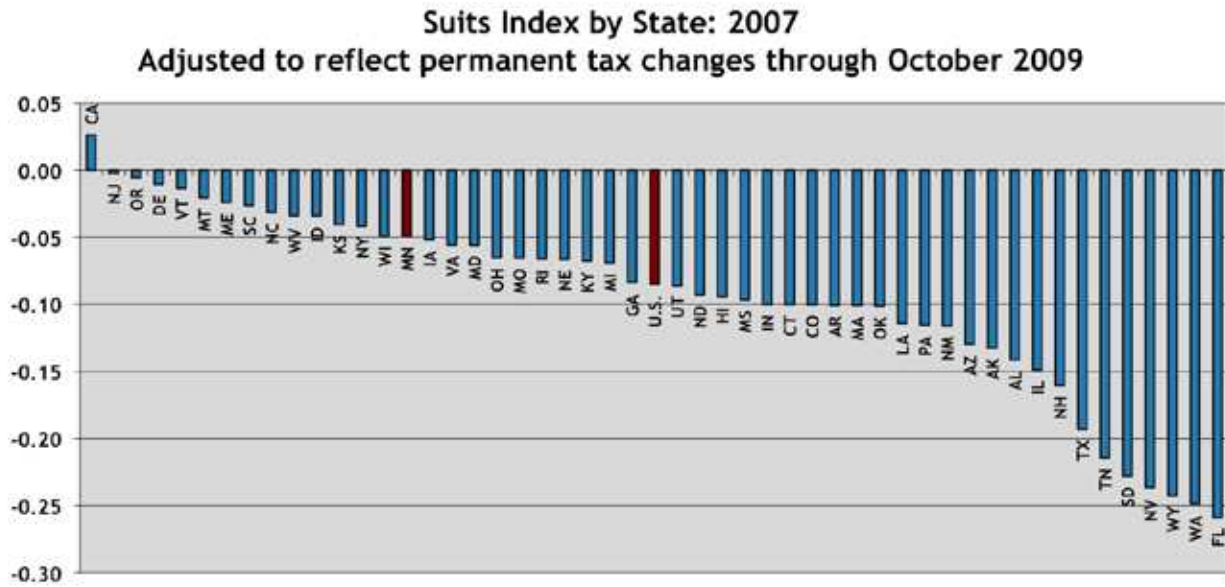
While Minnesota’s overall tax system is still less regressive than most states, it is slipping more aggressively, relative to other states, toward greater regressivity. From 2000 to 2007, Minnesota dropped from the 11<sup>th</sup> least regressive state to the 15<sup>th</sup> least regressive. In addition, Minnesota’s

Suits index fell much more rapidly than the national average; a large decline in the Suits index denotes a large increase in tax regressivity. Minnesota ranks 39<sup>th</sup> in terms of the magnitude of decline in the Suits index from 2000 to 2007, which means that only 11 other states moved toward increased tax regressivity more rapidly than Minnesota.

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<sup>1</sup> Data for Suits index calculations were obtained from the last two “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” published by the Institute on Taxation and Economic Policy, which covered taxes paid in 2000 and 2007. The most recent “Who Pays” report is based on 2007 data, but incorporates permanent tax changes made through October 2009. The previous “Who Pays” report is based on 2000 data, but incorporates permanent tax changes made through 2002.



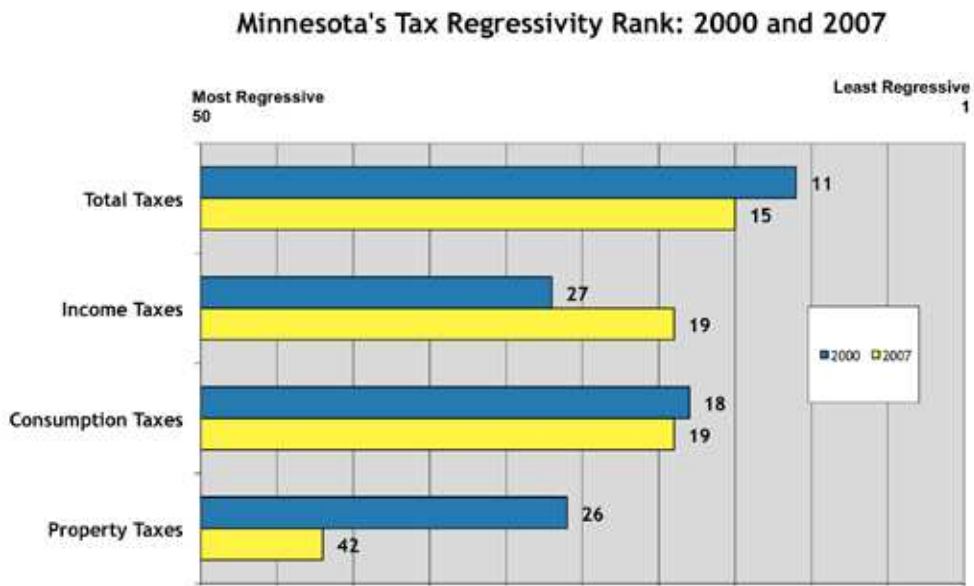


**FIGURE A**

**Figure A** shows the Suits index value for the state and local tax systems in all 50 states, ordered from the highest Suits value (i.e., the least regressive) to the lowest (i.e., the most regressive).

This report examines the Suits index for the entire state and local tax systems in all 50 states, along with the three major categories of taxes: income, consumption, and property taxes.

**Figure B** shows Minnesota’s 2000 and 2007 rank among the 50 states in terms of the degree of regressivity for the total state and local tax system, as well as for income, consumption, and property taxes; a high rank denotes relatively low regressivity, while a low rank denotes high regressivity.



**FIGURE B**

The degree of property tax regressivity in Minnesota increased markedly both in absolute terms and relative to other states during the period from 2000 to 2007. During this period, Minnesota's property tax Suits index went from above the national average to below the average. Minnesota's rank in terms of property tax regressivity fell from 26<sup>th</sup> in 2000 to 42<sup>nd</sup> in 2007; only eight other states had a property tax system more regressive than Minnesota's.

Minnesota's rank in terms of income tax progressivity rose from 27<sup>th</sup> to 19<sup>th</sup>; this improvement was likely due to increases in the working family credit and the dependent care credit. Minnesota's consumption tax ranking did not change significantly.

**A regressive tax system takes dollars disproportionately from the pockets of low and middle income families.**

Regressive taxes are particularly detrimental during a fragile economic recovery. The weak recovery, characterized by low job growth, is largely the result of weak aggregate demand; in other words, consumers lack the ability to purchase the goods and services necessary to stimulate economic growth. A regressive tax system takes dollars disproportionately from the pockets of the low and middle income families who tend to spend a larger share of their disposable income than high income families. Furthermore, low and middle income families tend to spend a larger share of their income within the local economy; thus, taxing these families at a disproportionately high rate is particularly damaging to aggregate demand and especially harmful to a state during a fragile recovery.

**Efforts to reduce regressivity are not “socialism” or “class warfare,” but simple tax fairness.**

Low and middle income families, who are already struggling to make ends meet, should not be asked to pay a larger percentage of their income to fund state and local government services than high income households. Efforts to reduce regressivity are not “socialism” or “class warfare,” but simple tax fairness.

## FINDINGS

- In nearly every state, including Minnesota, state and local taxes are regressive, meaning low and moderate income families, which have the least ability to pay, shoulder a disproportionate share of taxes.
- From 2000 to 2007, Minnesota's taxes have become more regressive in actual terms and relative to other states. During this period, Minnesota slipped from the 11<sup>th</sup> least regressive state to 15<sup>th</sup>.
- Minnesota's movement toward greater tax regressivity has proceeded more rapidly than in all but eleven states, driven largely by an increased dependence on regressive property taxes and de-emphasis on the more progressive income tax.
- Both nationally and in Minnesota, consumption taxes have become more regressive during the period from 2000 to 2007. The degree of descent toward increased consumption tax regressivity in Minnesota is similar to the national average.
- Income taxes among the 50 states became less progressive from 2000 to 2007. This was not the case in Minnesota; the degree of income tax progressivity in Minnesota as measured by the Suits index changed little from 2000 to 2007.
- States that rely heavily on progressive taxes, such as the personal income tax, tend to have less regressive tax systems.
- States that rely heavily on regressive consumption and property taxes tend to have more regressive tax systems.
- Economic trends, such as the growth in income inequality, contributed to the nationwide growth in tax regressivity.
- A statistical analysis shows that (1) the mix of taxes upon which states depend and (2) the degree of income inequality explain over three-fourths of the variation in tax regressivity from state to state. Of these two factors, the mix of taxes is far more powerful than income inequality in explaining variation in regressivity.
- Tax policy decisions also contributed to increased regressivity in Minnesota. These include:
  - ✓ Reduced revenue sharing with local governments. Since 2000, real (i.e., inflation-adjusted)<sup>2</sup> per capita state aid to local governments fell, contributing to an increase in regressive local property taxes despite an overall reduction in real per capita local government revenue.
  - ✓ A failure of the renters' property tax refund to keep pace with rental property tax growth.
  - ✓ A shift of property taxes from less regressive commercial/industrial property taxes to somewhat more regressive residential property taxes.

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2 Inflation adjustments in this report are based on the implicit price deflator for state and local government purchases, which is the appropriate measure of inflation for state and local governments. For more information, please see "Taking the Spin out of Inflation Estimates" (<http://www.mn2020.org/issues-that-matter/fiscal-policy/taking-the-spin-out-of-inflation-estimates>).

## POLICY OPTIONS

State policymakers should take steps to halt and ultimately reverse the trend of rising tax regressivity. This would not only help to preserve tax fairness, but would also assist in stimulating economic growth. The following strategies would reduce tax regressivity.

- ✓ One of the most effective ways to reduce regressivity is by increasing dependence on progressive revenues, such as the income tax, and reducing dependence on regressive revenues, such as property and consumption taxes.
- ✓ The progressivity of income taxes can be enhanced by using a graduated rate structure and through refundable credits, such as the working family and dependent care credits.
- ✓ The regressivity of consumption taxes can be reduced through use of progressive sales tax credits and by relying more on relatively less regressive sales taxes instead of more regressive excise taxes.
- ✓ The regressivity of property taxes can be reduced through use of property tax refund programs, also known as “circuit breakers,” which direct property tax relief to lower income families.
- ✓ Property taxes can also be made less regressive by shifting property taxes away from relatively more regressive residential property taxes toward less regressive commercial/ industrial property taxes.

Of course, reduced regressivity is only one of several goals that policymakers must be cognizant of when making tax policy decisions. However, given the trend toward rising tax regressivity and the deleterious effect of regressivity upon an already struggling economy, policy makers should give serious consideration toward policies that halt if not reverse the growth in tax regressivity.

# State and Local Tax Regressivity

*Fifty-State Comparative Analysis, with a Particular Focus on Minnesota*

## I. INTRODUCTION

“Tax incidence” refers to who pays the taxes. If high income households pay a larger percentage of their income in taxes than lower income households, the tax system is said to be “progressive.” If, on the other hand, low income households pay a higher percentage of their income in taxes, the tax system is said to be “regressive.”

### Regressivity is Prevalent

Minnesota’s state and local tax system is regressive and has been for at least twenty years, according to the Minnesota Department of Revenue’s biennial tax incidence studies.<sup>3</sup> Moreover, the degree of tax regressivity in Minnesota has increased since 2002. In other words, an increasing share of state and local government taxes in Minnesota has been shifted to low and moderate income households that have the least ability to pay.

State and local tax systems in most states are regressive. An important data source regarding the degree of regressivity in the state and local tax systems in all 50 states is “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States,” published periodically by the Institute on Taxation and Economic Policy (ITEP).<sup>4</sup> “Who Pays” is unique in that it not only provides information on taxes in every state, but also presents information on taxes paid by the taxpayer’s level of income.

**Minnesota’s state and local tax system is regressive and has been for at least twenty years.**

However, neither “Who Pays” nor any other publication ranks all 50 states in terms of the degree of regressivity in state and local tax systems based on the most current information available.<sup>5</sup> This report fills this gap by providing a comparative analysis which quantifies the degree of tax regressivity in all 50 states and which ranks states based on the degree of regressivity using data from “Who Pays.”

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3 Links to each of the Minnesota tax incidence studies since 1995 can be found at: [http://taxes.state.mn.us/legal\\_policy/pages/research\\_reports\\_content\\_incidence.aspx](http://taxes.state.mn.us/legal_policy/pages/research_reports_content_incidence.aspx). The most current Minnesota Tax Incidence Study, published in 2009, can be found at: [http://taxes.state.mn.us/legal\\_policy/Documents/other\\_supporting\\_content\\_2009\\_tax\\_incidence\\_study\\_links.pdf](http://taxes.state.mn.us/legal_policy/Documents/other_supporting_content_2009_tax_incidence_study_links.pdf)

4 The most current “Who Pays” report, which was released in November 2009 and incorporates data for taxes paid in 2007, can be found on-line at: <http://www.itepnet.org/whopays3.pdf>. The previous “Who Pays” report, which was released in January 2003 and incorporates 2000 data, can be found at: <http://www.itepnet.org/pdf/wp2003.pdf>

5 The 2009 Minnesota Tax Incidence Study (MTIS) from the Minnesota Department of Revenue contains a regressivity ranking for all 50 states based on calculations from Minnesota 2020 which utilized 2000 tax incidence data from ITEP (chapter 4, section G, p. 67). However, the MTIS analysis does not incorporate the 2007 ITEP tax incidence data.

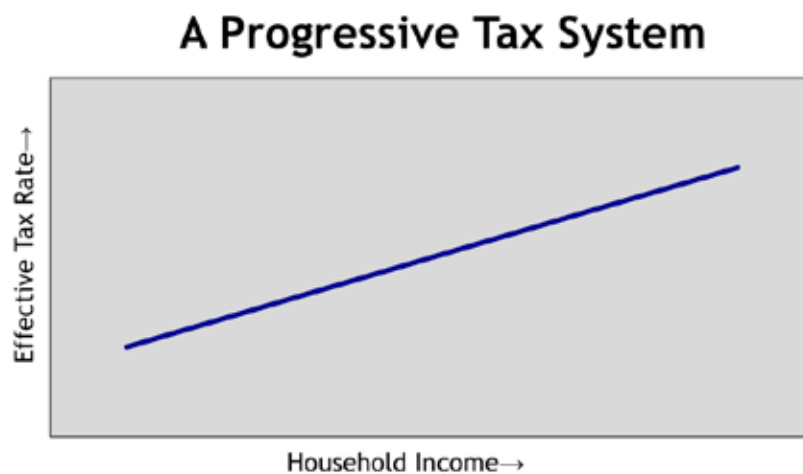


## Effective Tax Rates

A key concept in the analysis of tax incidence is the “effective tax rate.” The effective tax rate (or ETR) refers to taxes as a percentage of household income. For example, a household that pays \$10,000 in state and local taxes and has a household income of \$100,000 would have an effective tax rate of 10.0 percent ( $\$10,000 \text{ taxes} \div \$100,000 \text{ household income}$ ). The ETR can be applied not only to a single household, but to an entire group of households. For example, if total state and local taxes for all households in Minnesota equal ten percent of total statewide household income, the aggregate statewide household ETR would be 10.0 percent.

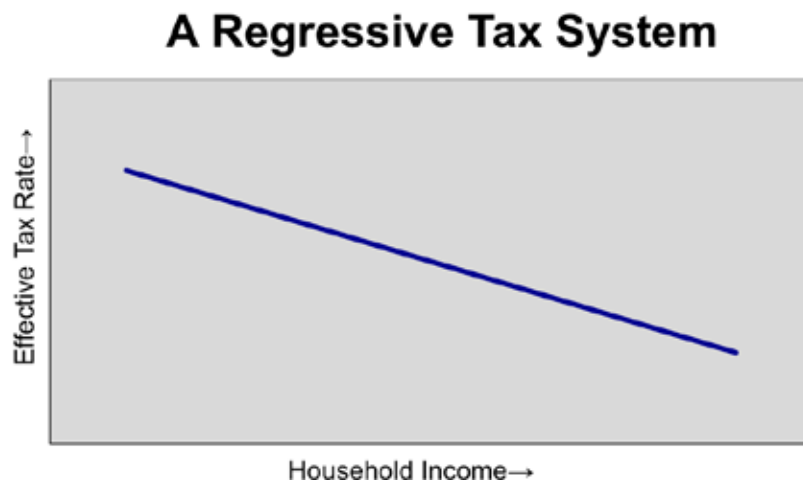
In a progressive tax system, the ETR rises as income rises. In other words, in a progressive tax system higher income households tend to pay a larger percentage of their income in taxes than do low income households, as illustrated in **figure 1**.

**FIGURE 1:**



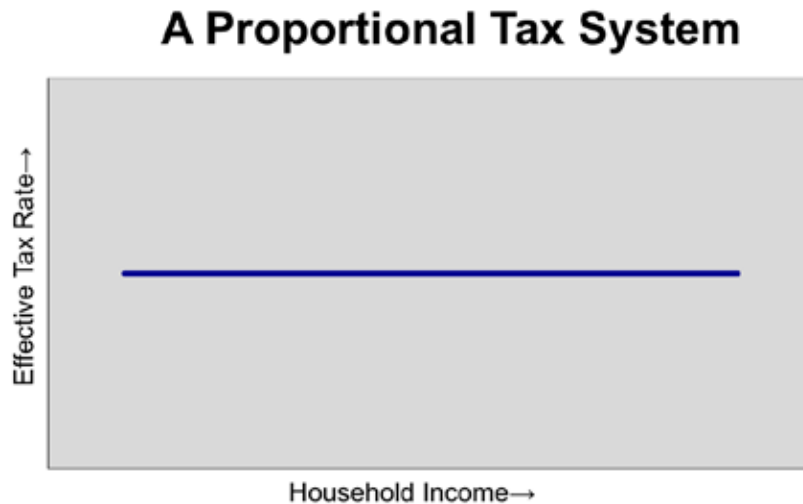
In a regressive tax system, the opposite is true; the ETR falls as income rises. In a regressive system, higher income households tend to pay a lower percentage of their income in taxes than do low income households. This is illustrated in **figure 2**.

**FIGURE 2:**



In its simplest form, a proportional tax system is one in which the ETR of all households is the same, regardless of income. In other words, the ETR remains constant as income rises, as illustrated in figure 3.

**FIGURE 3:**



However, the ETRs of all households do not necessarily have to be the same under a proportional tax system. The hallmark of a proportional tax system is not that all ETRs are identical, but that there is no simple linear relationship between income and the ETR. In a proportional system, particularly high or low ETRs among households in some income ranges are offset by correspondingly high or low ETRs among households in other ranges, so that there is no aggregate bias for high or low ETRs among households of differing income levels.

## Measuring Regressivity: The Suits Index

As noted in the 2009 Minnesota Tax Incidence Study (MTIS), “it is sometimes difficult to summarize the overall distribution of a tax (progressive, proportional, or regressive) from the individual effective tax rates.” In other words, it is difficult to judge the overall regressivity or progressivity of a tax system simply by “eyeballing” the ETRs.

To overcome this problem, the MTIS uses a statistical measure known as the “Suits index” to measure the regressivity of Minnesota’s tax system. According to the MTIS, “The Suits index has the numerical properties that make it easy to identify the degree of progressivity or regressivity of a tax.” This report will also measure the progressivity/regressivity of the state and local tax systems in each of the 50 states using the Suits index.

The value of the Suits index ranges from +1.0 to -1.0, with values above zero denoting a tax system that is progressive and values below zero denoting a tax system that is regressive. A Suits index with a value of zero denotes a tax system that is proportional.

For a Suits index to reach +1.0, all taxes would have to be paid exclusively by the wealthiest household(s). For a Suits index to reach -1.0, all taxes would have to be paid by the poorest household(s). Values of the Suits index at the extreme ends — +1.0 and -1.0 — never occur in the real world. In practice, a Suits index with a value of +0.2 or higher is considered very progressive, while a Suits index of -0.2 or less is considered very regressive.<sup>6</sup>

## More About ITEP’s “Who Pays” Reports

The calculation of the Suits index for all fifty states is based on data from the last two “Who Pays” reports from ITEP. “Who Pays” includes information for the following state and local taxes in all 50 states: sales and excise taxes (referred to in this report as “consumption taxes”), property taxes, and personal and corporate income taxes (referred to in this report collectively as “income taxes”). The most current edition of “Who Pays” focuses on taxes paid in 2007, adjusted to reflect the impact of permanent tax changes enacted through October of 2009; the previous edition of “Who Pays” focuses on 2000 data, adjusted to reflect the impact tax of changes in tax laws through 2002.

The 2007 “Who Pays” data used in the report does not reflect the impact of the “great recession,” which began in 2008. The upcoming 2011 Minnesota Tax Incidence Study, which will include actual data for 2008 and projected data for 2013, will reflect the impact of the great recession on Minnesota tax regressivity.

The information in “Who Pays” is derived from ITEP’s “microsimulation tax model.” According to ITEP, this model is “based on a very large sample of federal tax returns, Census data, Consumer Expenditure Survey data and information from many other sources. It encompasses 690,000 statistically-matched records, selected to produce reliable results on a state-by-state basis. The ITEP Model includes all significant current national, state and local tax laws, and is equipped to evaluate changes to those laws.”

“Who Pays” reports the effective tax rate (ETR) by type of tax for income quintiles (i.e., groups of 20 percent of the population), with the highest income quintile broken down into three sub-groups, for a total of seven income groups, as listed below:

- The 20 percent of household with the lowest income (i.e., the first or bottom quintile)
- The second 20 percent (i.e., the second quintile)
- The third 20 percent (i.e., the third or middle quintile)
- The forth 20 percent (i.e., the fourth quintile)
- The next 15 percent
- The next 4 percent
- The 1 percent of households with the highest income

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<sup>6</sup> Even a Suits index with a value as high as -0.05 or -0.025 denotes a tax system that is significantly regressive. For more on this, please see: “How Regressive is Minnesota’s Tax System? Very Regressive,” Minnesota 2020, April 29, 2009 (<http://www.mn2020.org/issues-that-matter/fiscal-policy/how-regressive-is-minnesota-s-tax-system-very-regressive>).

Using this data, it is possible to calculate Suits indices for all fifty states. In addition to the Suits index for the total tax system, this report also provides the Suits index for (1) total income taxes, (2) consumption taxes, and (3) property taxes.

According to the Minnesota Department of Revenue, the methodology used in “Who Pays” is “relatively close” to what is used in the MTIS. However, due to the fact that “Who Pays” is examining data for all 50 states, while the MTIS has the luxury of focusing on only one state, the 50 state data in “Who Pays” is generally less comprehensive and detailed than the Minnesota data in the MTIS. Differences between the two reports are summarized below.

- ✓ The MTIS includes some types of taxes not included in “Who Pays,” including mortgage and deed taxes, mining production taxes, and estate taxes.
- ✓ The most recent MTIS (released in March of 2009) is based tax data for 2006, with projections for 2011. “Who Pays” is based on taxes paid in 2007, with adjustments for permanent tax changes enacted through October of 2009.
- ✓ While both the MTIS and “Who Pays” examine the final incidence of taxes after taxes imposed on businesses have been shifted to those who bear the final burden (e.g., consumers, labor), the two studies employ different assumptions regarding these shifts.
- ✓ “Who Pays” focuses on non-senior households because “state tax systems often treat elderly families very differently from other families” (“Who Pays,” p. 2). The MTIS, on the other hand, focuses on all Minnesota households.
- ✓ The MTIS reports the distribution of taxes within Minnesota based on ten equal sized groups known as “deciles,” with additional detail reported for the tenth decile (i.e., the decile with the highest income).<sup>7</sup> As noted above, “Who Pays” reports the distribution based on seven groups.

Because they are based on ten groups instead of just seven, Suits indices calculated from data in the MTIS<sup>8</sup> are more accurate than Suits indices calculated from data in “Who Pays.”

Despite these differences, the total state and local Suits index for Minnesota calculated based on ITEP data is similar to the population decile Suits index reported in the MTIS.<sup>9</sup>

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7 The MTIS reports information based on two different types of deciles: population deciles and income deciles. For population deciles, each decile represents one-tenth of the statewide households. For income deciles, each decile consists of one-tenth of statewide household income. For both population and income deciles, deciles are ordered by income, so that the first decile consists of the lowest income households and the tenth decile consists of the highest income households.

8 In addition to calculating Suits indices by population and income deciles (see previous footnote), the MTIS also calculates a “full sample” Suits index, which is based on the entire sample of households. Suits indices calculated based on the full sample maintain all of the detail available in the sample because they are not dependent on any grouping of data. For this reason, “full sample” Suits indices are more accurate than Suits indices based on deciles.

9 In terms of how the data is grouped, the population decile Suits index from the MTIS most closely resembles the seven group Suits index calculated from data in “Who Pays.” Minnesota’s 2006 total state and local Suits index calculated based on population deciles from the MTIS is -0.052, which is very close to the 2007 Suits index of -0.049 calculated using the seven group data from “Who Pays.”

The MTIS focuses primarily on the incidence of taxation without adjusting for the deductibility of state income taxes and homeowner property taxes. Adjusting for this “federal tax offset” generally has the effect of increasing the regressivity of the state and local tax system. In section C of the 2009 MTIS, the Minnesota Department of Revenue makes a strong case against making an adjustment for the federal tax offset. In calculating Suits indices for the 50 states, this report will use data from “Who Pays” that excludes the federal offset adjustment.

This report also examines data from the previous “Who Pays” report published in 2002 based on tax data from 2000. In this way, this report can not only examine the incidence of state and local taxes among the 50 states currently, but trends in tax regressivity over the last several years.



## II. TOTAL STATE AND LOCAL TAX SYSTEMS

Data from the most recent version of ITEP’s “Who Pays: A Distributional Analysis of the Tax Systems in All 50 States” confirms what was already known from the most recent version of the Minnesota Tax Incidence Study (MTIS) from the Minnesota Department of Revenue: Minnesota’s state and local tax system is regressive and has become more regressive in recent years.

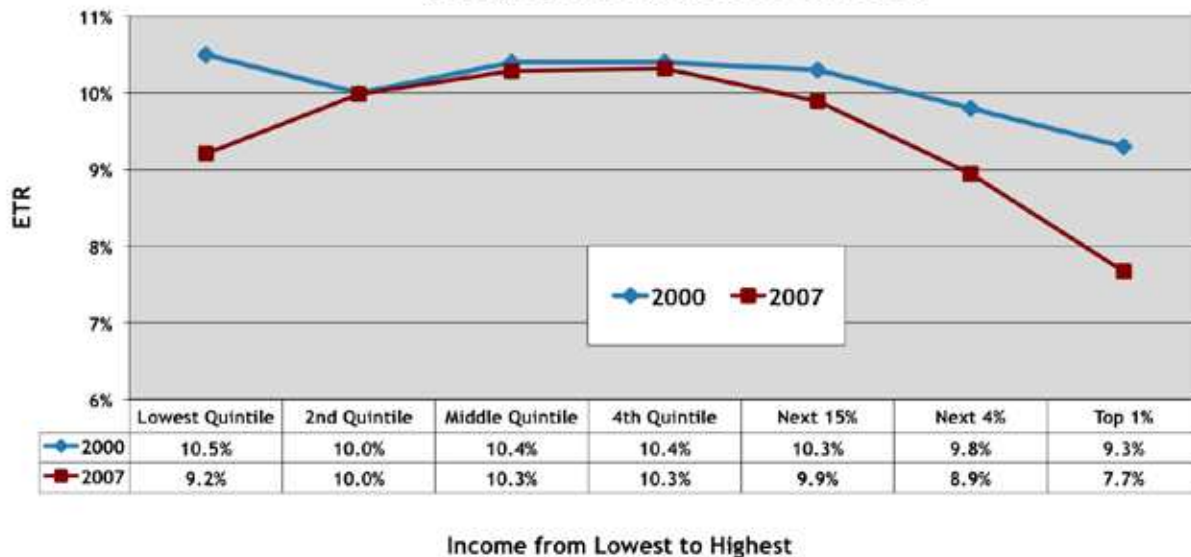
**Minnesota’s state and local tax system is regressive and has become more regressive in recent years.**

### Total Effective Tax Rates (ETRs) in Minnesota

Figure 4 shows Minnesota’s 2000 and 2007 total state and local effective tax rates by quintile, listed from lowest to highest income with the top quintile broken down into three parts, based on 2000 and 2007 data from the last two “Who Pays” reports.

Overall, Minnesota’s total ETR declined from 10.1 percent in 2000 to 9.4 percent in 2007, a drop of 0.7 percent. However, this 0.7 percent drop in ETR was not evenly distributed among income groups. While ETR of the lowest quintile fell by 1.3 percent from 2000 to 2007, the ETR of the second, third, and fourth quintiles—the group that comprises the middle 60 percent of all Minnesota households—stayed essentially flat.<sup>10</sup> The ETR of the top quintile declined, with the greatest decline concentrated at the top end of the top quintile. The ETR of the top one percent of households fell by 1.6 percent, more than in any other of the seven groups examined in “Who Pays.”

**FIGURE 4:** Minnesota Total State & Local Effective Tax Rate (ETR) by Income: 2000 vs. 2007



<sup>10</sup> Data from the MTIS for a similar period (2000 to 2006) show a significant increase in ETRs for the second and third (middle) quintiles and no change in the ETR for the fourth quintile. The difference between the ETR growth rates in “Who Pays” versus the MTIS is likely due to differences in data (the MTIS includes more taxes and a larger Minnesota sample) and time frame (2000-2007 for “Who Pays” and 2000-2006 for the MTIS).

Because the distribution of income is so heavily skewed toward the top quintile and especially the top one percent,<sup>11</sup> the ETR reduction in the bottom quintile is not nearly sufficient to offset the ETR reduction at the top end of the income spectrum in terms of the impact on tax regressivity. Thus, Minnesota’s tax system has become more regressive.

## Measuring Regressivity in the 50 States

**Table 1** shows the Suits index for the state and local tax system in all 50 states for 2000 and 2007 based on data from the last two “Who Pays” reports. As noted in the introduction, the lower the value of the Suits index, the higher the degree of tax regressivity; Suits indices with values between 0 and -1 denote a regressive tax system, while Suits indices with values between 0 and +1 denote a progressive system.

Table 1 also shows each state’s rank in terms of the degree of regressivity in 2000 and 2007; a rank of 1 denotes the state with the most progressive tax system, while a rank of 50 denotes the state with the most regressive tax system. In addition, table 1 ranks states in terms of the degree of change in regressivity as measured by the change in the Suits index. A rank of 1 denotes the state with the greatest change in the direction of increased progressivity (or reduced regressivity), while a rank of 50 denotes the state with the greatest change in the direction of increased regressivity (or reduced progressivity).

Not surprisingly, the states with the most regressive tax systems tend to be the states that rely most heavily on regressive forms of taxation. For example, consumption taxes are the most regressive of the three major types of taxes examined in “Who Pays.”<sup>12</sup> Tennessee and Washington, which have the highest dependence on consumption taxes in the nation, are both among the ten states with the most regressive state and local tax systems. Meanwhile, Oregon and Montana, the two states with the least dependence on consumption taxes, are among the ten most progressive states.

States that rely most heavily on income taxes tend to have the most progressive tax systems.

Conversely, states that rely most heavily on income taxes—the most progressive tax examined in “Who Pays”—tend to have the most progressive tax systems. For example, Delaware and Oregon, which have the highest dependence on income taxes, are among the ten states with the most progressive tax systems. Meanwhile, Wyoming and Washington, which have no personal or corporate income taxes, are among the ten states with the most regressive tax systems.

11 Based on data from the most recent “Who Pays” for 2007, the aggregate income of the top (wealthiest) 20 percent of Minnesota households is 19.2 times greater than the income of the bottom (poorest) 20 percent and the income of the top one percent is 6.6 times greater than the income of the bottom 20 percent.

12 Using data from the MTIS (specifically, the full sample Suits indices on page 27), it can be demonstrated that sales and excise taxes are more regressive than property taxes after the impact of property tax refunds are taken into account. Furthermore, the most recent edition of “Who Pays” states that “Sales and excise taxes are the most regressive element in most state and local tax systems” (p. 8).

**Table 1 - Suits Indices for Total State & Local Taxes: 2000 & 2007**

State	2000		2007		Change: 2000-2007	
	Index	Rank	Index	Rank	Index	Rank
Alabama	-0.1310	42	-0.1415	41	-0.0104	13
Alaska	-0.0352	16	-0.1327	40	-0.0974	50
Arizona	-0.0971	37	-0.1299	39	-0.0328	40
Arkansas	-0.0505	25	-0.1009	33	-0.0504	46
California	0.0141	2	0.0264	1	0.0123	3
Colorado	-0.0837	34	-0.1004	32	-0.0167	21
Connecticut	-0.0978	38	-0.1002	31	-0.0025	10
Delaware	0.0569	1	-0.0105	4	-0.0674	48
Florida	-0.2220	49	-0.2589	50	-0.0370	42
Georgia	-0.0710	29	-0.0836	25	-0.0126	18
Hawaii	-0.0751	33	-0.0944	28	-0.0193	25
Idaho	-0.0124	8	-0.0341	11	-0.0217	31
Illinois	-0.1202	41	-0.1490	42	-0.0288	37
Indiana	-0.0892	35	-0.1002	30	-0.0111	15
Iowa	-0.0492	22	-0.0516	16	-0.0024	9
Kansas	-0.0496	23	-0.0405	12	0.0091	5
Kentucky	-0.0407	18	-0.0677	23	-0.0270	35
Louisiana	-0.1021	39	-0.1143	36	-0.0122	17
Maine	0.0011	5	-0.0240	7	-0.0252	34
Maryland	-0.0347	14	-0.0559	18	-0.0212	29
Massachusetts	-0.0541	27	-0.1009	34	-0.0468	44
Michigan	-0.0933	36	-0.0691	24	0.0242	2
<b>Minnesota</b>	<b>-0.0172</b>	<b>11</b>	<b>-0.0491</b>	<b>15</b>	<b>-0.0319</b>	<b>39</b>
Mississippi	-0.0743	31	-0.0968	29	-0.0224	33
Missouri	-0.0432	19	-0.0655	20	-0.0224	32
Montana	0.0130	3	-0.0207	6	-0.0338	41
Nebraska	-0.0094	7	-0.0665	22	-0.0572	47
Nevada	-0.2151	48	-0.2367	47	-0.0216	30
New Hampshire	-0.1436	43	-0.1604	43	-0.0168	22
New Jersey	-0.0364	17	-0.0024	2	0.0340	1
New Mexico	-0.0475	21	-0.1161	38	-0.0686	49
New York	-0.0535	26	-0.0418	13	0.0117	4
North Carolina	-0.0279	13	-0.0313	9	-0.0034	11
North Dakota	-0.0739	30	-0.0930	27	-0.0191	23
Ohio	-0.0169	10	-0.0651	19	-0.0482	45
Oklahoma	-0.0639	28	-0.1013	35	-0.0374	43
Oregon	0.0025	4	-0.0054	3	-0.0079	12
Pennsylvania	-0.1169	40	-0.1153	37	0.0016	6
Rhode Island	-0.0467	20	-0.0663	21	-0.0195	27
South Carolina	-0.0130	9	-0.0263	8	-0.0133	19
South Dakota	-0.1997	46	-0.2282	46	-0.0285	36
Tennessee	-0.1955	45	-0.2147	45	-0.0191	24
Texas	-0.1737	44	-0.1933	44	-0.0195	26
Utah	-0.0750	32	-0.0860	26	-0.0110	14
Vermont	0.0004	6	-0.0135	5	-0.0138	20
Virginia	-0.0349	15	-0.0557	17	-0.0208	28
Washington	-0.2491	50	-0.2488	49	0.0003	8
West Virginia	-0.0225	12	-0.0340	10	-0.0115	16
Wisconsin	-0.0502	24	-0.0490	14	0.0012	7
Wyoming	-0.2118	47	-0.2429	48	-0.0312	38
All U.S.	-0.0663		-0.0849		-0.0186	

A statistical analysis confirms the relationship between the type of tax that a state depends on and the degree of regressivity. There is a strong positive correlation between the Suits index of the state tax system and dependence on income taxes, thereby demonstrating that tax progressivity generally increases as dependence on income taxes increase.<sup>13</sup> Conversely, there is a strong negative correlation between the Suits index and dependence on consumption taxes, which demonstrates that tax regressivity generally increases as dependence on consumption taxes increases.<sup>14</sup> There is also a statistically significant negative correlation between the Suits index and dependence on property taxes,<sup>15</sup> which are also regressive but not as regressive as consumption taxes.

While income taxes are generally progressive and consumption and property taxes are generally regressive, there are exceptions to these rules due to variation in tax policy from state to state. For example, in a small number of states, the property tax is actually progressive, while in one state the personal income tax is slightly regressive. Variation in the degree of regressivity among states for specific types of taxes will be examined further in subsequent sections.

## Regressivity in Minnesota Relative to Other States

In terms of the degree of regressivity, Minnesota is still better off than most states. The total state and local Suits index for all 50 states in 2007 is -0.0849, significantly more regressive than Minnesota's -0.0491. Minnesota's low level of regressivity relative to most other states is largely the result of Minnesota's relatively heavy dependence on income taxes; according to "Who Pays," 44 percent of Minnesota state and local tax revenue is derived from income taxes, compared to 36 percent nationally. At 15<sup>th</sup>, Minnesota falls within the third of states with the least regressive tax systems, though just barely.

**In terms of the degree of regressivity, Minnesota is still better off than most states.**

While the state and local tax system in Minnesota is less regressive than in most other states, the degree of regressivity in Minnesota has increased significantly in recent years. Table 1 reveals that Minnesota's Suits index fell from -0.0172 in 2000 to -0.0491 in 2007. This is consistent with trends observed in recent MTIS reports, which also shows a reduction in Minnesota's Suits index (i.e., an increase in tax regressivity) in recent years.

Not only has tax regressivity in Minnesota increased in an absolute sense, but it has also increased relative to other states. Minnesota's rank in terms of the degree of regressivity has fallen from 11<sup>th</sup> in 2000 to 15<sup>th</sup> in 2007. The value of Minnesota's Suits index declined by 0.0319, compared to a national decline of just 0.0186. In terms of the change in the Suits index from 2000 to 2007, Minnesota ranks 39<sup>th</sup>. In other words, only 11 states moved toward increased tax regressivity more rapidly than Minnesota.

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13 The correlation coefficient for the relationship between the Suits index and percentage of total tax revenue derived from the income tax is +0.866 ( $R^2 = 0.751$ ), which is statistically significant at the 0.01 level.

14 The correlation coefficient for the relationship between the Suits index and percentage of total tax revenue derived from consumption taxes is -0.736 ( $R^2 = 0.542$ ), which is statistically significant at the 0.01 level.

15 The correlation coefficient for the relationship between the Suits index and percentage of total tax revenue derived from the property tax is -0.308 ( $R^2 = 0.095$ ), which is statistically significant at the 0.05 level.

A powerful contributor to growth in tax regressivity in Minnesota and nationwide is growth in income inequality. As noted in the 2009 MTIS, increases in tax regressivity are generally associated with an increase in income inequality; in other words, tax regressivity generally increases when a larger share of aggregate income is concentrated in the hands of the highest income households. The MTIS further notes that income inequality was unusually high in 2006 and concludes that the “concentration of income by itself, with no change in tax law, will increase the measured regressivity of the tax system.”<sup>16</sup>

**The growth in income inequality in Minnesota explains in part why Minnesota’s tax system became more regressive.**

The growth in income inequality in Minnesota explains in part why Minnesota’s tax system became more regressive. However, it does not explain why the degree of regressivity in Minnesota increased more rapidly than in other states; while income inequality increased in Minnesota, it did not increase any more rapidly than the national average from 2000 to 2007 based on income data from the last two “Who Pays” reports.

Changes in tax policy have also contributed to the increase in tax regressivity in Minnesota relative to other states. From 2000 to 2007, property taxes in Minnesota as a percentage of all taxes examined in “Who Pays” increased from 24 percent to 26 percent,<sup>17</sup> while incomes taxes declined from 46 percent to 44 percent. According to both the MTIS and “Who Pays,” property taxes are regressive, while income taxes are progressive. Thus, Minnesota was increasing dependence on regressive property taxes while decreasing dependence on progressive income taxes, thereby contributing to increased overall regressivity.

Nationally, dependence on property taxes also increased from 2000 to 2007. However, on a nationwide basis, the increased dependence on property taxes was not offset by decreased dependence on income taxes, but by decreased dependence on consumption taxes.

Thus, both nationally and in Minnesota, dependence on property taxes increased from 2000 to 2007. However, the similarity ends there. In exchange for increased dependence on property taxes, Minnesota was reducing dependence on progressive income taxes, while the rest of the nation was reducing dependence on more regressive consumption taxes. These trends help to explain why the regressivity of Minnesota’s state and local tax system increased relative to the rest of the nation from 2000 to 2007.

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<sup>16</sup> “2009 Minnesota Tax Incidence Study,” Minnesota Department of Revenue ([http://taxes.state.mn.us/legal\\_policy/Documents/other\\_supporting\\_content\\_2009\\_tax\\_incidence\\_study\\_links.pdf](http://taxes.state.mn.us/legal_policy/Documents/other_supporting_content_2009_tax_incidence_study_links.pdf)), p. 21.

<sup>17</sup> The growth in Minnesota’s dependence on the property tax from 2000 to 2007 may come as a surprise to some, given that the state virtually eliminated the general education levy in 2002. However, the large reduction in property taxes in 2002 was offset by a steady decline in state revenue sharing with local governments in subsequent years as the state struggled to deal with recurring deficits. Despite significant reductions in real per capita and per pupil county, city, and school district total revenue, property taxes increased primarily in response to state aid reductions. More information on this trend can be found in a 2010 report entitled “Minnesota 2020 Property Tax Report: 2002-2010” which can be found on-line at: <http://www.mn2020.org/issues-that-matter/fiscal-policy/minnesota-2020-property-tax-report-2002-2010>.



Not only did Minnesota's dependence on the property tax increase from 2000 to 2007, but the property tax itself became sharply more regressive. On a nationwide basis, property taxes also became more regressive, but the increase in property tax regressivity was far more pronounced in Minnesota. This trend will be discussed in more detail in section V. The increased dependence on property taxes in Minnesota combined with the especially sharp rise in property tax regressivity helps to explain why Minnesota's state and local tax system became more regressive relative to the rest of the nation from 2000 to 2007.

**On a nationwide basis, property taxes also became more regressive, but the increase in property tax regressivity was far more pronounced in Minnesota.**

In summary, while state and local taxes in Minnesota are still less regressive than in most other states, they are nonetheless becoming more regressive over time both in an absolute sense and relative to the rest of the nation. The growth in tax regressivity is driven in part by growth in income inequality, although changes in tax policy—especially increased dependence on property taxes and reduced dependence on income taxes—play a role in explaining why tax regressivity is increasing more rapidly in Minnesota than in other states.

### III. INCOME TAXES

The income tax is the most progressive of the major taxes levied in the United States. As used in this report, “income taxes” refer to both personal and corporate income taxes. Both in Minnesota and nationwide, approximately 97 percent of total non-exported income taxes are from personal income taxes, while only 3 percent come from corporate income taxes.<sup>18</sup>

Approximately 97 percent of total income taxes are from personal income taxes, while only 3 percent come from corporate income taxes.

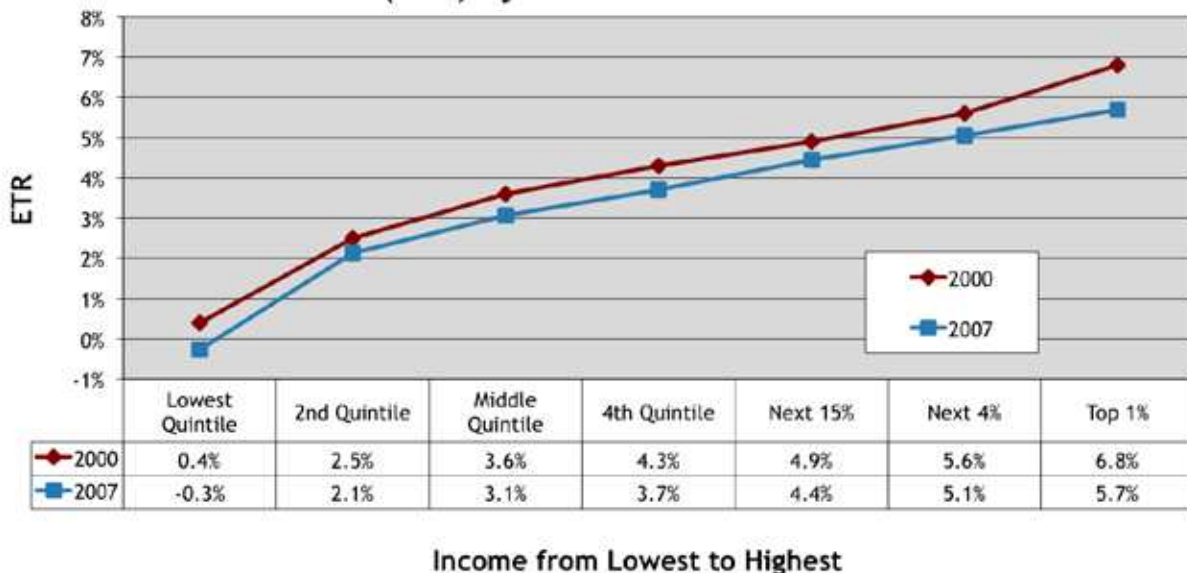
#### Income Tax ETRs in Minnesota

Figure 5 shows Minnesota’s 2000 and 2007 effective tax rates (ETRs) for the income tax by quintile, listed from lowest to highest income with the top quintile broken down into three parts, based on 2000 and 2007 data from the last two “Who Pays” reports.

From 2000 to 2007, income tax ETRs fell for all income groups.<sup>19</sup> In aggregate, the decline in Minnesota income tax ETRs was fairly uniform across income groups and thus the overall progressivity of the income tax in Minnesota changed little from 2000 to 2007.

FIGURE 5:

Minnesota Income Tax (Personal & Corporate) Effective Tax Rate (ETR) by Income: 2000 vs. 2007



18 Information from the most recent Minnesota Price of Government (POG) report from Minnesota Management & Budget shows that individual income taxes (which corresponds to what ITEP refers to as “personal income taxes”) have comprised on average approximately 89 percent of total income tax collections from FY 2005 to 2010, although there is significant yearly variation in this percentage due primarily to volatility in corporate income tax collections. The disparity between the POG data and “Who Pays” data is primarily due to the fact that POG data includes all individual and corporate income tax data, whereas, as noted in section I, “Who Pays” excludes all taxes that are exported out of state. According to 2006 data from the most recent MTIS, 39 percent of Minnesota corporate income taxes are exported, while only 4 percent of individual income taxes are exported.

19 The negative 2007 ETR for the lowest income quintile is the result of refundable tax credits (e.g., the working family credit, the dependent care credit), which more than offset income tax liabilities. The most recent MTIS also shows negative income tax ETRs for low income households.

## Measuring Income Tax Progressivity in the 50 States

**Table 2** shows the income tax Suits index for all 50 states for 2000 and 2007 based on data from the last two “Who Pays” reports. As noted in the introduction, the higher the value of the Suits index, the higher the degree of tax progressivity; Suits indices with values between 0 and +1 denote progressivity, while Suits indices with values between 0 and -1 denote regressivity.

Table 2 also shows each state’s rank in terms of the degree of income tax progressivity in 2000 and 2007; a rank of 1 denotes the state with the most progressive income tax, while a rank of 50 denotes the state with the most regressive income tax. In addition, table 2 ranks the states in terms of the degree of change in income tax progressivity as measured by the change in the Suits index. A state with a rank of 1 denotes the state with the greatest change in the direction of increased progressivity (or reduced regressivity), while a rank of 50 denotes the state with the greatest change in the direction of increased regressivity (or reduced progressivity).

There is tremendous variability among states in the degree of income tax progressivity. The state with the most progressive income tax in 2007 was Tennessee, with a Suits index of +0.6120, followed by Florida,<sup>20</sup> with an index of +0.4382. Despite having highly progressive income taxes, Tennessee and Florida have among the most regressive total state and local tax systems in the nation, as indicated in table 1. This is because both states derive only a very small share of total state and local tax revenue from the income tax and rely more heavily on regressive consumption and property taxes.

**“Refundable credits” are most effective at enhancing the progressivity of the income tax.**

Common characteristics of states with the most progressive income taxes are (1) a highly graduated rate structure with relatively high tax rates for high income households, (2) large personal and dependent exemptions and standard deductions, and (3) presence of low-income tax credits. “Refundable credits” are most effective at enhancing the progressivity of the income tax. These are sometimes referred to as “negative taxes” because the amount of the credit can exceed a taxpayer’s income tax liability.

While income taxes are progressive in most states, one state—Nevada—has a regressive income tax.<sup>21</sup> Nevada’s income tax regressivity is due to the fact that Nevada has only a corporate income tax and no personal income tax. While personal income taxes are progressive, corporate income taxes tend to be regressive. The overall progressivity of the income tax in most states is due to the fact that most income tax revenue is from progressive personal income taxes, not regressive corporate income taxes.<sup>22</sup>

20 Florida is one of five states that have a corporate income tax but no personal income tax based on “Who Pays” data for 2007.

21 Nevada’s income tax rank in terms of the Suits index is 48th. That is because two states—Washington and Wyoming—have no income tax and thus are not ranked.

22 The resident share of income taxes is particularly heavily skewed toward the personal income tax and away from the corporate income tax. This is because a large share of corporate income taxes are exported out of state. For more on this, see footnote 18.

**Table 2 - Suits Indices for Total Income Taxes: 2000 & 2007**

State	2000		2007		Change: 2000-2007	
	Index	Rank	Index	Rank	Index	Rank
Alabama	0.0148	47	0.0246	46	0.0098	9
Alaska	0.3734	6	0.3794	4	0.0060	12
Arizona	0.2079	18	0.1852	14	-0.0227	23
Arkansas	0.2072	19	0.1585	21	-0.0488	37
California	0.3274	7	0.3536	5	0.0262	3
Colorado	0.1036	38	0.0793	40	-0.0243	24
Connecticut	0.1606	28	0.1347	29	-0.0259	26
Delaware	0.1890	23	0.1395	26	-0.0495	38
Florida	0.8168	2	0.4382	2	-0.3786	44
Georgia	0.1333	32	0.1143	32	-0.0190	20
Hawaii	0.0860	40	0.1059	33	0.0199	5
Idaho	0.2187	15	0.2299	9	0.0112	8
Illinois	0.0749	43	0.0433	44	-0.0316	28
Indiana	0.0402	46	0.0267	45	-0.0135	18
Iowa	0.1140	36	0.1207	31	0.0067	11
Kansas	0.1997	20	0.1610	20	-0.0386	33
Kentucky	0.0804	42	0.0473	43	-0.0332	30
Louisiana	0.1940	21	0.1445	23	-0.0495	39
Maine	0.2352	13	0.2162	10	-0.0191	21
Maryland	0.0856	41	0.1000	35	0.0145	7
Massachusetts	0.1043	37	0.0682	42	-0.0362	31
Michigan	0.0546	44	0.0870	39	0.0324	2
<b>Minnesota</b>	<b>0.1676</b>	<b>27</b>	<b>0.1668</b>	<b>19</b>	<b>-0.0008</b>	<b>13</b>
Mississippi	0.2514	12	0.1766	18	-0.0748	43
Missouri	0.1792	26	0.1225	30	-0.0567	40
Montana	0.1845	24	0.1366	28	-0.0478	36
Nebraska	0.2605	11	0.1930	12	-0.0675	42
Nevada	n/a	n/a	-0.2647	48	n/a	n/a
New Hampshire	0.4743	4	0.0918	37	-0.3825	45
New Jersey	0.3012	9	0.3085	7	0.0073	10
New Mexico	0.3022	8	0.2377	8	-0.0645	41
New York	0.2109	16	0.1848	15	-0.0262	27
North Carolina	0.1604	29	0.1425	24	-0.0178	19
North Dakota	0.2101	17	0.2021	11	-0.0080	14
Ohio	0.1411	31	0.1033	34	-0.0378	32
Oklahoma	0.1512	30	0.1404	25	-0.0108	15
Oregon	0.1186	35	0.0990	36	-0.0196	22
Pennsylvania	0.0546	45	0.0146	47	-0.0400	34
Rhode Island	0.2208	14	0.1891	13	-0.0317	29
South Carolina	0.1940	22	0.1826	16	-0.0114	16
South Dakota	0.8505	1	0.4336	3	-0.4168	46
Tennessee	0.4739	5	0.6120	1	0.1381	1
Texas	0.7144	3	0.1771	17	-0.5373	47
Utah	0.1332	33	0.0911	38	-0.0421	35
Vermont	0.2891	10	0.3136	6	0.0246	4
Virginia	0.0905	39	0.0783	41	-0.0123	17
Washington	n/a	n/a	n/a	n/a	n/a	n/a
West Virginia	0.1805	25	0.1557	22	-0.0248	25
Wisconsin	0.1217	34	0.1382	27	0.0165	6
Wyoming	n/a	n/a	n/a	n/a	n/a	n/a
All U.S.	0.1801		0.1670		-0.0131	

In addition to heavy reliance on corporate income taxes, the characteristics of states with the least progressive income taxes are (1) deductions and exemptions which disproportionately benefit high income households<sup>23</sup> and (2) flat tax rates that are the same for all taxpayers, regardless of income.

## Income Tax Progressivity in Minnesota Relative to Other States

From 2000 to 2007, income taxes in most states have become less progressive, as the income tax Suits index for all 50 states dropped modestly from +0.1801 to +0.1670. However, in Minnesota the income tax did not become significantly more regressive, as the income tax Suits index declined only slightly from +0.1676 to +0.1668. As a result of these trends, Minnesota's rank among the 50 states in terms of income tax progressivity improved from 27<sup>th</sup> in 2000 to 19<sup>th</sup> in 2007. Minnesota's income tax Suits index, which was modestly below the nationally average in 2000, was approximately equal to the national average in 2007.

During the period from 2000 to 2007, the income tax became more progressive in only 12 states and less progressive in 35 states. Meanwhile, in Minnesota the income tax did not become significantly more or less regressive based on the income tax Suits index. (Two other states have no income tax.)

Both nationally and in Minnesota, the increased concentration of income among high income households contributed to less income tax progressivity. However, in Minnesota this trend toward reduced progressivity appears to have been offset by other changes, including increases in the working family credit (which is similar to the federal earned income tax credit) and the dependent care credit. These two refundable credits are powerful mechanisms for enhancing income tax progressivity.

**The bottom line is that Minnesota bucked the national trend toward reduced income tax progressivity during the period from 2000 to 2007.**

The bottom line is that Minnesota bucked the national trend toward reduced income tax progressivity during the period from 2000 to 2007. In 2007, Minnesota is fairly typical among the 50 states in terms of the degree of income tax progressivity.

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23 According to a 2009 publication from the House Research and Fiscal Analysis Departments ("A Review of Selected Tax Expenditures: A Presentation to the House Taxes Committee"), Minnesota has several deductions and exemptions which increase regressivity, including the mortgage interest deduction, itemized deductions for property and other taxes, the charitable contribution deduction, the exemption for interest on Minnesota state and local government bonds, and the subtraction for K-12 education expenses. On the other hand, the Minnesota income tax has some features which reduce regressivity, such as the exemption for social security benefits and the subtraction for the charitable contributions of non-itemizers, both of which are subject to limitations.



## IV. CONSUMPTION TAXES

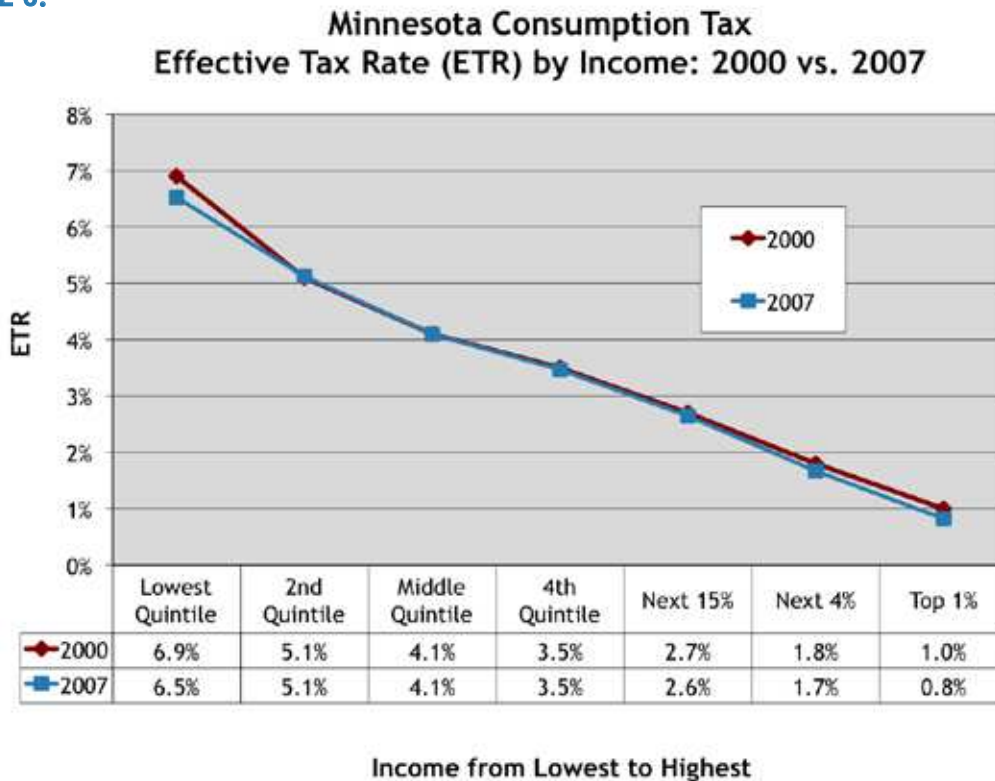
The two types of consumption taxes examined in the “Who Pays” report are sales and excise taxes. Sales and excise taxes are the most regressive of the three major categories of taxes examined in the “Who Pays” report. Sales taxes are generally levied as a percentage of the price paid for a good, while excise taxes are typically imposed on the volume of the good being purchased. For example, in Minnesota and many other states the tax on gasoline is an excise tax because it is based on the number of gallons purchased, not on the price of gasoline.

### Consumption Tax ETRs in Minnesota

Consumption taxes are regressive because they are applied at a uniform rate and because spending on taxable goods as a share of income generally falls as income rises. Based on information from the 2009 MTIS and from the most recent “Who Pays” report, excise taxes are in aggregate more regressive than sales taxes.<sup>24</sup>

Figure 6 shows Minnesota’s 2000 and 2007 effective tax rates (ETRs) for consumption taxes by quintile, listed from lowest to highest income with the top quintile broken down into three parts, based on 2000 and 2007 data from the last two “Who Pays” reports.

FIGURE 6:



24 Based on information from the 2009 MTIS, the aggregate Suits index for the general sales tax and the motor vehicle sales tax is -0.204, while the aggregate Suits index for the excise taxes listed in the MTIS (motor fuels, alcoholic beverages, and cigarettes and tobacco) is -0.380 (both Suits indices are “full sample”). The most recent “Who Pays” notes that “excise taxes are usually the most regressive kind of tax.”

The lowest income quintile experienced a 0.4 percent decline in the consumption tax ETR from 2000 to 2007, the largest decline among the seven income groups. The middle three quintiles experienced no decline in the consumption tax ETR. The top income quintile experienced a modest reduction in consumption tax ETRs, with the magnitude of the ETR reduction within this quintile increasing as income increases; the top one percent of households experienced a 0.2 percent reduction in the consumption tax ETR.

Because the distribution of income is so heavily skewed toward the top quintile and especially the top one percent,<sup>25</sup> the consumption tax ETR reduction in the bottom quintile is not sufficient to offset the ETR reduction at the top of the income spectrum in terms of the impact on tax regressivity. Thus, Minnesota's consumption taxes became somewhat more regressive from 2000 to 2007.

## Measuring Consumption Tax Regressivity in the 50 States

**Table 3** shows the consumption tax Suits index for all 50 states for 2000 and 2007 based on data from the last two "Who Pays" reports. As noted in the introduction, the lower the value of the Suits index, the higher the degree of tax regressivity.

Table 3 also shows each state's rank in terms of the degree of consumption tax regressivity in 2000 and 2007; a rank of 1 denotes the state with the least regressive consumption taxes, while a rank of 50 denotes the state with the most regressive consumption taxes. In addition, table 3 ranks the states in terms of the degree of change in consumption tax regressivity as measured by the change in the Suits index. A state with a rank of 1 denotes the state with the greatest change in the direction of increased progressivity (or reduced regressivity), while a rank of 50 denotes the state with the greatest change in the direction of increased regressivity (or reduced progressivity).

**Consumption taxes are significantly regressive in all 50 states, without exception.**

Consumption taxes are significantly regressive in all 50 states, without exception. Relative to income and property taxes, there is little variation in the degree of consumption tax regressivity from state to state. For example, the gap between the state with highest consumption tax Suits index (-0.2544) and the lowest (-0.3808) is just 0.1264. In contrast, the gap between the state with the highest income tax Suits index (+0.6120) and the lowest (-0.2647) is 0.8767.<sup>26</sup>

The variability that does exist among states in terms of the degree of consumption tax regressivity depends largely on the extent to which the state relies on excise taxes as opposed to sales taxes. The state with the most regressive consumption taxes is Oregon, which has only excise taxes and no general sales tax. The fact that excise taxes are more regressive than sales taxes explains why Oregon has the most regressive consumption taxes in the nation.

25 For more on the income disparity between the lowest and highest income quintile in Minnesota, see footnote 11.

26 This information arguably exaggerates the gap between the highest and lowest state in terms of the income tax Suits index because, as noted in the previous section, the state with the lowest income tax Suits index—Nevada—has no progressive personal income tax, only a regressive corporate income tax. If we exclude Nevada, the gap between the states with the highest and lowest income tax Suits index is 0.597, which is still 4.7 times greater than the gap between the states with the highest and lowest consumption tax Suits index.

**Table 3 - Suits Indices for Consumption Taxes: 2000 & 2007**

State	2000		2007		Change: 2000-2007	
	Index	Rank	Index	Rank	Index	Rank
Alabama	-0.2661	24	-0.2979	26	-0.0318	34
Alaska	-0.3118	44	-0.3333	40	-0.0215	15
Arizona	-0.2853	32	-0.3069	31	-0.0216	16
Arkansas	-0.2425	6	-0.2740	9	-0.0315	33
California	-0.3123	45	-0.3286	39	-0.0163	5
Colorado	-0.2697	28	-0.3046	30	-0.0350	36
Connecticut	-0.3216	48	-0.3336	41	-0.0120	3
Delaware	-0.3040	42	-0.3563	46	-0.0523	48
Florida	-0.3063	43	-0.3713	47	-0.0650	49
Georgia	-0.2895	35	-0.3096	34	-0.0201	9
Hawaii	-0.2508	13	-0.3016	28	-0.0508	46
Idaho	-0.2629	20	-0.2869	17	-0.0239	18
Illinois	-0.2932	36	-0.3146	37	-0.0215	12
Indiana	-0.2554	15	-0.2688	5	-0.0134	4
Iowa	-0.2279	2	-0.2643	2	-0.0363	40
Kansas	-0.2607	19	-0.2798	13	-0.0191	7
Kentucky	-0.2341	4	-0.2697	6	-0.0356	37
Louisiana	-0.2579	17	-0.2800	14	-0.0221	17
Maine	-0.2362	5	-0.2834	15	-0.0472	45
Maryland	-0.2867	33	-0.3138	36	-0.0271	21
Massachusetts	-0.2958	37	-0.3386	42	-0.0428	43
Michigan	-0.2551	14	-0.2748	11	-0.0197	8
<b>Minnesota</b>	<b>-0.2587</b>	<b>18</b>	<b>-0.2885</b>	<b>19</b>	<b>-0.0298</b>	<b>28</b>
Mississippi	-0.2448	9	-0.2725	8	-0.0277	23
Missouri	-0.2488	12	-0.2700	7	-0.0212	11
Montana	-0.3307	49	-0.3714	48	-0.0407	41
Nebraska	-0.2643	22	-0.2914	21	-0.0272	22
Nevada	-0.2982	40	-0.3446	44	-0.0465	44
New Hampshire	-0.3158	46	-0.3408	43	-0.0250	20
New Jersey	-0.2965	38	-0.2975	25	-0.0010	2
New Mexico	-0.2556	16	-0.2864	16	-0.0309	31
New York	-0.3180	47	-0.3475	45	-0.0295	27
North Carolina	-0.2631	21	-0.2872	18	-0.0241	19
North Dakota	-0.2309	3	-0.2666	4	-0.0357	38
Ohio	-0.2442	7	-0.2657	3	-0.0215	14
Oklahoma	-0.2446	8	-0.2962	23	-0.0516	47
Oregon	-0.3885	50	-0.3808	50	0.0077	1
Pennsylvania	-0.2822	31	-0.3024	29	-0.0203	10
Rhode Island	-0.2886	34	-0.3101	35	-0.0215	13
South Carolina	-0.2463	10	-0.2788	12	-0.0325	35
South Dakota	-0.2801	30	-0.3087	32	-0.0286	25
Tennessee	-0.2696	27	-0.3006	27	-0.0309	32
Texas	-0.2977	39	-0.3277	38	-0.0300	29
Utah	-0.2656	23	-0.2958	22	-0.0302	30
Vermont	-0.2686	26	-0.2974	24	-0.0288	26
Virginia	-0.2668	25	-0.3094	33	-0.0425	42
Washington	-0.2728	29	-0.2895	20	-0.0168	6
West Virginia	-0.2182	1	-0.2544	1	-0.0361	39
Wisconsin	-0.2463	11	-0.2740	10	-0.0277	24
Wyoming	-0.3019	41	-0.3750	49	-0.0732	50
All U.S.	-0.2870		-0.3135		-0.0265	

However, because Oregon derives only a small portion of its tax revenue from regressive consumption taxes (choosing instead to rely heavily on progressive income taxes), Oregon has among the least regressive total state and local tax systems in nation, as noted in section II. Montana and Delaware are similar to Oregon in this regard.

A factor that influences the degree of consumption tax regressivity among states that have sales taxes is the items that are included in the sales tax base. The most recent “Who Pays” notes that “The single most important factor affecting the fairness [i.e., the degree of regressivity] of different state sales taxes is the treatment of groceries. Taxing groceries is a particularly regressive strategy because poor families spend most of their income on groceries and other necessities.”

## Consumption Tax Regressivity in Minnesota Relative to Other States

Based on a comparison of Suits indices, 2007 state and local consumption taxes in Minnesota are somewhat less regressive than the national average; Minnesota’s 2007 consumption tax Suits index is -0.2885, while the average consumption tax Suits index for all 50 states is -0.3135. Minnesota ranks 19th among the 50 states in terms of the degree of consumption tax regressivity.

The somewhat lower degree of consumption tax regressivity in Minnesota is due in part to the fact that, unlike some states,<sup>27</sup> Minnesota does not impose a sales tax on groceries; as noted above, sales taxes on groceries are particularly regressive. In addition, based on FY 2007 Census Bureau data, consumption taxes in Minnesota appear to be more heavily weighted toward sales taxes and less heavily weighted toward excise taxes than the national average; this could help explain why Minnesota’s consumption taxes are somewhat less regressive than the national average, given that sales taxes are somewhat less regressive than excise taxes.<sup>28</sup>

**State and local consumption taxes in Minnesota are somewhat less regressive than the national average**

From 2000 to 2007, consumption taxes became more regressive, both nationally and within Minnesota. The degree of increase in regressivity as measured by the change in the consumption tax Suits index in Minnesota (0.0298) was similar to the national average (0.0265). As a result, Minnesota’s rank in terms of consumption tax regressivity changed by only one place from 2000 to 2007. Increased concentration of income among high income households (discussed in section II) likely contributed to the growth in consumption tax regressivity both nationally and in Minnesota.

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27 According to data from the Federation of Tax Administrators as reported in a 2008 Minnesota 2020 article (<http://www.mn2020.org/issues-that-matter/fiscal-policy/contemplating-a-fair-equitable-tax-base>), seven states tax groceries at the same rate as the general sales tax rate, while seven others tax groceries but at a rate below the general sales tax rate.

28 A caveat regarding this conclusion is that state and local tax information from the Census Bureau includes all consumption taxes, including the portion of consumption tax revenue that is exported. Calculations of tax regressivity, such as those in ITEP’s “Who Pays” and the MTIS, do not include exported taxes.

## V. PROPERTY TAXES

Property taxes are the primary source of local government tax revenue, although state governments in most states, including Minnesota, also collect property taxes. State or local governments in every state have some sort of tax on real property (i.e., land and buildings) and a number of states also tax some forms of personal property (e.g., equipment, fixtures, and inventory). Property taxes are generally based on property value.

Though not as regressive as consumption taxes, property taxes in most states are nonetheless significantly regressive. The regressivity of the property tax arises in part from the fact that residential property values comprise a larger share of the income of low income households than of high income households, so a tax based on property value consumes a larger share of the income of low income households. Renters who do not own real estate do not escape property taxes. As noted in the most current version of “Who Pays”:

“A portion of the property tax on rental property is passed through to renters in the form of higher rent—and these taxes represent a much larger share of income for poor families than for the wealthy. This adds to the regressivity of the property tax.”

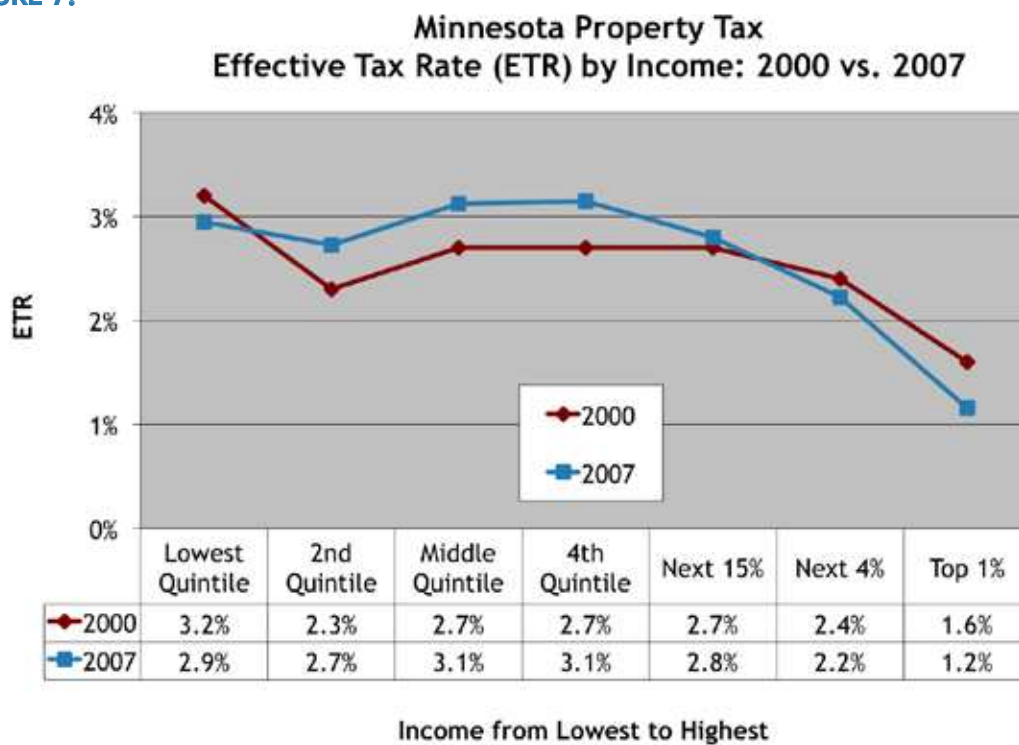


## Property Tax ETRs in Minnesota

**Figure 7** shows Minnesota’s 2000 and 2007 property tax effective tax rates (ETRs) by quintile, listed from lowest to highest income with the top quintile broken down into three parts, based on 2000 and 2007 data from the last two “Who Pays” reports.

Apart from a modest 0.3 percent reduction in property tax ETRs in the lowest income quintile, property ETR’s increased for all but the five percent of Minnesota households with the highest income during the period from 2000 to 2007. The largest increases were in the middle three quintiles, which saw property tax ETRs increase by 0.4 percent. While property tax ETRs were increasing for middle income households, they declined by 0.4 for the wealthiest one percent of Minnesota households. These trends denote a significant increase in Minnesota property tax regressivity from 2000 to 2007.

**FIGURE 7:**



**Table 4 - Suits Indices for Property Taxes: 2000 & 2007**

State	2000		2007		Change: 2000-2007	
	Index	Rank	Index	Rank	Index	Rank
Alabama	-0.0395	12	-0.0176	4	0.0218	5
Alaska	0.0207	3	-0.0908	25	-0.1115	49
Arizona	-0.0750	27	-0.1277	35	-0.0526	40
Arkansas	-0.0314	10	-0.1112	30	-0.0798	46
California	-0.1064	40	-0.1311	37	-0.0247	29
Colorado	-0.1284	45	-0.1155	31	0.0129	8
Connecticut	-0.2242	50	-0.2345	50	-0.0103	20
Delaware	-0.0806	32	-0.1377	40	-0.0571	41
Florida	-0.0490	20	-0.1277	36	-0.0787	45
Georgia	-0.0511	21	-0.0530	12	-0.0019	12
Hawaii	0.0106	4	-0.1010	29	-0.1116	50
Idaho	-0.1072	41	-0.1159	32	-0.0086	18
Illinois	-0.1031	38	-0.1505	44	-0.0474	37
Indiana	-0.0446	15	-0.0318	6	0.0128	9
Iowa	-0.0439	14	-0.0587	14	-0.0148	24
Kansas	-0.0446	16	-0.0504	10	-0.0058	16
Kentucky	-0.0466	18	-0.0605	15	-0.0139	23
Louisiana	0.0390	1	0.0331	1	-0.0059	17
Maine	-0.0414	13	-0.0674	18	-0.0260	30
Maryland	-0.0830	33	-0.1319	38	-0.0489	39
Massachusetts	-0.1199	43	-0.2051	49	-0.0852	47
Michigan	-0.0451	17	-0.0174	3	0.0277	3
<b>Minnesota</b>	<b>-0.0657</b>	<b>26</b>	<b>-0.1395</b>	<b>42</b>	<b>-0.0739</b>	<b>43</b>
Mississippi	-0.0366	11	-0.0211	5	0.0155	7
Missouri	-0.0518	22	-0.0873	23	-0.0355	34
Montana	-0.1052	39	-0.1241	34	-0.0188	27
Nebraska	-0.0612	25	-0.1361	39	-0.0748	44
Nevada	-0.0928	36	-0.0953	28	-0.0025	13
New Hampshire	-0.1353	47	-0.1669	47	-0.0316	32
New Jersey	-0.1527	48	-0.1409	43	0.0118	10
New Mexico	-0.0989	37	-0.1169	33	-0.0180	26
New York	-0.1238	44	-0.1866	48	-0.0628	42
North Carolina	-0.0766	29	-0.0426	9	0.0339	1
North Dakota	-0.0001	5	-0.0395	7	-0.0395	35
Ohio	-0.0476	19	-0.0749	19	-0.0273	31
Oklahoma	-0.0606	24	-0.1653	46	-0.1048	48
Oregon	-0.1291	46	-0.1384	41	-0.0093	19
Pennsylvania	-0.1156	42	-0.0920	27	0.0236	4
Rhode Island	-0.0806	31	-0.0858	21	-0.0053	15
South Carolina	-0.0288	7	-0.0396	8	-0.0109	21
South Dakota	-0.0553	23	-0.0672	17	-0.0119	22
Tennessee	-0.0869	34	-0.0904	24	-0.0035	14
Texas	-0.0099	6	-0.0556	13	-0.0456	36
Utah	-0.0757	28	-0.0919	26	-0.0162	25
Vermont	-0.0301	8	-0.0783	20	-0.0482	38
Virginia	-0.0305	9	-0.0513	11	-0.0208	28
Washington	-0.1857	49	-0.1557	45	0.0300	2
West Virginia	0.0367	2	0.0038	2	-0.0329	33
Wisconsin	-0.0884	35	-0.0869	22	0.0015	11
Wyoming	-0.0805	30	-0.0622	16	0.0183	6
All U.S.	-0.0856		-0.1240		-0.0384	

## Measuring Property Tax Regressivity in the 50 States

**Table 4** shows the property tax Suits index for all 50 states for 2000 and 2007 based on data from the last two “Who Pays” reports. As noted in the introduction, the lower the value of the Suits index, the higher the degree of tax regressivity.

Table 4 also shows each state’s rank in terms of the degree of property tax regressivity in 2000 and 2007; a rank of 1 denotes the state with the least regressive property tax, while a rank of 50 denotes the state with the most regressive property tax. In addition, table 4 ranks the states in terms of the degree of change in property tax regressivity as measured by the change in the Suits index. A state with a rank of 1 denotes the state with the greatest change in the direction of increased progressivity (or reduced regressivity), while a rank of 50 denotes the state with the greatest change in the direction of increased regressivity.

Based on 2007 data, property taxes are regressive in 48 of the 50 states. The gap between the state with the highest property tax Suits index (+0.0331) and the lowest (-0.2345) is 0.2676, which denotes significantly less variation among states in the degree of regressivity/progressivity than there is among income taxes, but significantly more than there is among consumption taxes.

The gross property tax (prior to subtracting property tax refunds) on residential properties, including owner-occupied and rental properties, tend to be more regressive than the property tax on commercial and industrial properties.<sup>29</sup> For this reason, states that have the least regressive property tax systems are those which have policies that focus on reducing residential property taxes. The most recent “Who Pays” notes that states with “exemptions, tax credits, and preferential tax rates for homeowners” tend to have the least regressive property taxes.

**The gross property tax on residential properties, including owner-occupied and rental properties, tend to be more regressive than the property tax on commercial and industrial properties.**

For example, the only state with significant property tax progressivity—Louisiana—has income sensitive property tax credits that reduce residential property taxes for low income households and a homestead “exemption.”<sup>30</sup> Because this exemption provides a much larger percentage tax reduction for owners of lower value homes and because lower income families are more likely to reside in low value homes, the exemption in Louisiana has the effect of reducing the regressivity of Louisiana’s property tax to the point where it is actually progressive.

Nationwide, property tax regressivity increased from 2000 to 2007, as the state and local property tax Suits index for all 50 states fell by 0.0384, from -0.0856 to -0.1240. As with increases in income and consumption tax regressivity, the nationwide increase in property tax regressivity was probably due in part to increased concentration of aggregate income among high income households.

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<sup>29</sup> Based on data for 2006 from the 2009 MTIS, the gross property tax Suits index is -0.407 for rental property, -0.214 for owner-occupied (i.e., homestead) property, -0.166 for commercial property, and +0.045 for industrial property (all “full sample” Suits indices). While these Suits indices are specific to Minnesota, observations in the most recent “Who Pays” confirm that residential property taxes in other states are more regressive than business and other non-residential property taxes.

<sup>30</sup> The Louisiana homestead exemption is described in more detail in “Louisiana Property Tax Basics” from the Lafayette Parish Assessor (<http://www.lafayetteassessor.com/TopicsPDFs/Louisiana%20Property%20Tax%20Basics%20booklet%203.pdf>).

## Property Tax Regressivity in Minnesota Relative to Other States

The increase in property tax regressivity was far greater in Minnesota than in most other states. In 2000, Minnesota's property tax Suits index was -0.0657. By 2007, Minnesota's property tax Suits index had more than doubled to -0.1395. During this seven year span, Minnesota's rank among the 50 states in property tax regressivity fell from 26th to 42nd, as Minnesota went from a state with below average property tax regressivity to a state with above average property tax regressivity as measured by the Suits index.

**Minnesota went from a state with below average property tax regressivity to a state with above average property tax regressivity.**

It is difficult to quantify the causes of growth in property tax regressivity in Minnesota or why growth in property tax regressivity in Minnesota exceeded the national average. No doubt broad economic trends, such as the growing concentration of income among high income households, played a role. Using MTIS data it is possible to identify other causes of the growth in Minnesota property tax regressivity; these fall into two categories.

First, there was a sharp rise in the regressivity of rental property taxes from 2000 to 2006. The growth in the regressivity of rental property taxes was the result of:

- ✓ **A sharp rise in the gross property tax effective tax rate (ETR) for low-income renters.** Based on data for 2000 and 2006 from the 2003 and 2009 MTIS, the rental property ETR for the lowest income quintile increased from 0.87 percent to 1.44 percent. This trend was due to a sharp increase in rental property taxes combined with relatively stagnant income in the lowest income quintile.<sup>31</sup>
- ✓ **Failure of the renters' property tax refund to keep pace with growth in rental property taxes.** Based on MTIS data, gross rental property taxes increased by 49 percent from 2000 to 2006, while the renters' property tax refund increased by 27 percent. The renters' property tax refund is critical to reducing the regressivity of rental property taxes; the decline in the renters' refund relative to gross rental property taxes leads to an increase in the regressivity of net rental property taxes.<sup>32</sup>

As a result of these trends, the net rental property tax Suits index fell dramatically from +0.068 in 2000 to -0.196 in 2006.<sup>33</sup>

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31 Gross rental property taxes paid by renters in the lowest income quintile increased by 86 percent from 2000 to 2006 based on MTIS data, while the household income of the lowest income quintile increased by 12 percent. (The rate of inflation over this period as measured by the Consumer Price Index was 17 percent; in contrast, the income of the highest income quintile increased by 28 percent.)

32 The data from the MTIS and "Who Pays" do not include the impact of the \$52 million reduction in the renters' property tax refund, first imposed by Governor Pawlenty in 2009 using his unallotment authority and later ratified by the legislature. This reduction will have the effect of further increasing property tax regressivity.

33 The net property tax Suits index takes into account the impact of the property tax refund. Unlike elsewhere in this report, the MTIS Suits indices cited here are based on population deciles instead of the more accurate full sample Suits index. This is because full sample Suits indices for 2000 are not available.

Second, the increase in Minnesota property tax regressivity was due in small part to changes in tax policy that shifted a larger share of aggregate statewide property taxes away from commercial/industrial property to residential homestead property.<sup>34</sup> MTIS data reveals that from 2000 to 2006, the homestead share of non-exported Minnesota property taxes (the basis of Suits calculations) increased from 56 percent to 62 percent, while the commercial/industrial share fell from 20 percent to 16 percent.<sup>35</sup>

Based on MTIS data, homestead property taxes are more regressive than commercial and industrial property taxes. Thus, by shifting property taxes from less regressive commercial/industrial property taxes to more regressive homestead property taxes, changes in state policy have contributed in a small but discernable way to growth in property tax regressivity.

**Based on MTIS data, homestead property taxes are more regressive than commercial and industrial property taxes.**

The decisions of state policymakers are not the only factor influencing the incidence of property taxes. However, tax policy decisions do have an impact on property tax regressivity. Decisions regarding funding for the property tax refund and the distribution of property taxes by property type are two ways in which policymakers have influenced the regressivity of Minnesota's property tax system.

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34 Contrary to some assertions, the growth in the share of total property taxes borne by homeowners since 2000 was not the result of growth in the estimated market value (EMV) of homestead property, since homestead EMV has increased less rapidly than the EMV of other classes of property. Rather, the increase in homestead property taxes and the decline in commercial / industrial property taxes since 2002 was the result of changes in state policy, including class rate compression and its interaction with the fiscal disparity program, the structure of the homestead market value credit, increased dependence on referendum market value levies, and a new state property tax on businesses that partially insulated business properties from the property tax increases affecting other property taxpayers. The phase-out of the limited market value program may have also contributed to the more rapid growth in homestead property taxes. These factors are described in "Minnesota 2020 Property Tax Report: 2002-2010," which can be found on-line at: <http://www.mn2020.org/issues-that-matter/fiscal-policy/minnesota-2020-property-tax-report-2002-2010>.

35 Based on MTIS data, including the state property tax for 2006.

## VI. CONCLUSION

“Who Pays? A Distributional Analysis of the Tax Systems in All 50 States” from the Institute on Taxation and Economic Policy (ITEP) is an invaluable source of information regarding the distribution of state and local taxes in the U.S. by level of income. This report applies a statistical measure known as the Suits index to data from the last two “Who Pays” reports to determine in quantifiable fashion which states have the most regressive tax systems and which states have seen the largest increase in regressivity from 2000 to 2007.

### Regressivity Among the 50 States

The Suits indices calculated from “Who Pays” data confirm conventional wisdom that the state and local tax systems in most states are regressive. Based on 2007 data, 49 of the 50 states have a Suits index below zero, which denotes regressivity in the state and local tax system. However, there is tremendous variability in the degree of regressivity among states.

Not surprisingly, the states with the most regressive tax systems are the states that are most dependent on regressive taxes. For example, there is a strong positive correlation between dependence on income taxes and the Suits index, which demonstrates that states that rely heavily on progressive income taxes generally have the least regressive tax systems. Meanwhile, there is a strong negative correlation between dependence on sales and excise taxes and the Suits index, which shows that states that rely heavily on regressive consumption taxes generally have the most regressive tax systems.

Another factor that determines the degree of regressivity in the state and local tax systems is the degree of income inequality. There is a statistically significant correlation between the degree of income inequality in a state<sup>36</sup> and the degree of tax regressivity as measured by the Suits index. States in which a particularly large share of income is concentrated in high income households tend to have more regressive tax systems than other states.

**States in which a particularly large share of income is concentrated in high income households tend to have more regressive tax systems than other states.**

While the degree of income inequality influences regressivity, the type of taxes that a state relies on is more important in determining the degree of tax regressivity from state to state. Based on a regression analysis in which each state is a data point, the level of dependence on the income tax is about four times more powerful in explaining variation in the Suits index than is the degree of income inequality. Combined, the level of dependence on the income tax and the degree of income inequality explain over three-fourths of the variation in tax regressivity from state to state.

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<sup>36</sup> Income inequality is measured by means of an income inequality index developed by Minnesota 2020 based on data from the “Who Pays” reports.



Not only are the tax systems in the vast majority of states regressive, but they have been growing more regressive over time. While six states had progressive tax systems in 2000, only one state has a progressive tax system in 2007. The 2007 Suits index for all state and local tax systems in the U.S. is -0.0849, down from -0.0663 in 2000. Furthermore, the Suits index in 42 of the 50 states fell from 2000 to 2007, denoting growth in regressivity.

While the type of taxes on which a state depends is the most important variable in explaining the degree of tax regressivity at a fixed point in time, it is not necessarily the most important factor in explaining the change in regressivity over time. Based on a regression equation in which each state is a data point, changes in the level of dependence on the income tax and the degree of income inequality are both of approximately equal importance in determining the change in Suits index values from 2000 to 2007. These two factors in combination explain about one-third of the variation in the change in Suits index values from state to state over this seven year span.

**While six states had progressive tax systems in 2000, only one state has a progressive tax system in 2007.**

Tax policy impacts the degree of regressivity in a state not only by shaping the type of taxes that a state relies on, but also through impacting the degree of regressivity of each of the individual types of taxes (although this is also affected by the degree of income inequality). For example:

- State tax policies can make the personal income tax less progressive by providing exemptions that disproportionately benefit high income households. Conversely, state policies can make the income tax more progressive through a graduated rate system that taxes higher income households at a higher rate than low income households or by providing refundable low-income tax credits.
- State tax policies can make consumption taxes less regressive by exempting items that comprise a particularly large portion of the budgets of low income households, such as groceries. Furthermore, the regressivity of sales taxes can be reduced through sales tax credits.<sup>37</sup> Conversely, state tax policies can make consumption taxes more regressive by relying less on relatively less regressive sales taxes and more on more regressive excise taxes.
- Property taxes can be made less regressive through property tax refund programs (i.e., circuit breakers) that target property tax relief to low-income households. Conversely, state policies can make the property tax more regressive by shifting tax burden from relatively less regressive commercial and industrial property taxes to more regressive residential taxes.

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37 A 2007 ITEP policy brief discusses exemptions and sales tax credits as a way of reducing the regressivity of Nevada's sales tax. This publication can be found at: <http://www.fairtaxnevada.org/npb14.pdf>.

## Regressivity in Minnesota

From 2000 to 2007, Minnesota's tax system has grown more regressive both in absolute terms and relative to other states. Over this seven year period, Minnesota's Suits index fell by 0.0319 (from -0.0172 in 2000 to -0.0491 in 2007), while nationally the Suits index fell by 0.0186. Only 11 other states moved more rapidly into increased tax regressivity.

Minnesota's tax system still ranks the 15th least regressive among the 50 states, although the Gopher State has lost ground in terms of providing a more equal distribution of taxes among residents. No doubt, growth in income inequality plays a role in the growth of tax regressivity in Minnesota. However, given that income inequality has not increased any more rapidly in Minnesota than in other states, it is not a particularly good explanation as to the above average increase in regressivity in Minnesota. Changes in tax policy explain some of the increase in Minnesota regressivity relative to other states.

**The Gopher State has lost ground in terms of providing a more equal distribution of taxes among residents.**

The first change in tax policy that has resulted in increased tax regressivity in Minnesota is increased reliance on regressive property taxes and reduced reliance on progressive income taxes. Collectively, the other 49 states have also increased dependence on property taxes from 2000 to 2007; however, increased dependence on property taxes in other states was accompanied by reduced dependence on even more regressive consumption taxes. Thus, while other states were in aggregate shifting taxes in a way that reduced regressivity, Minnesota was shifting in a way that increased regressivity.

The second change in tax policy that resulted in increased regressivity in Minnesota was in the form of modifications to the property tax system. Specifically, since 2000 the renters' property tax refund—which is the single most progressive feature of Minnesota's tax system based on the 2009 MTIS—failed to keep pace with growth in rental property taxes. In addition, a combination of statutory changes resulted in a shift of taxes from commercial and industrial property to residential property; because residential property taxes are somewhat more regressive than commercial and industrial property taxes, this change contributed to an increase in overall property tax regressivity in Minnesota.

These and other changes contributed to a dramatic increase in property tax regressivity. From 2000 to 2007, Minnesota's property tax Suits index fell from -0.0657 to -0.1395, while the property tax Suits index for all 50 states dropped from -0.0856 to -0.1240; in other words, Minnesota property taxes were less regressive than the national average in 2000 but more regressive by 2007. In 2000, Minnesota ranked in the middle of the pack among states in terms of the degree of property tax regressivity; by 2007, property taxes in only eight states were more regressive than in Minnesota.

To be certain, tax policy was not the only factor contributing to the decline in Minnesota's Suits index. However, choices made by Minnesota policymakers undoubtedly contributed to a growth in state and local tax regressivity both in an absolute sense and relative to other states.

## Reduced Regressivity in the Context of Other Tax System Goals

The quest for tax progressivity or at least reduced regressivity is certainly not the only goal of state and local tax systems in Minnesota or any other state. Tax systems should also promote revenue adequacy and stability and enhance economic growth and quality of life. How does pursuit of reduced regressivity affect achievement of these other goals?

In 2008, Minnesota 2020 examined the connection between (1) the degree of tax regressivity and (2) state performance based on six different measures of state economic health, business vitality, and livability.<sup>38</sup> This analysis found that “There was a slight tendency of states with more progressive [or less regressive] state and local tax systems to perform better on each of the six state performance indices.”

**States with the most progressive tax systems are better able to finance education, transportation infrastructure, and public services**

One explanation for this, as noted in the article, is that states with the most progressive tax systems are better able to finance education, transportation infrastructure, and public services a modern economy requires because they don't shift a disproportionate burden of these investments to households with the least ability to pay. Conversely, states with heavily regressive tax systems will have a hard time funding public investments because a disproportionate share of the cost is borne by families that can least afford it.

On the other hand, the principle form of progressive taxation—the income tax—has the disadvantage of being the least stable of the three major state and local taxes. A state that is exclusively dependent on income taxes for funding public services could have significant volatility problems as revenues soar when the economy is performing well and taxable income is up and crash when the economy is performing poorly and taxable income is down. Thus, some dependence on regressive but stable revenues—such as the property tax—would seem to be unavoidable.

However, there are ways of addressing the regressivity of property and consumption taxes, several of which are discussed above. In addition, the volatility of the income tax revenue can be mitigated through budget reserves, sometimes referred to as “rainy day” accounts. Adequate reserves can mitigate income tax volatility by shoring up state finances during periods when income tax collections are low; these reserves can then be replenished when income tax collections are up.

Revenue stability is an important goal for state and local governments. However, there are ways of promoting stability without shifting a disproportionate share of taxes to low and middle income families. The goal of progressivity (or reduced regressivity) need not be sacrificed on the altar of revenue stability.

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38 This analysis is based on tax incidence information from the 2003 “Who Pays” report along with state economic performance, business vitality, competitiveness, and livability information from the corresponding period. For more information, see “Progressive Taxation: Not So Bad for Business After All,” which can be found on-line at: <http://www.mn2020.org/issues-that-matter/fiscal-policy/progressive-taxation-not-so-bad-for-business-after-all>.

## Regressivity and Perceptions of Government Growth

A pernicious effect of growth in tax regressivity is that it can create the illusion of growth in government when in fact there is none. For example, property taxes—the most visible and arguably most unpopular of the major three taxes levied by state and local government—increased significantly from 2000 to 2007 for households that comprise the middle 60 percent of Minnesota’s income distribution based on “Who Pays” data.

**Property taxes increased significantly from 2000 to 2007 for households that comprise the middle 60 percent of Minnesota’s income distribution.**

However, the increased property taxes paid by these middle-income families was not paying for bigger government (real per capita state and local government revenue declined from 2000 to 2007), but for a reduction in the property tax Effective Tax Rates (ETRs) for high income households and for a reduction in income taxes, which also disproportionately benefited those at the top of the income ladder. In other words, the property tax increases borne by middle-income Minnesotans was not paying for more government, but for more tax relief for the wealthiest households.

MTIS data show a similar trend. The total statewide ETR was the same in 2006 as it was in 2000. However, ETRs for lower and middle income families—who represent the bulk of Minnesota’s population—increased, while ETRs for the higher income households declined.

The fact that the ETRs of most Minnesotans increased from 2000 to 2006 fueled the misperception that government was growing. In fact, the rise in ETRs for most Minnesotans was not due to real per capita growth in state and local government revenue, but to a tax shift from high income households to the rest of the population. In this way, growth in tax regressivity fueled the misperception of growth in government.

## Economic Arguments

State and national economies are in crisis. While the national recession is technically over, unemployment remains high and job creation is low. The nation’s ongoing economic doldrums is largely the result of a lack of what economists call “aggregate demand.” The ability of consumers to purchase goods and services is down because of high unemployment, the home foreclosure crisis, and the loss equity due to a decline in home values and stock prices. When people cannot afford to purchase what businesses produce, businesses will not invest in increasing production and creating new jobs.

In the words of public policy professor and former U.S. Labor Secretary Robert Reich, “Without enough purchasing power, the middle class will be unable to sustain a strong recovery. Over the longer term, the economy will stagnate.”<sup>39</sup>

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39 Robert B. Reich, “Aftershock: The Next Economy and America’s Future,” 2010.

Increased tax regressivity compounds the problem of lagging aggregate demand by reducing the purchasing power of those consumers that spend the largest share of their income on goods and services: lower and middle income families. State and local governments have a particular incentive to reduce the share of the tax load borne by low and middle income households, since these are the households that tend to spend a larger share of their income in the state and local economies and thus provide the most “bang for the buck” in terms of state and local stimulus.<sup>40</sup>

Continued growth in tax regressivity will further weaken aggregate demand and undermine economic recovery. A major focus of policymakers in Minnesota and around the nation should be on strengthening aggregate demand by reducing tax regressivity.

## A Matter of Fairness

Opponents of reduced regressivity have argued that high income households should have lower effective tax rates because they consume fewer public services. This argument is unconvincing. Suppose that I am a well-to-do owner of a successful widget company. I not only benefit from my own education, but from the education of my workers, which makes my company more productive and profitable. Insofar as these workers are educated in public schools, I am benefiting from public investment. I am also benefiting from public transportation infrastructure, which allows me to transport goods to and from my business.

The profitability of my business is also dependent upon a court system that enforces contracts and protects property rights. Furthermore, high income households benefit proportionally more from public safety functions geared to protecting property because they own more property. For example, a high-income individual who owns more than one house benefits more from police and fire protection than does the typical family who owns or rents only one residential unit.

Tax dollars support a system of state and local public services and infrastructure geared to protecting property rights, promoting commerce, and enhancing the social stability from which high income households derive the most benefit. For this reason, it is only fair that these households pay for this system in proportion to their income.

Ultimately, arguments revolving around fairness are in favor of reduced tax regressivity. Low and middle income families, who are already struggling to make ends meet, should not be asked to pay a larger percentage of their income to fund state and local government services than high income households. Efforts to reduce regressivity are not “socialism” or “class warfare,” but simple tax fairness.

The increase in regressivity in Minnesota and other states noted in this report is a cause for concern for many reasons, but most importantly because it undermines the notion of fairness which is essential for public support of the tax system. State policymakers should take steps to halt and ultimately reverse the trend of rising tax regressivity.

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<sup>40</sup> This is among several points raised by Nobel Laureate Joseph Stiglitz and former director of the U.S. Office of Management and Budget Peter Orszag in a 2001 piece published by the Center for Budget and Policy Priorities entitled, “Budget Cuts vs. Tax Increases at the State Level: Is One More Counter-Productive than the Other During a Recession?,” which can be found on-line at: <http://www.cbpp.org/archiveSite/10-30-01sfp.pdf>.



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