

MINNESOTA • REVENUE

PROPERTY TAXES & COMPLEXITY

Presented to the Property Tax Working Group
October 7, 2010

OVERVIEW

- ▶ Property Taxes 101
 - Basic Concepts
 - Additional Features and Components
 - Common Misperceptions
- ▶ Minnesota's Complexities
- ▶ Examples

PROPERTY TAXES 101

- ▶ The TAXPAYER's perspective:

TAX = VALUE x RATE

TAXES PAYABLE = TAX - CREDITS

NET TAX = TAXES PAYABLE - REFUNDS



PROPERTY TAXES 101

- ▶ The TAXING AUTHORITY's perspective:

LEVY = a factoring of REVENUE NEED relative to AIDS and OTHER REVENUES

TAX BASE = sum of all individual VALUES

RATE = $LEVY / TAX\ BASE$



PROPERTY TAXES 101

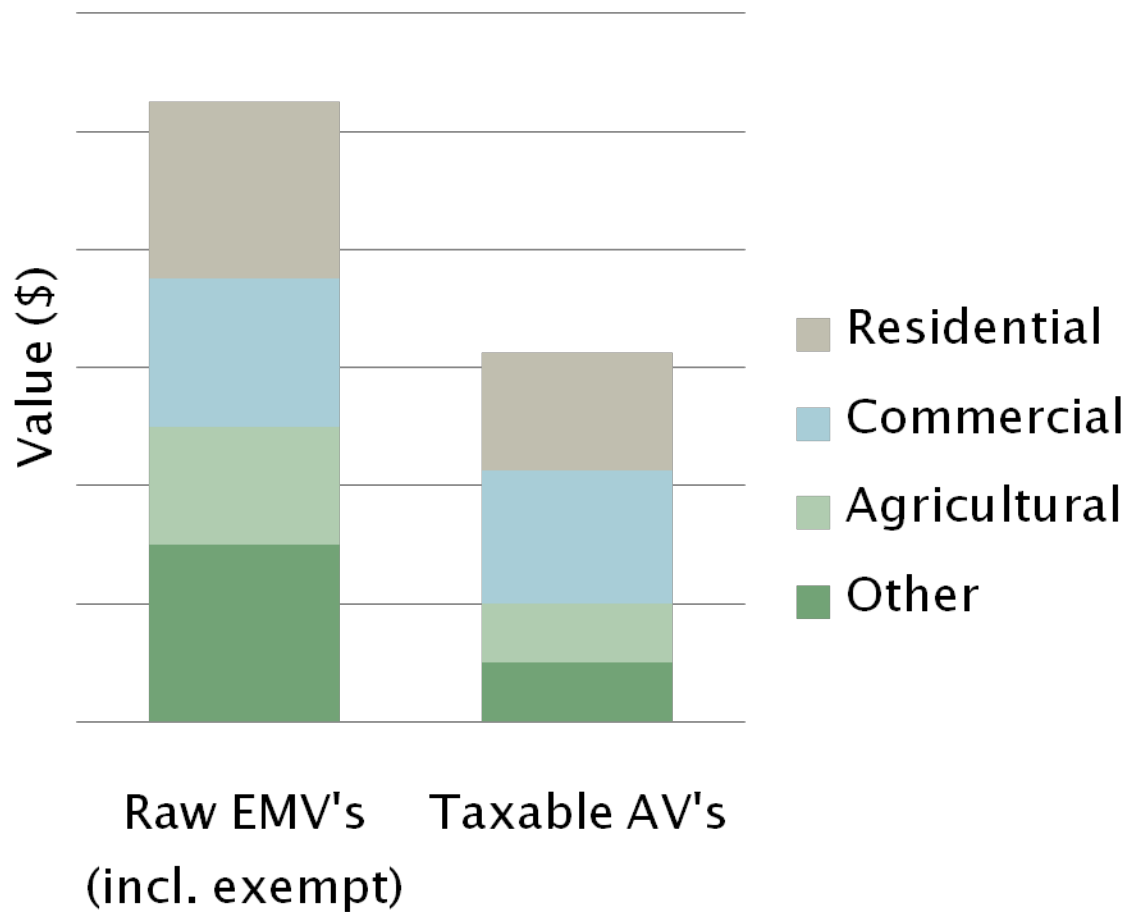


- ▶ The STATE's perspective:
 - Define TAXABLE ASSESSED VALUE or the structure of the TAX BASE(S).
 - Grant LEVY authority to specific taxing authorities and determine the nature and extent of the authority.
 - Provide relief through CREDITS and REFUNDS.
 - Provide AIDS to taxing authorities in recognition of state mandates or to equalize revenue raising capacity.
 - Define processes for review and appeal.

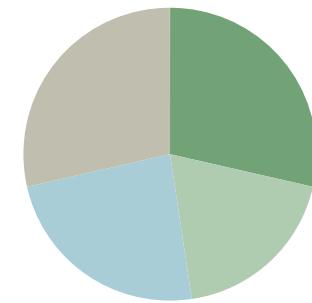
Defining Taxable Assessed Value

- ▶ What is taxable? How are taxes assessed against the taxable value?
 - Determine what is taxable versus EXEMPT.
 - Start with the ESTIMATED MARKET VALUE (what property is worth) of taxable property.
 - Apply SPECIAL VALUATIONS/DEFERMENTS and EXCLUSIONS to identify the TAXABLE MARKET VALUE.
 - Define CLASSIFICATIONS (i.e. residential, agricultural, commercial/industrial, etc.) with ASSESSMENT RATIOS (or CLASS RATES) that are applied to yield the TAXABLE ASSESSED VALUE (or NET TAX CAPACITY in Minnesota's terminology).

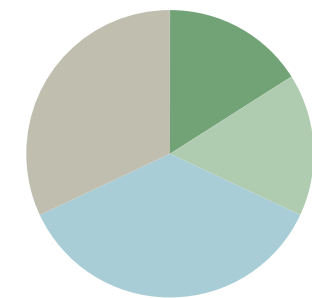
Defining Taxable Assessed Value



Raw EMV's



Taxable AV's



Granting Levy Authority

- A state property tax levy?
- Counties, cities, towns, and school districts
- Special taxing districts
 - watershed districts, HRA's/EDA's/RDC's, hospital districts, sanitary sewer districts, etc.
- Sub-jurisdictional taxing areas (i.e. service districts)
- Referenda levies
- Unlimited vs. limited (by dollar, rate, or other)
- Levies determine the level/size of taxes

Providing Relief

- ▶ Providing CREDITS and REFUNDS:
 - Expenditures (as opposed to shifts) to direct tax relief to individual taxpayers.
- ▶ Providing AIDS:
 - Expenditures (affecting the size of levies) to direct relief to taxing jurisdictions and their taxpayers to address overburden and/or equalize revenue capacity.

Defining Review/Appeal Processes

- **VALUES:**
 - Valuation notices
 - Contacting the assessor
 - Open book meetings
 - Local/county board of review
 - State board of review
 - Tax Court
 - **LEVIES:**
 - Proposed tax notices & hearings (Truth-in-Taxation)
 - Regular budget hearings
 - **TAXES:**
 - Abatements for corrections
 - Tax court appeals
 - Additional oversight is provided by the Department of Revenue and State Auditor
- or otherwise engaging local officials

Additional Features/Components

▶ SPECIAL VALUATIONS

- Program/feature may apply some special valuation that is not a reflection of EMV (such as a use value or some other artificial value).

▶ DEFERRALS

- “Pure” deferrals delay payment of a levied tax. (Possibly advanced by state to locals to make whole.)
- Combined with a special valuation program, a deferral triggers a future, deferred obligation that is not explicitly included in the levy, but are considered “restitution” for the benefits of the program.

Additional Features/Components

▶ ABATEMENTS

- The cancellation of taxes. Used mostly for corrections & court orders.
- Usually are not reimbursed by the state. (MN reimburses disaster abatements.)
- May also be used for economic development purposes, with the abated tax sometimes still being paid but directed to a specific use.

▶ SALES RATIOS

- Evaluate EMV's to sales prices.
 - Used by assessors, boards of review, and tax court to evaluate values for adjustments, corrections or orders.
 - May be used to determine ADJUSTED VALUES (for use in aid or program calculations) that attempt to account for variations in assessment levels across jurisdictions.

Additional Features/Components

- ▶ **TAX INCREMENT FINANCING (TIF)**
 - A financing method for economic development and redevelopment that limits the amount of a property's value used for raising local levies to an original value and then captures the increases in value to generate additional tax increments used to fund development.
 - The captured value is not used in calculating RATES but when the RATE is applied to the CAPTURED VALUE it generates the additional revenue (the tax increments).

Additional Features / Components

- ▶ **LIMITS, CAPS, and FREEZES:**
 - Limits, caps, or freezes on VALUES shift taxes, often to perverse degrees over time, resulting in unintended inequities that can be avoided by more overt classification/design.
 - Limits, caps, or freezes on TAX amounts create gaps between levies and collections that undermine budgeting while also creating equity concerns.
 - Limits, caps, or freezes on LEVIES might best constrain overall tax amounts but they can also be stimulative, overly restrictive, or ineffectively loose depending on their design, making them inefficient and undesirable.

Common Misperceptions

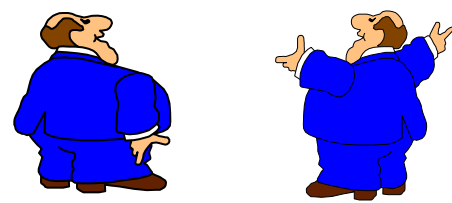
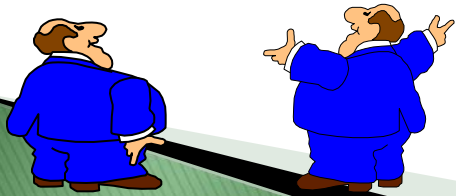
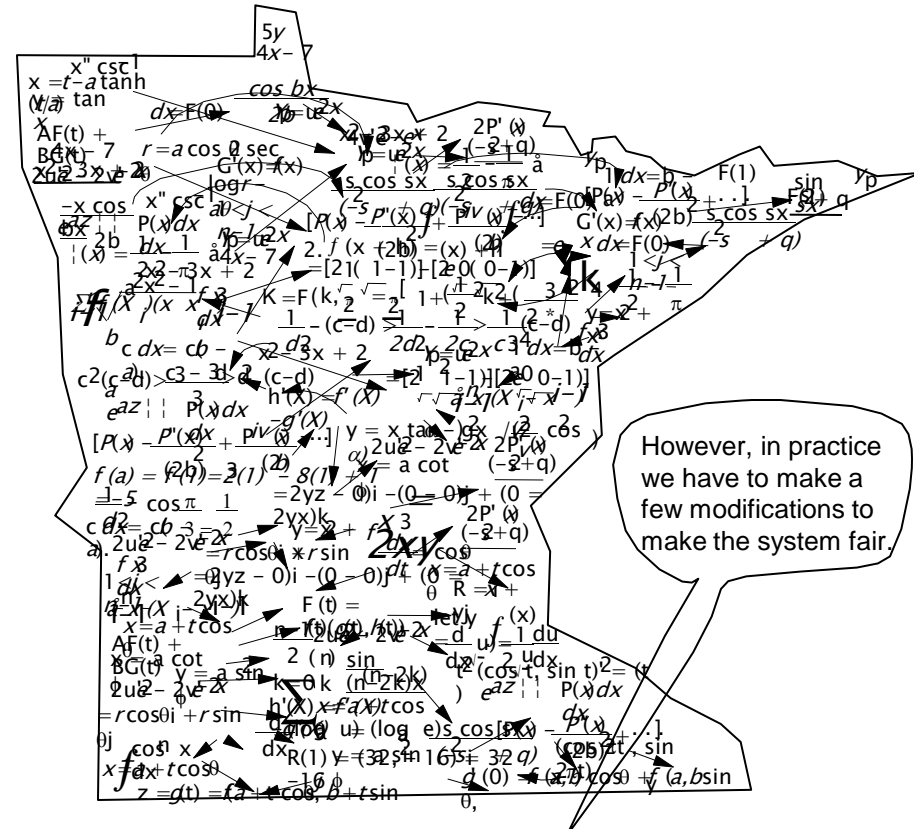
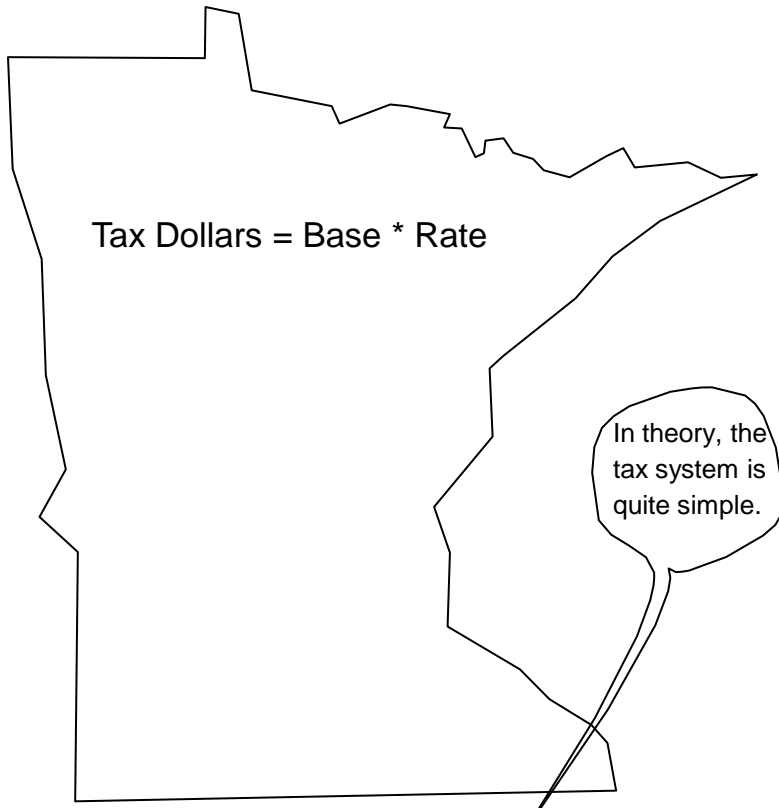
- ▶ The impact of VALUE changes on TAXES
 - VALUE increases do not necessary drive TAX increases. If one taxpayer's value increases to a lesser degree than the total tax base, and all other factors do not change, then their tax will decrease.
 - Factors affecting a property's tax include:
 - Relative changes in value (the property's value and the value of all other properties)
 - Changes in levies (referenda, decisions by jurisdictions)
 - Changes in the structure of the system

Common Misperceptions

- ▶ The impact of VALUE changes on REVENUES
 - VALUE increases do not directly generate additional revenues for levying jurisdictions.
 - The amount of the LEVY is set. The RATE is calculated accordingly. Only if RATES were set would and the LEVY yield was calculated would changes in VALUE directly affect the size of the LEVY.
 - However, jurisdictions might:
 - Experience increase demand for services with new construction and raise their levy, or
 - Compare RATES with neighboring jurisdictions as a measure of the price of their services or the pain index of taxes, so increasing VALUES may indirectly encourage increases in LEVIES.

MINNESOTA'S COMPLEXITIES

Minnesota's Tax System in Theory and in Practice



MINNESOTA'S COMPLEXITIES

▶ Tax Base Values

- Most property taxes in Minnesota are levied against NET TAX CAPACITY, where
 - NET TAX CAPACITY = TMV x CLASS RATE
- Class rates are small percentages, making tax rates very large percentages. (Originally meant to loosely identify the ideal tax amount where a normal tax rate would be 100%.)

▶ Another state:

- Residential TMV=\$100,000;
- Assessment ratio=80%;
- Mill rate=13.00
- Tax = $(\$100,000 \times 0.80 \times 0.01300) = \$1,140$

▶ Minnesota:

- Residential TMV= \$100,000;
- Class rate=1.00%;
- Tax rate=114.000%
- Tax = $(\$100,000 \times 0.0100 \times 1.14000) = \$1,140$

MINNESOTA'S COMPLEXITIES

▶ Tax Base Values

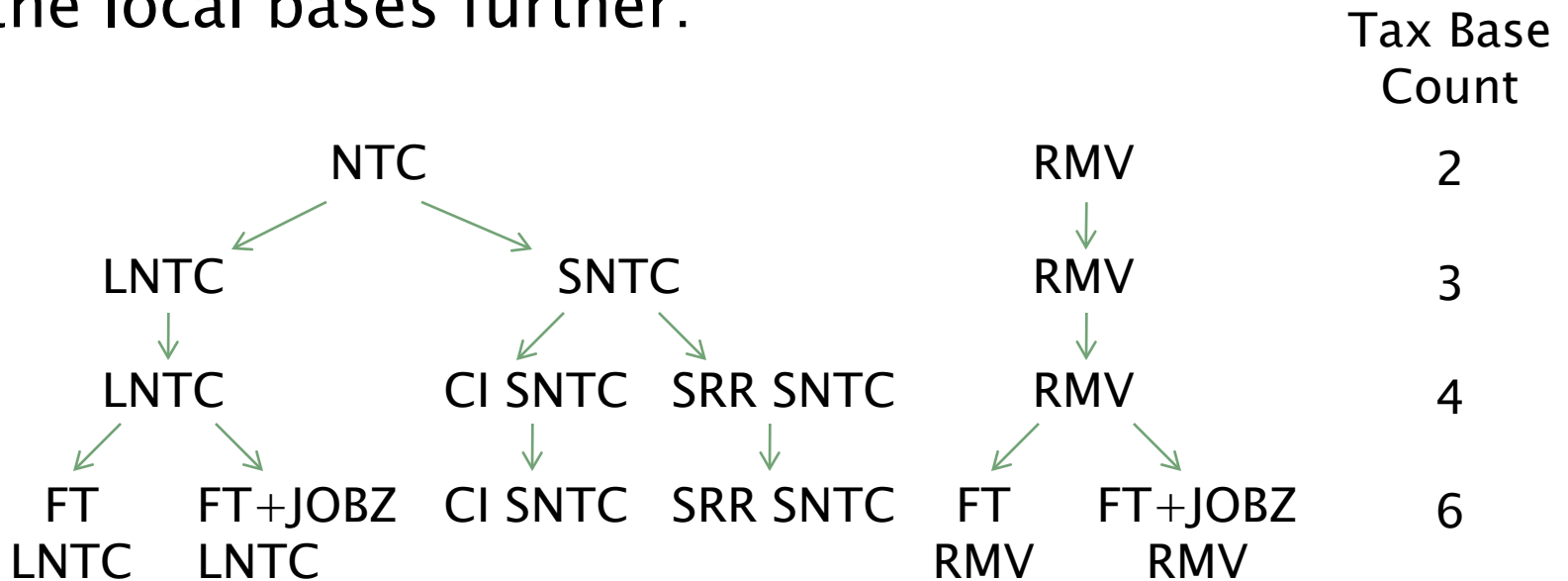
- Other taxes in Minnesota are levied against REFENDUM MARKET VALUE (or RMV), where
 - $RMV = 0$ [for classes made exempt from RMV taxes (this includes some additional exemptions vs NTC taxes)]
 - $RMV = NTC \times 100$ [for classes with class rates $< 1.00\%$]
 - $RMV = TMV$ [for all other classes]
- Note: Some referenda levies are levied on RMV, while others are levied on NTC.

MINNESOTA'S COMPLEXITIES

- ▶ State and Local NTC's
 - Minnesota has a state property tax that is also levied on NTC, but only for certain classes. One class rate is also different. Therefore, there is a distinction between “local net tax capacity (LNTC)” and “state net tax capacity (SNTC).”
 - Generally NTC refers to LNTC unless used specifically in regard to the state tax.

MINNESOTA'S COMPLEXITIES

- ▶ Minnesota has multiple tax bases
 - In addition to RMV and NTC, and the distinction between State NTC and Local NTC, the State NTC is further split into two tax bases, and JOBZ multiplies the local bases further:



MINNESOTA'S COMPLEXITIES

- ▶ Minnesota's system is HIGHLY classified
 - 5 categories of classifications have proliferated to:
 - 42 specific classes counting by description, or
 - 56 specific classes counting separate tiers.
 - There are 9 different class rates assigned to the classes as follows:

• 0.40% (1)	• 1.00% (16)
• 0.45% (1)	• 1.25% (19)
• 0.50% (3)	• 1.50% (6)
• 0.65% (1)	• 2.00% (7)
• 0.75% (2)	

MINNESOTA'S COMPLEXITIES

Classification Rate Table for Assessment Year 2010

Class	Description	Tiers	Class Rate	State Rate
1a	Residential Homestead	First \$500,000	1.00%	NA
		Over \$500,000	1.25%	NA
1b	Blind/Disabled Homestead	First \$50,000	0.45%	NA
1c	Ma & Pa Resort	First \$600,000	0.50%	NA
		\$600,000 - \$2,300,000	1.00%	NA
		Over \$2,300,000	1.25%	1.25%
1d	Migrant Housing (Structures Only)	First \$500,000	1.00%	NA
		Over \$500,000	1.25%	NA
2a	Homestead House, Garage, One Acre (HGA)	First \$500,000	1.00%	NA
		Over \$500,000	1.25%	NA
2a/2b	1 st Tier Homestead Property	First \$1,140,000 (2a+2b)	0.50%	NA
2a/2b	Farming Entities Excess 1 st Tier (Unused From Hmstd)	Unused First \$1,140,000	0.50%	NA
2a	Agricultural Land (Hmstd Remainder & Non-Hmstd; Includes Structures)		1.00%	NA
2b	Rural Vacant Land (Hmstd Rem. & Non-Hmstd; Incl. Minor Ancil. Structures)		1.00%	NA
2c	Managed Forest Land		0.65%	NA
2d	Private Airport		1.00%	NA
2e	Land with a Commercial Aggregate Deposit		1.00%	NA
3a	Commercial/Industrial and Public Utility	First \$150,000	1.50%	1.50%
		Over \$150,000	2.00%	2.00%
		Electric Generating Public Utility Machinery	2.00%	NA
		All Other Public Utility Machinery	2.00%	2.00%
		Transmission Line Right-Of-Way (Owned in fee by a utility)	2.00%	2.00%
3b	Employment Property (Border City Zones)	First \$150,000	1.50%	1.50%
		Over \$150,000	2.00%	2.00%

MINNESOTA'S COMPLEXITIES

4a	Apartment (4+ Units, Including Private For-Profit Hospitals)		1.25%	NA
4b(1)	Residential Non-Homestead (1-3 Units Not 4bb or SRR)		1.25%	NA
4b(2)	Unclassified Manufactured Home		1.25%	NA
4b(3)	Ag Non-Homestead (2 or 3 Units, Garage, One Acre)		1.25%	NA
4b(4)	Unimproved Residential		1.25%	NA
4bb(1)	Residential Non-Homestead (Single Unit)	First \$500,000	1.00%	NA
		Over \$500,000	1.25%	NA
4bb(2)	Ag Non-Homestead (Single Unit, Garage, One Acre)	First \$500,000	1.00%	NA
		Over \$500,000	1.25%	NA
4c(1)	Seasonal Residential Recreational (SRR) Commercial (Resort)	First \$500,000	1.00%	1.00%
		Over \$500,000	1.25%	1.25%
	Non-Commercial (Cabin)	First \$76,000	1.00%	0.40%
		\$76,000 - \$500,000	1.00%	1.00%
		Over \$500,000	1.25%	1.25%
4c(2)	Qualifying Golf Course		1.25%	NA
4c(3)(i)	Non-Profit Comm. Service Oriented Organization (Non-Revenue)		1.50%	NA
4c(3)(ii)	Non-Profit Comm. Service Oriented Organization (Donations)		1.50%	1.50%
4c(4)	Post-Secondary Student Housing		1.00%	NA
4c(5)(i)	Manufactured Home Park		1.25%	NA
4c(5)(ii)	MH Park Cooperative (Over 50% Shareholder Occupied)		0.75%	NA
4c(5)(ii)	MH Park Cooperative (50% or Less Shareholder Occupied)		1.00%	NA
4c(6)	Metro Non-Profit Recreational Property		1.25%	NA
4c(7)	Certain Non-Comm Aircraft Hangars and Land: Leased Land		1.50%	NA
4c(8)	Certain Non-Comm Aircraft Hangars and Land: Private Land		1.50%	NA
4c(9)	Bed and Breakfast (Up To 5 Units)		1.25%	NA
4c(10)	Seasonal Restaurant on a Lake		1.25%	NA
4c(11)	Marina	First \$500,000	1.00%	NA
		Over \$500,000	1.25%	NA
4d	Qualifying Low-Income Rental Housing		0.75%	NA
5(1)	Unmined Iron Ore and Low-Grade Iron-Bearing Formations	2.00%	2.00%	
5(2)	All Other Property Not Otherwise Classified		2.00%	NA

MINNESOTA'S COMPLEXITIES

- ▶ Minnesota grants numerous exemptions
 - The main statute identifying exemptions has grown from 44 to 94 subdivisions from 2000 to 2010.
- ▶ Minnesota has increasingly granted exclusions
 - Platted Vacant Lands (1992)
 - This Old House (1993)
 - This Old (Flooded) Business (1997 & 2002)
 - Mold Damage (2005)
 - Lead Hazard (2005)
 - Disabled Vets (2008)

MINNESOTA'S COMPLEXITIES

- ▶ Minnesota has several substantial deferral / special valuation programs:
 - The Senior Citizen deferral is the only “pure” deferral of levied taxes. (273 taxpayers as of 2010)
 - The other deferrals provide a future, deferred obligation based on preferential valuations:
 - Open Space
 - Green Acres
 - Rural Preserves
 - Aggregate Resource Preservation
 - (Similar Metro Ag Preserve & Non-Metro Ag Preserve programs are also provided but operate as credits.)

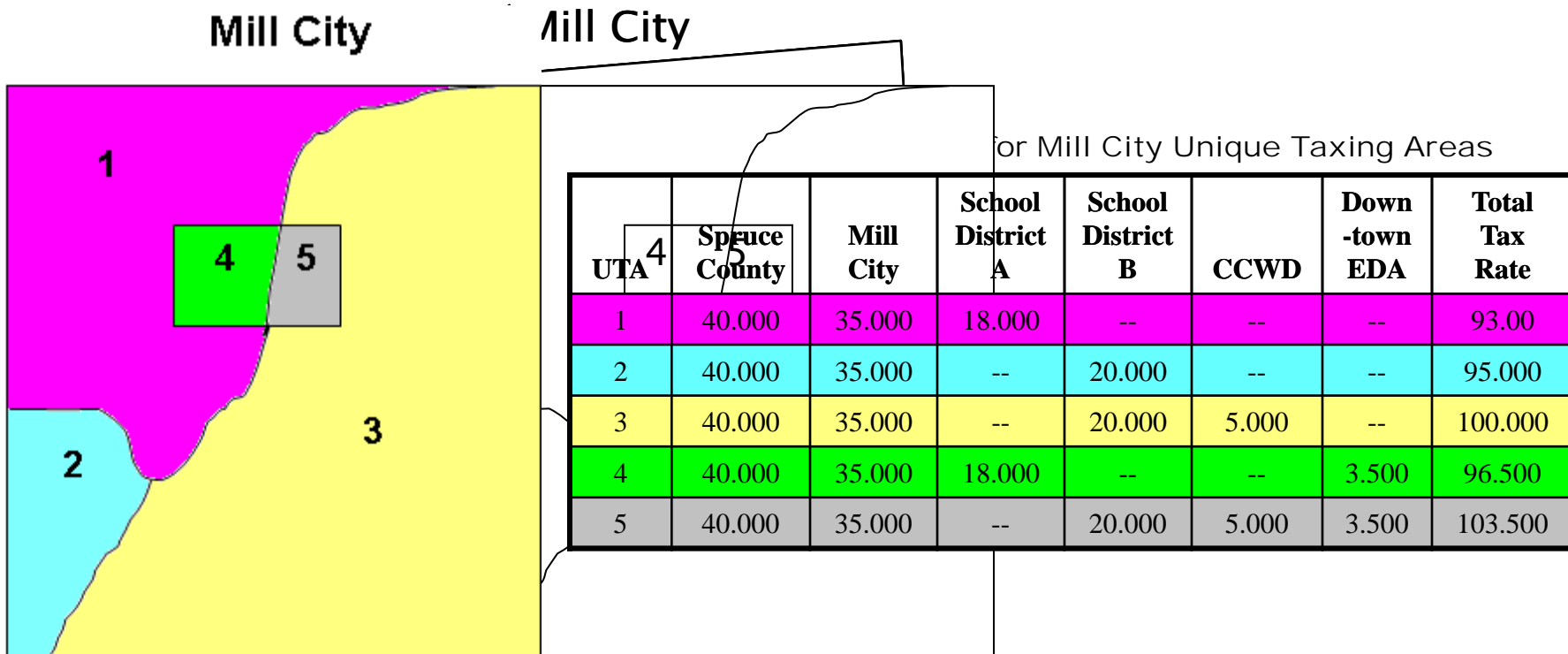
MINNESOTA'S COMPLEXITIES

- ▶ Minnesota grants a great variety of LEVY authority
 - 87 counties, 855 cities, 1,800 towns, 338 school districts, and 298 special taxing districts; plus
 - Unknown numbers of special service districts and other sub-jurisdictional differences; plus
 - Disparity Reduction Aid, results in 6,200+ unique taxing areas.

MINNESOTA'S COMPLEXITIES

Note: This example has been excerpted into a separate PDF for greater readability. [Click here to open.](#)

UTA Illustration for Mill City



MINNESOTA'S COMPLEXITIES

- ▶ Minnesota employs a unique “Truth-in-Taxation” process requiring proposed tax notices and hearings.
- ▶ Minnesota employs specific and overall levy limits
 - Overall levy limits are combined with various “special levy” exceptions, creating onerous administration with inconsistent effectiveness.
 - Specific levy limits are scattered amongst the scattered levy authority provisions.

MINNESOTA'S COMPLEXITIES

- ▶ Minnesota has unique RATE calculation features
 - The tax base used to calculate rates is not the total NTC. In addition to subtracting TIF captured value, certain powerline value and fiscal disparities contribution value are also subtracted, where:
$$\text{Taxable NTC} = \text{Total NTC} - \text{Powerline NTC} - \text{FD Contribution NTC} - \text{TIF Captured NTC}$$
 - “Initial Tax Rates” are calculated dividing the levies by the taxable NTC, but Disparity Reduction Aid is a grandfathered “aid” that directly buys down the rate in certain UTA’s to yield the “Local Tax Rates” that are actually extended against property value.

MINNESOTA'S COMPLEXITIES

- ▶ Minnesota provides numerous CREDITS:
 - Disaster Credits
 - Local Option Disaster Credits
 - Powerline Credits
 - Ag Preserves Credits
 - Disparity Reduction Credits
 - County Conservation Credits
 - Residential Homestead Market Value Credits
 - Agricultural Homestead Market Value Credits
 - Taconite Homestead Credits
 - Supplemental Homestead Credits
 - Bovine Tuberculosis Credits

MINNESOTA'S COMPLEXITIES

- ▶ Minnesota provides substantial REFUND programs:
 - Renter Refunds
 - Homestead Circuit Breaker Refunds
 - Targeted Special Refunds
- ▶ Minnesota has two FISCAL DISPARITIES programs:
 - Metro
 - Iron Range

MINNESOTA'S COMPLEXITIES

- ▶ The preponderance of features and programs by itself makes Minnesota's system uniquely complex.
- ▶ Specific details exacerbate complexity:
 - Extensive homestead determination distinctions
 - Fractional homesteads
 - Linkages (due to tiered classifications and homestead provisions)
 - Split classifications

EXAMPLES

- ▶ Special Ag Homestead Determinations
- ▶ Farm Entities Classification

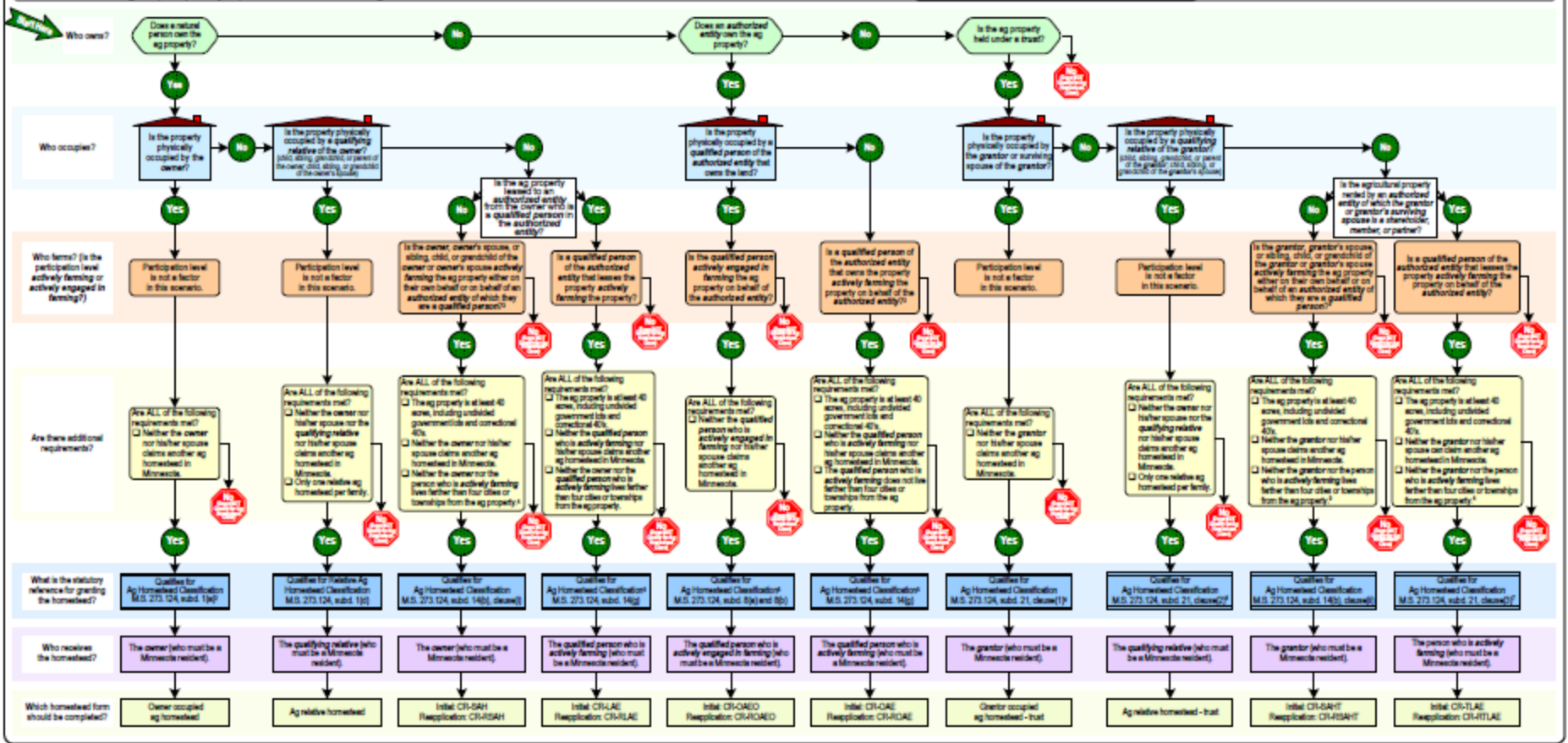
MINNESOTA'S COMPLEXITIES

MINNESOTA · REVENUE

Determining if property qualifies for the agricultural homestead¹ classification

2009 Revisions

Note: Terms in **bold**, *italic four* are defined in the glossary



Footnotes

Note: Terms in **bold**, *italic four* are defined in the glossary

- The property must first properly qualify as agricultural pursuant to M.S. 273.13, subd. 21.
- If the entire property including the HGA is leased, the property must meet the requirements of M.S. 273.124, subd. 1(c) to qualify as an owner occupied ag homestead.
- In some cases, the Farm Service Agency number may be in an *authorized entity's* name when the person actively farming is doing so on behalf of the *authorized entity*.
- If the *owner* or the *owner's spouse* or *grantor* or *grantor's spouse* is required by their employer to live in employer-provided housing, the *owner* or *owner's spouse*, *whenever he or she is actively farming the agricultural property*, may live more than four townships or cities, or combinations of four townships or cities from the agricultural property.
- This is limited to *authorized entities* with 12 or fewer members, shareholders or partners. If the entire property including the HGA is leased, the property must qualify under M.S. 273.124, subd. 21, clause (5) to qualify as an owner occupied ag homestead.
- This statute was amended by Laws 2005, Chapter 151, Article 5, Section 21. Previously, this provision required a *qualified person* of the *authorized entity* to occupy the property and *actively farm* it on behalf of the *authorized entity* to receive homestead (the *qualified person* did not have to be the *grantor*, *spouse of the grantor* or *son or daughter of the grantor*). Those receiving homestead under this clause for years payable in 2005, but no longer qualify as of the 2005 law change, may continue to receive homestead as long as the requirements of this clause as it existed for years payable in 2005 are met.

Glossary

Note: Terms used in the flow chart are defined below. See the full glossary in the agricultural bulletin for definitions of **bold**, *italic words* listed below

- actively engaged in farming** - participation on the farm on a regular and substantial basis.
- actively farming** - participation in the day-to-day decision making, labor, administration and management of the farm as well as assisting all or a portion of the financial risks and sharing in any profits or losses. The person who is actively farming must be a Minnesota resident.
- authorized entity** - can be a *family farm cooperative*, *joint family farm venture*, *limited liability company*, or *partnership operating a family farm* (M.S. 273.124, subdivision 1)(b)). This is limited to authorized entities with 12 or fewer members, shareholders or partners. The following entities would be eligible for homestead treatment: *authorized farm limited liability company* (operating a family farm), *authorized farm partnership* (operating a family farm), *family farm corporation*, *family farm limited liability company* (operating a family farm), *family farm partnership*, *general partnership* (operating a family farm).
- grantor** - is defined as the person creating or establishing a testamentary, *inter vivos*, renewable or irrevocable trust by written instrument or through the exercise of a power of appointment (M.S. 273.124, subdivision 2). For a trust that is held under a trust to receive an agricultural homestead, the grantor must be a Minnesota resident and neither the grantor nor the spouse of the grantor can claim another agricultural homestead.
- owner** - is defined as an individual person or multiple people who own the property (i.e. not owned by a business or entity). To receive an agricultural homestead, the owner must be a Minnesota resident, and neither the owner nor the spouse of the owner can claim another agricultural homestead.
- qualified person** - must be a Minnesota resident and can be a member in an *authorized entity*, a shareholder in an *authorized entity*, or a partner in an *authorized entity*.
- qualified relative or surviving relative** - the definition depends on the type of property: Residential property: a qualified relative of the owner or grantor can be a parent, stepparent, child, stepchild, grandparent, grandchild, sibling, stepbrother, or niece/nephew (M.S. 273.124, subdivision 1)(c)). Agricultural property: a qualified relative can be a child, sibling, grandchild of the grantor or grantor's parent of the owner of agricultural property or a child, sibling or grandchild of the spouse of the owner or grantor of the agricultural property (M.S. 273.124, subdivision 1)(d)).
- trust** - a fiduciary relationship under which one party holds property for the benefit of another party.
- trustee** - means the party that holds property rights for the benefit of another party through a trust.

Farm Entities Class? (273.124, subd. 8)

(d) Agricultural property that (1) is owned by a family farm corporation, joint farm venture, limited liability company, or partnership and (2) is contiguous to a class 2a homestead under section 273.13, subdivision 23, or if noncontiguous, is located in the same township or city, or not farther than four townships or cities, or combination thereof from a class 2a homestead, and the class 2a homestead is owned by one of the shareholders, members, or partners; is entitled to receive the first tier homestead class rate up to the first tier maximum market value on any remaining market value not received on the shareholder's, member's, or partner's homestead class 2a property. The owner must notify the county assessor by July 1 that a portion of the market value under this subdivision may be eligible for homestead classification for the current assessment year, for taxes payable in the following year.

WHY COMPLEXITY MATTERS

- ▶ Diminishes the ability of taxpayers, administrators, and policy makers to understand the system
- ▶ Diminishes transparency and accountability
- ▶ Leads to errors
- ▶ Promotes incremental change that exacerbates problems
- ▶ Inefficiency / expense (mostly borne locally)
- ▶ Unintended consequences and inequities