



**Tax Cuts and Rebates:
The Fiscal Impact of
Five Years of Tax Cuts
(1997 – 2001)**

Money Matters 02-09

Revised for the November 2002 Forecast

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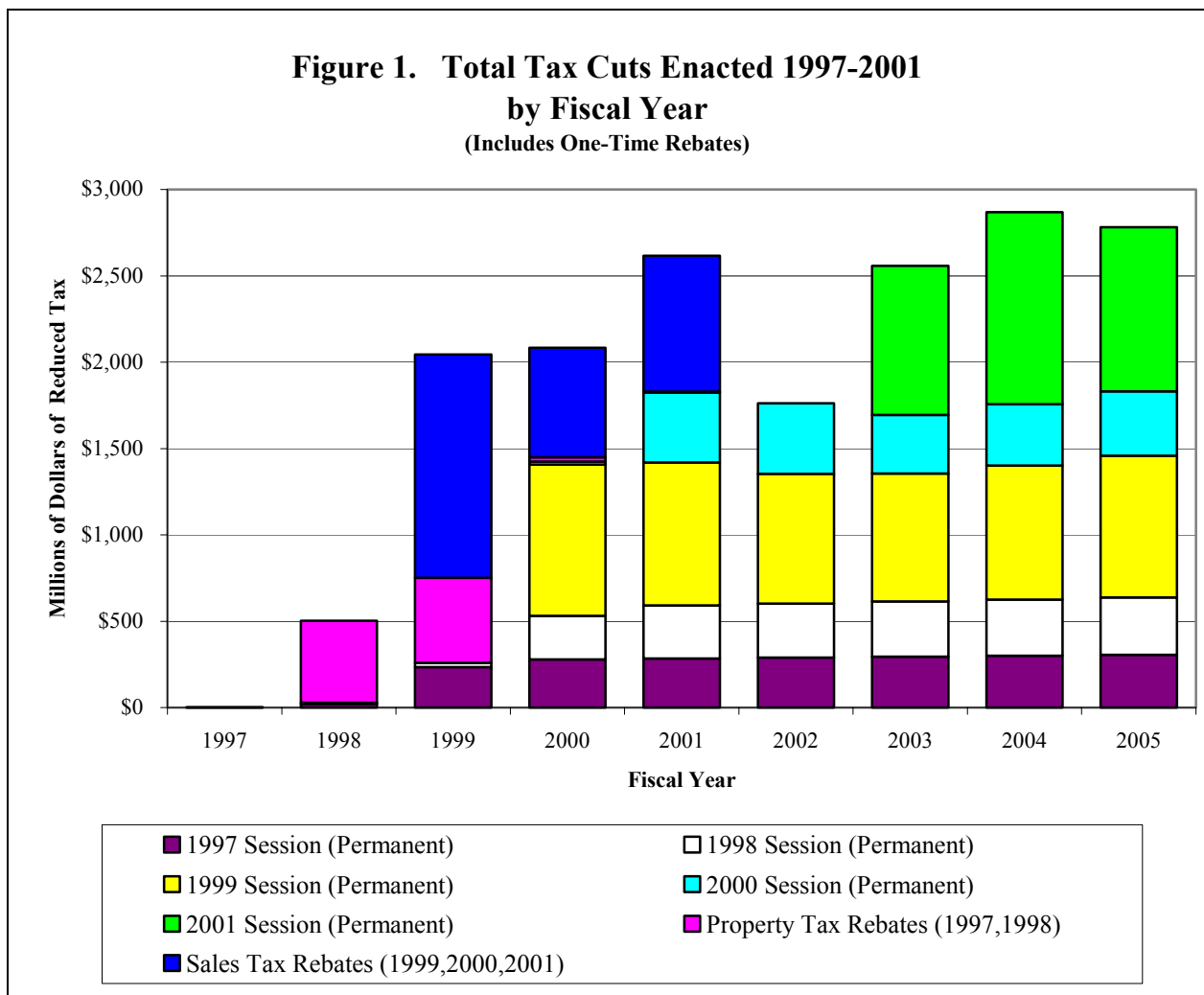
Fiscal Analysis Department
Minnesota House of Representatives

From 1997 to 2001, Minnesota enacted major tax cuts in each of five consecutive legislative sessions. This Money Matters summarizes the fiscal impact of those tax cuts by addressing the following questions:

- How large were the tax cuts?
- How did the tax cuts change the mix of state and local taxes?

How large were the tax cuts?

The fiscal impact of the tax cuts enacted between 1997 and 2001 is shown in Figure 1. One-time tax rebates were enacted each year, at a total cost of \$3.7 billion. A total of \$1.0 billion in property tax rebates was enacted in 1997 and 1998, followed by a total of \$2.7 billion of sales tax rebates enacted in 1999, 2000, and 2001.



Permanent tax cuts were also enacted each year. Permanent property tax reductions were enacted in 1997, 1998, 1999, and 2001; permanent income tax rate reductions were enacted in both 1999 and 2000; and motor vehicle registration taxes were reduced in 1999. These permanent tax cuts have a fiscal impact that continues each year after they are enacted.

This on-going impact of the permanent tax cuts can be illustrated by calculating the state cost of the combined tax cuts in a single year – FY 2005. The cost to the state in that year is forecast at about \$2.78 billion.¹ Of that amount, the FY 2005 cost of the combined property tax cuts is estimated at \$1.74 billion, over half of which was enacted in 2001. Lower individual income taxes (mostly enacted in 1999 and 2000) will cut FY 2005 revenues by \$835 million, and lower motor vehicle registration tax rates enacted in 1999 will cut FY 2005 revenues by about \$190 million.² There was little permanent change in either sales taxes or other miscellaneous taxes.

Figure 2.
Permanent Tax Cuts -- Impact in FY 2005
(Dollars in millions*)

Year Enacted	Total	Individual Income Tax	Property Taxes (state & local)	Sales Tax (incl. MVST)	Motor Vehicle Registration Tax	Other Taxes
1997	\$ (306)	\$ 2	\$ (304)	\$ (11)	\$ -	\$ 7
1998	\$ (331)	\$ (18)	\$ (295)	\$ (11)	\$ -	\$ (7)
1999	\$ (821)	\$ (655)	\$ (148)	\$ (2)	\$ -	\$ (16)
2000	\$ (373)	\$ (168)	\$ (12)	\$ (4)	\$ (190)	\$ 2
2001	\$ (950)	\$ 5	\$ (981)	\$ 50	\$ -	\$ (24)
Total	\$ (2,781)	\$ (835)	\$ (1,740)	\$ 23	\$ (190)	\$ (38)

*Columns and rows may not sum to totals due to rounding.

How will total tax collections in 2005 compare to those in 1997?

Despite these tax cuts, total tax collections are forecast to be 30 percent higher in FY 2005 than they were in FY 1997. After adjusting for both population growth and inflation, tax revenues in FY 2005 are forecast to be roughly the same as they were in FY 1997. So on the one hand, despite five years of permanent tax cuts, total state and local tax revenues per capita still grow at a rate roughly equal to inflation.³ On the other hand, however, tax collections will grow much more slowly than personal income.⁴

¹ The House Income Tax Simulation (HITS) Model based on the November 2002 forecast is used to estimate the fiscal impact of the major income tax cuts (lower rates, the marriage penalty credit, and expansion of the working family credit). The impact of cuts in other taxes is generally based on estimates made at the time the tax cuts were enacted. For these other taxes, the fiscal impact for years beyond the range of official revenue estimates (2 years for 1997 and 1998 session changes; one year for 1999 and 2000 session changes) was projected to grow at a fixed rate (2% for property tax aids and credits, 4% for motor vehicle registration taxes, 0% for other taxes).

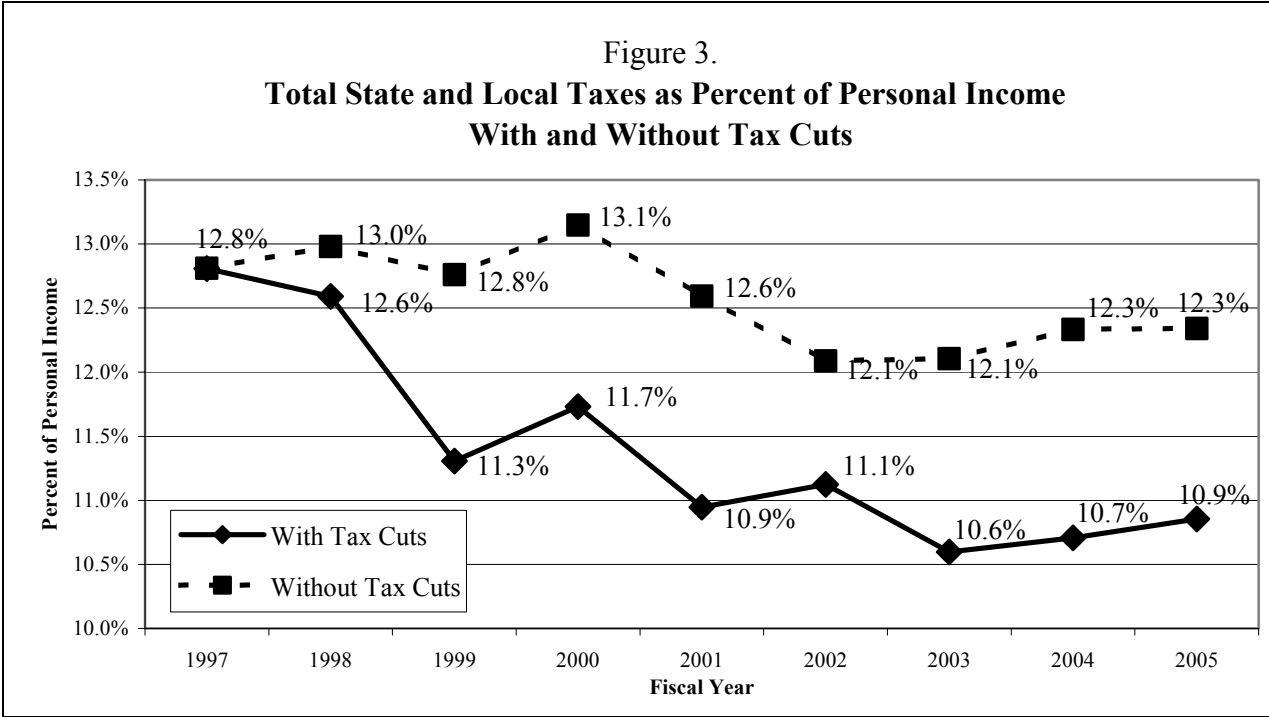
Figure 1 includes temporary tax cuts (MinnesotaCare taxes) and one-time tax shifts (such as changes in the June accelerated sales tax). However, it does not include the one-time property tax shift of \$180 million into FY 2002. If this shift (enacted in 2001) is included, the total tax cut in FY 2002 is reduced from the \$1.78 billion shown in Figure 1 to \$1.60 billion. Detailed estimates by fiscal year and tax type are given in the appendices.

² The total permanent tax cut in the FY 2004-05 biennium – disregarding provisions with only a one-time fiscal impact – is \$5.5 billion.

³ For FY 1997 to FY 2005, total tax revenues are forecast to grow an average of 3.3% per year. Population grows by about 1.1% per year, and the consumer price index is forecast to rise by an average of 2.3% per year.

⁴ The November 2002 forecast shows Minnesota personal income growing by more than 50 percent between 1997 and 2005, much more than the 30 percent rise in tax collections.

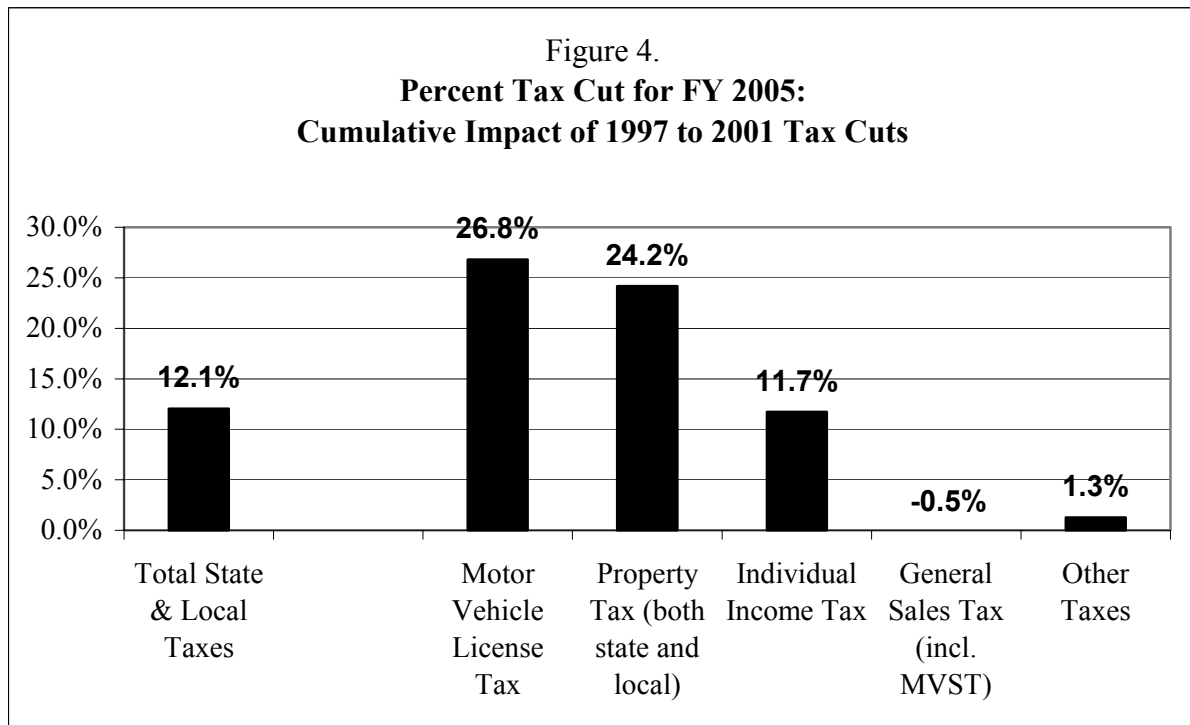
While total state and local taxes equaled 12.8 percent of personal income in FY 1997, they are forecast to fall to 10.9 percent of income in FY 2005. As shown in Figure 3, without the tax cuts, taxes as a percent of income would have fallen from 12.8 percent of personal income in FY 1997 to 12.3 percent of personal income in FY 2005. So, although the FY 2005 tax burden *per person* remains virtually the same as in FY 1997 (after adjusting for inflation), the tax burden *as a percent of income* declines noticeably.



The state induces reductions in local property taxes primarily by increasing aid payments to local governments, by taking over services previously funded by local governments (such as trial courts), or by providing property tax credits to individual property owners (homeowners and farmers). The “without tax cut” percentages shown as the dashed line in Figure 3 assume that each dollar the state spent to “buy down” property taxes resulted in a full dollar reduction in property taxes. Figure 3 may overstate the impact of tax cuts on total state and local taxes to the extent that state spending directed at buying down property taxes was instead used partly to reduce property taxes and partly to increase local spending.

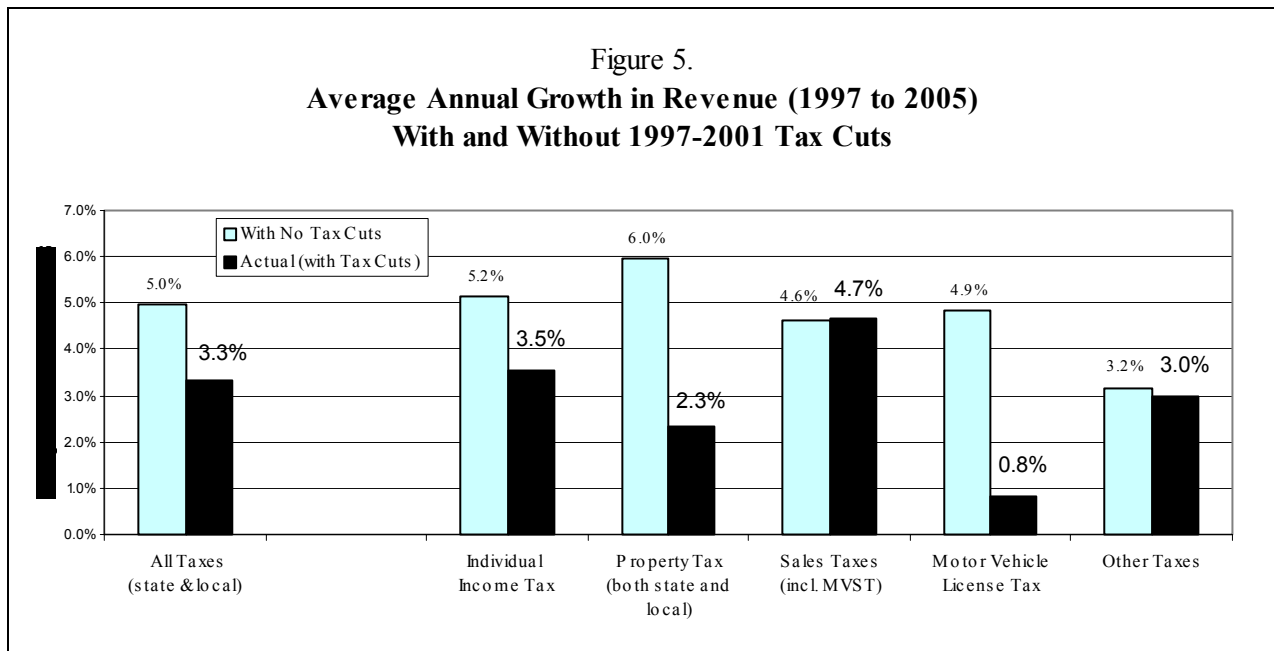
How did the permanent tax cuts change the overall mix of taxes in the state and local tax system?

The tax cuts enacted from 1997 through 2001 cut total state and local tax collections in FY 2005 by 12.1 percent compared to what they would have been in the absence of those cuts. The size of tax cuts varied greatly by tax type, however. While property and motor vehicle license taxes were each reduced by roughly one quarter, individual income taxes were cut by 11.7 percent (slightly less than the percentage for total taxes). In contrast, sales taxes were actually *increased* somewhat. There was little change for other taxes.



As shown in Figure 5 (on next page), the tax cuts reduced the growth in total state and local tax revenue from an average of 5.0 percent per year to an average of 3.3 percent per year. The remaining 3.3 percent annual growth is due partly to economic growth, partly to population growth, and partly to inflation. Because inflation averages 2.3 percent per year and population grows 1.1 percent per year, tax revenues *per capita*, adjusted for inflation, will be approximately the same in FY 2005 as they were in FY 1997. In contrast, without the tax cuts, inflation-adjusted taxes per capita would have grown by about 20 percent between FY 1997 and FY 2005.

On the other hand, the 3.3 percent annual growth rate for tax revenue is considerably below the growth rate for personal income (averaging 5.5 percent per year). If there had been no permanent tax cuts, tax revenue would have grown almost as fast as personal income – at an average rate of 5.0 percent per year.



For each of the major tax types, Figure 5 compares the growth in tax collections under the November 2002 forecast with what would have occurred without the tax cuts.

- In the absence of the income tax cuts enacted in 1999 and 2000, individual income tax revenues would have risen at an average rate of 5.2 percent per year, almost as fast as the increase in personal income.⁵ Despite the income tax cuts, income tax revenues still grew faster than inflation (3.3 percent compared to 2.3 percent), though they grew more slowly than personal income (5.5 percent).
- In the absence of the tax cuts, property tax revenues would have risen faster than personal income (6.0 percent compared to 5.5 percent). As a result of the tax cuts, property tax revenue will have grown by an average of only 2.0 percent per year, below the average rate of inflation (2.3 percent).
- The tax cuts reduced the average annual growth rate for motor vehicle registration tax revenues from an average of 4.9 percent to only 0.8 percent.
- There were no significant sales tax changes. Total sales tax revenue (including the motor vehicle sales tax) rose by an average of 4.7 percent per year, a rate below the growth in personal income (5.5 percent per year).

⁵ The income tax is indexed for inflation, so inflation does not result in significant “bracket creep.” Each percentage increase in inflation raises income tax revenue by roughly one percent. When incomes grow faster than inflation, though, *real* incomes rise and more of the typical taxpayer’s income is taxed in a higher tax bracket. Each one percent increase in federal adjusted gross income (above the rate of inflation) increases Minnesota’s income tax revenue by about 1.2 percent. As a result, income tax revenues (without the tax cuts) would have been expected to grow by *more* than the 5.5 percent rise in personal income. A revenue growth rate *below* the growth rate for personal income is mostly due to the pattern of capital gains realizations over this period. Personal income does not include capital gains, and capital gains are forecast to be a smaller portion of the income reported on tax returns in 2005 than they were in 1997.

The tax cuts have had a significant impact on the mix of state and local taxes in Minnesota. Figure 6 compares the mix of Minnesota taxes in FY 1997 to (a) the tax mix now forecast for FY 2005 and (b) what the mix would have been in that year if no tax cuts had been enacted.

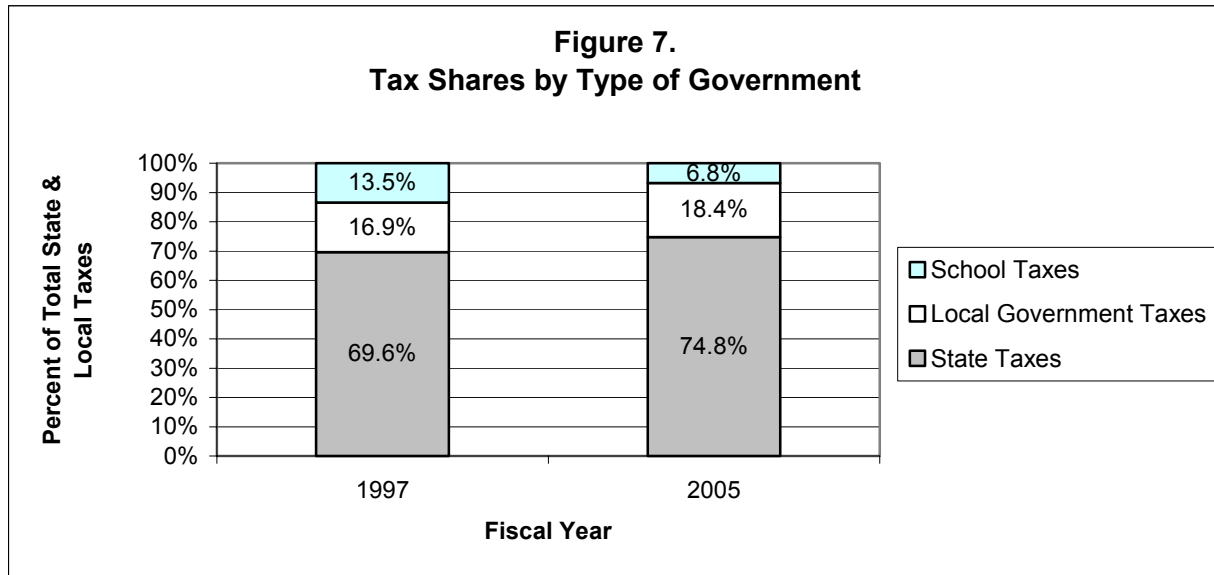
Figure 6: Minnesota State & Local Tax Mix in FY 1997 and FY 2005 With and Without Tax Cuts Enacted in 1997-2001 (Includes both state and local taxes)			
Type of Tax	FY 1997	FY 2005	
		Without Tax Cuts	With Tax Cuts
Individual Income Tax	30.5%	30.9%	31.0%
Property Tax (state & local)	29.0%	31.2%	26.9%
Sales Tax (incl. MVST)	22.3%	21.7%	24.8%
Motor Vehicle License Tax	3.1%	3.1%	2.6%
Other Taxes	15.1%	13.1%	14.7%
Total Taxes	100.0%	100.0%	100.0%

- If there had been no tax cuts, the tax share would have increased for both the property tax and (to a lesser extent) the income tax. The relative share for motor vehicle registration taxes would have remained constant. The importance of the sales taxes would have fallen noticeably, as would that of other miscellaneous taxes (including excise taxes and corporate income taxes).
- The income tax cuts, as a percent of revenue, were roughly equal to the cut in total taxes, so the tax cuts did not undo the growing *share* for the income tax that would have resulted in the absence of any tax cuts.
- The property tax cuts were large enough to overcome the increased share of total taxes that would otherwise have come from that tax, significantly reducing its role relative to 1997. Rather than rising from 29 to 31 percent of total taxes, the property tax share is now forecast to fall to 27 percent.
- The motor vehicle registration tax cuts reduced the share of taxes coming from that source from 3.1 percent to 2.6 percent.
- In contrast, the share of the sales taxes (including the motor vehicle sales tax), which would otherwise have fallen, will rise significantly between 1997 and 2005.
- There were few permanent cuts in other miscellaneous taxes.⁶ Their share of total tax revenue – though slightly lower than in FY 1997 – will be significantly higher in FY 2005 than it would otherwise have been.

⁶ See footnote 7 in the Appendix for more detail on the cuts in corporate and gambling taxes and the significant but *temporary* cuts in health care taxes.

How did the permanent tax cuts change the tax shares of state versus local government?

The tax cuts enacted between 1997 and 2001 have significantly increased the *state* share of total state and local taxes. The state share rose from less than 70 percent in FY 1997 to 75 percent in FY 2005. The share of taxes levied by school districts was cut in half, falling from 13.5 percent of the total to 6.8 percent of the total. Taxes levied by local governments (excluding schools) rose from 16.9 percent of the total to 18.4 percent of the total.



Compared to FY 1997, school district taxes in FY 2005 are forecast to fall by 35 percent, while taxes collected by both the state and local governments (excluding schools) are forecast to rise by over 40 percent.⁷

As noted above, the tax cuts will reduce FY 2005 state and local taxes by 12 percent relative to what they would have been in the absence of the tax cuts. After netting out the new state-level property tax, however, *state* taxes were cut less than 3 percent, while *local* taxes (by schools and local governments combined) were cut by over 30 percent.

This significant shift in the tax burden by type of government means that any comparison of state-only taxes across these years should be done with care. Much of the change in the state tax burden represents a take-over of funding previously funded by local property taxes. Looking at the trend in *state* taxes alone will be misleading.

⁷ So per capita state taxes and local government taxes (other than schools) rose faster than inflation – though still below the 50 percent increase in personal income over the eight-year period.

Conclusions

The tax cuts enacted over five years – 1997 to 2001 – included both large one-time rebates totaling \$3.7 billion and permanent tax cuts that reduce expected FY 2005 total state and local tax revenues by \$2.78 billion (or 12 percent). Without the permanent tax cuts, total state and local tax collections would have risen more slowly than personal income, averaging about 5 percent growth per year between 1997 and 2005. Even if taxes had not been cut, total state and local tax collections would have fallen from 12.8 percent of personal income in FY 1997 to 12.3 percent of personal income in FY 2005.

With a 12 percent permanent cut in taxes, the portion of personal income paid in state and local taxes is expected to fall by more – to 10.9 percent of personal income in FY 2005. Despite those tax cuts, however, total state and local tax collections *per capita* are expected to rise at a rate roughly equal to inflation (averaging 2.3 percent).

The tax cuts have shifted Minnesota's tax structure, increasing the importance of the sales tax and miscellaneous taxes while reducing the role of both property and motor vehicle registration taxes. Revenue raised by the individual income tax was cut by roughly the same percent as total taxes (12 percent). So the tax share for the individual income tax, though higher than in 1997, is roughly the same as it would have been with no tax cuts (accounting for 31 percent of total state and local taxes).

The tax changes enacted between 1997 and 2005 have increased the share of *state* taxes and significantly reduced the share of taxes levied by school districts. Some financing for both schools and local governments was shifted to the state level. As a result, the state share of the total state and local tax burden has risen from 70 percent in FY 1997 to 75 percent in FY 2005. Because the tax burden has been shifted between levels of government, any comparisons of 1997 taxes to 2005 taxes should look at the entire state and local tax system, rather than focus on either state taxes or local taxes by themselves.

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**Table A1: Estimated Fiscal Impact of Tax Changes Enacted
1997 – 2001 Legislative Sessions**

By Fiscal Year

(Dollars in \$1000s)

(Negative numbers represent a cut in tax revenue.)

1. Property Tax Rebates									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	0	(475,000)	(25,000)	0	0	0	0	0	0
1998	0	0	(467,463)	(25,200)	0	0	0	0	0
1999	0	0	0	0	0	0	0	0	0
2000	0	0	0	0	0	0	0	0	0
2001	0	0	0	0	0	0	0	0	0
1997-2001	0	(475,000)	(492,463)	(25,200)	0	0	0	0	0

2. Sales Tax Rebates									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	0	0	0	0	0	0	0	0	0
1998	0	0	0	0	0	0	0	0	0
1999	0	0	(1,292,015)	(10,130)	(493)	0	0	0	0
2000	0	0	0	(623,672)	1,501	(32)	0	0	0
2001	0	0	0	0	(788,783)	11,181	0	0	0
1997-2001	0	0	(1,292,015)	(633,802)	(787,775)	11,049	0	0	0

3. Property Taxes									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	0	(17,100)	(241,255)	(277,590)	(281,790)	(287,254)	(292,827)	(298,511)	(304,310)
1998	0	0	(10,000)	(204,126)	(272,229)	(277,674)	(283,227)	(288,892)	(294,669)
1999	0	0	0	(3,032)	(136,869)	(138,444)	(141,855)	(144,692)	(147,586)
2000	0	0	0	(18,146)	(146)	(10,020)	(11,320)	(11,546)	(11,777)
2001	0	0	0	0	0	180,399	(795,773)	(960,667)	(981,428)
1997-2001	0	(17,100)	(251,255)	(502,894)	(691,034)	(532,992)	(1,525,002)	(1,704,309)	(1,739,770)

4. Individual Income Taxes									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	(5,700)	(6,700)	4,900	3,400	1,700	1,700	1,700	1,700	1,700
1998	0	(6,590)	(23,360)	(16,972)	(18,138)	(18,138)	(18,138)	(18,138)	(18,138)
1999	0	0	1,480	(859,726)	(647,347)	(568,633)	(581,610)	(613,367)	(655,438)
2000	0	0	0	(280)	(233,456)	(147,877)	(149,547)	(157,589)	(168,335)
2001	0	0	0	0	(200)	(180)	15,940	15,020	4,850
1997-2001	(5,700)	(13,290)	(16,980)	(873,578)	(897,441)	(733,128)	(731,655)	(772,374)	(835,361)

5. Sales & Use Tax (including motor vehicle sales tax)									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	(200)	1,400	(3,600)	(12,100)	(11,000)	(11,000)	(11,000)	(11,000)	(11,000)
1998	0	(58)	(4,547)	(9,336)	(10,653)	(10,653)	(10,653)	(10,653)	(10,653)
1999	0	0	(110)	(2,142)	(2,220)	(1,612)	(1,545)	(1,545)	(1,545)
2000	0	0	0	0	(2,792)	(45,854)	(4,282)	(4,282)	(4,282)
2001*	0	0	0	0	0	31,047	17,182	(87,586)	50,094
1997-2001	(200)	1,342	(8,257)	(23,578)	(26,665)	(38,072)	(10,298)	(115,066)	22,614

*includes correction to June accelerated sales tax change.

6. Motor Vehicle Registration Taxes									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	0	0	0	0	0	0	0	0	0
1998	0	0	0	0	0	0	0	0	0
1999	0	0	0	0	0	0	0	0	0
2000	0	0	0	0	(149,804)	(161,723)	(176,000)	(183,040)	(190,362)
2001	0	0	0	0	0	0	0	0	0
1997-2001	0	0	0	0	(149,804)	(161,723)	(176,000)	(183,040)	(190,362)

7. Other Taxes ⁸									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	3,400	200	5,400	6,700	(7,400)	(7,400)	(7,400)	(7,400)	(7,400)
1998	0	1,049	12,790	(21,825)	(7,310)	(7,310)	(7,310)	(7,310)	(7,310)
1999	0	0	7,535	(10,405)	(40,005)	(42,659)	(16,035)	(16,035)	(16,035)
2000	0	0	0	860	(20,285)	(42,543)	1,695	1,695	1,695
2001	0	0	0	0	(3,800)	(49,475)	(99,869)	(79,915)	(23,550)
1997-2001	3,400	1,249	25,725	(24,670)	(64,000)	(134,587)	(114,119)	(94,165)	(37,800)

TOTAL TAX CHANGES									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	(2,500)	(497,200)	(259,555)	(279,590)	(283,690)	(289,154)	(294,727)	(300,411)	(306,210)
1998	0	(5,599)	(492,580)	(277,459)	(308,330)	(313,775)	(319,328)	(324,993)	(330,770)
1999	0	0	(1,283,110)	(885,435)	(826,934)	(751,348)	(741,045)	(775,639)	(820,604)
2000	0	0	0	(641,238)	(404,982)	(408,049)	(339,454)	(354,762)	(373,061)
2001	0	0	0	0	(792,783)	172,872	(862,520)	(1,113,148)	(950,034)
1997-2001	(2,500)	(502,799)	(2,035,245)	(2,083,722)	(2,616,719)	(1,589,453)	(2,557,074)	(2,868,954)	(2,780,679)

⁸ The tax cut for "other taxes" includes significant (mostly temporary) cuts in health care taxes enacted in 1999, 2000, and 2001 and totaling \$283 million over the period covered in the table. These included reductions in the provider tax rate and delayed effective dates for the HMO insurance premiums tax. Only about \$1 million of these cuts (changes in the provider tax base itself) are permanent cuts remaining effective in FY 2005.

The tax cuts for "other taxes" also include permanent reductions in the corporate franchise tax totaling about \$100 million over the period shown in the table. The permanent corporate tax cut included for FY 2005 (\$35 million) is misleading, however. Technical changes in the taxation of S-corporations, enacted in 2001, shifted \$27 million in tax collections from the franchise tax to the individual income tax. After adjusting for this, the net corporate tax cut is roughly one percent. Most of the remaining change in "other taxes" represents permanent cuts in tax rates on gambling.

**Table A2: More Detailed Breakdown of Individual Income Tax Cuts
1997 – 2001 Legislative Sessions
By Fiscal Year**
(Dollars in \$1000s)
(Negative numbers represent a cut in tax revenue.)

1. Reduced Tax Rates (with Marriage Penalty Credit)									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	0	0	0	0	0	0	0	0	0
1998	0	0	0	0	0	0	0	0	0
1999	0	0	0	(842,039)	(563,872)	(556,230)	(567,742)	(599,243)	(641,050)
2000	0	0	0	0	(221,973)	(139,285)	(141,993)	(149,626)	(159,942)
2001	0	0	0	0	0	0	0	0	0
1997-2001	0	0	0	(842,039)	(785,845)	(695,515)	(709,735)	(748,869)	(800,992)

2. Expansion of Working Family Credit									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	0	0	0	0	0	0	0	0	0
1998	0	0	(4,400)	(5,000)	(5,100)	(5,100)	(5,100)	(5,100)	(5,100)
1999	0	0	0	(6,877)	(6,630)	(7,128)	(7,558)	(7,814)	(8,078)
2000	0	0	0	0	(10,915)	(11,746)	(12,465)	(12,874)	(13,304)
2001	0	0	0	0	0	(3,000)	(3,000)	(3,000)	(3,000)
1997-2001	0	0	(4,400)	(11,877)	(22,645)	(26,974)	(28,123)	(28,788)	(29,482)

3. All Other Changes to Individual Income Taxes									
	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2004	FY 2004	FY 2005
Year Enacted									
1997	(5,700)	(6,700)	4,900	3,400	1,700	1,700	1,700	1,700	1,700
1998	0	(6,590)	(18,960)	(11,972)	(13,038)	(13,038)	(13,038)	(13,038)	(13,038)
1999	0	0	1,480	(10,810)	(76,845)	(5,275)	(6,310)	(6,310)	(6,310)
2000	0	0	0	(280)	(568)	3,154	4,911	4,911	4,911
2001	0	0	0	0	(200)	2,820	18,940	18,020	7,850
1997-2001	(5,700)	(13,290)	(12,580)	(19,662)	(88,951)	(10,639)	6,203	5,283	(4,887)

Source: Rate changes (including marriage penalty credit) and expanded Working Family Credit (except 1998 change) estimated using the House Income Tax Simulation (HITS) model, based on the House sample and the November 2002 forecast. Numbers may differ somewhat from official estimates from the Department of Revenue because the House income tax sample is less complete. Other income tax changes based on estimates made at time of enactment, with constant fiscal impact assumed for years beyond the forecast window.