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**Minnesota's Fiscal Disparities
Programs**

**Twin Cities Metropolitan Area
and Iron Range**

This publication provides an overview of the state's two tax-base sharing programs, providing information on their backgrounds, policy rationales, program mechanics, redistributive effects, and tax burden impacts.

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Introduction

In 1971, the state of Minnesota instituted a program of commercial-industrial tax-base sharing within the Twin Cities metropolitan area. While the program is most often referred to by its nickname, the fiscal disparities program, the official statutory name of the program is the Charles R. Weaver Metropolitan Revenue Distribution Act. Although the concept of tax-base sharing has been discussed in policy and academic circles for many years, Minnesota's implementation is unique within the United States and may be unique worldwide in terms of the geographic area covered and the amount of tax base that is shared. In 1995, a parallel program was established on the Iron Range of northeastern Minnesota.

This report is a primer on Minnesota's two tax-base sharing programs. It is intended for use by at least two different groups of people: those affected by the programs who would like a better understanding of how the programs work, and those in other parts of the state, elsewhere in the United States, or other places in the world who have heard about Minnesota's tax-base sharing program and would like to learn more about it.

In trying to provide some background to these two diverse audiences, the report briefly covers many topics. The report:

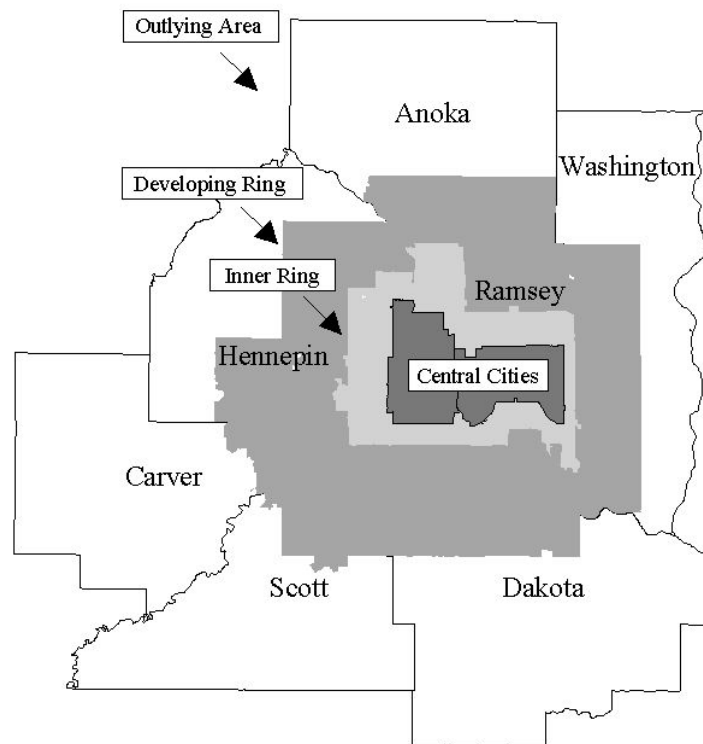
- provides some background on the geographic area(s) covered by the program(s), including demographic and economic data;
- discusses the policy rationale(s) for the program(s), and even more briefly, aspects of the program currently being debated in the policy arena;
- describes in some detail the mechanics of the program;
- provides historical and current data on the redistribution that actually takes place under the program (i.e., the "winners" and the "losers"); and
- looks at the impact of the program on tax burdens by simulating the property tax system in the absence of fiscal disparities (metro program).

Although the report describes the two programs separately, because the Iron Range program is patterned so closely after the metro program, those portions on how the program works are included only in the section describing the Twin Cities metropolitan program, but are applicable to both.

The Twin Cities Metropolitan Area Fiscal Disparities Program

The Twin Cities area fiscal disparities program was enacted in 1971, but court challenges prevented the program's implementation until 1975. The program is codified in Minnesota Statutes, chapter 473F. The Twin Cities area fiscal disparities program shares 40 percent of the growth in the commercial-industrial (C/I) property tax base of Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington counties (Figure A). The map shows the various development areas within the seven-county region as they existed in the early 1970s. The tables on the following page show how development has occurred some 30 years later.

Figure A:
**Fiscal Disparities Geographic Area:
Seven-County Twin Cities Metropolitan Area**



Development of the Metropolitan Area

The Twin Cities metropolitan area of today is quite different from that of the late 1960s and early 1970s when the fiscal disparities program began. Many of these differences result from demographic and developmental factors predicted by planners; many more are due to unforeseen factors.

Table 1:
**Total Population of Metro Area by Type of Location:
 1970 and 2002**

	1970 Population	% of Total	2002 Population	% of Total
Central Cities (Mpls./St. Paul)	744,300	39.7	670,700	24.8
Inner Ring	527,200	28.2	510,000	18.9
Developing Ring	432,600	23.1	1,086,000	40.2
Outlying Area	<u>168,600</u>	<u>9.0</u>	<u>438,100</u>	<u>16.2</u>
Total*	1,872,700	100.0	2,704,800	100.0

* Totals may not add up to 100% due to rounding.

Table 2:
**Commercial-Industrial (C/I) Property Tax Base
 of Metro Area by Type of Location: 1971 and 2003**

	1971 C/I Net Tax Capacity* (millions)	% of Total	2003 C/I Net Tax Capacity (millions)	% of Total
Central Cities (Mpls./St. Paul)	\$38.0	47.9	\$185.6	23.9
Inner Ring	22.2	28.0	167.6	21.6
Developing Ring	14.9	18.8	355.1	45.8
Outlying Area	<u>4.2</u>	<u>5.3</u>	<u>66.8</u>	<u>8.6</u>
Total**	\$79.4	100.0	\$775.2	100.0

* 1971 assessed value converted to net tax capacity.

** Totals may not add up to 100% due to rounding.

Fiscal Disparities Program: What Is Its Purpose?

As originally enacted, the fiscal disparities statute identifies six objectives that the program seeks to accomplish:¹

- To provide a way for local governments to share in the resources generated by the growth of the area, without removing any resources that local governments already have
- To increase the likelihood of orderly urban development by reducing the impact of fiscal considerations on the location of business and residential growth and of highways, transit facilities, and airports
- To establish incentives for all parts of the area to work for the growth of the area as a whole
- To provide a way whereby the area's resources can be made available within and through the existing system of local governments and local decision making
- To help communities in different stages of development by making resources increasingly available to communities at those early stages of development and redevelopment when financial pressures on them are the greatest
- To encourage protection of the environment by reducing the impact of fiscal considerations so that flood plains can be protected and land for parks and open space can be preserved

Modern-day proponents of the fiscal disparities program have come to focus on two broad goals:

- **Promoting more orderly regional development**
- **Improving equity in the distribution of fiscal resources**

The following aspects of the fiscal disparities program contribute toward one or both of these goals:

- Tax-base sharing spreads the fiscal benefit of business development attracted by regional facilities, such as large shopping centers, airports, and freeway interchanges, or recreational facilities, such as sports stadiums and arenas.
- Communities with low tax bases must impose higher tax rates to deliver the same services as communities with higher tax bases. These high tax rates make poor

¹ Minn. Stat. 2004, § 473F.01, subd. 1. The original language included a seventh objective that was eventually repealed because it related to a component of the program that was never enacted.

communities less attractive places for businesses to locate or expand in, exacerbating the problem. Sharing of C/I tax base can reduce this effect.

- Communities generally believe that commercial and industrial properties pay more in taxes than it costs to provide services to them. This encourages communities to compete for these properties by providing tax concessions or special services. Tax-base sharing may reduce this competition, thereby discouraging urban sprawl and reducing the cost of providing regional services, such as sewage and transportation.
- Tax-base sharing equalizes the imbalance between some local governments' public service needs and financial resources. The uneven distribution of property tax base, particularly commercial and industrial property, is a major cause of this imbalance.
- Communities may be more willing to accept low tax-yield regional facilities, such as parks, to preserve environmental amenities because they know they will share the benefits of other communities' commercial development.
- Tax-base sharing can provide additional resources to older areas to finance urban redevelopment.

How Does the Fiscal Disparities Program Work?

This section describes how the fiscal disparities program works as part of the property tax system. A simplified pictorial illustration of the fiscal disparities process is shown in Appendix A.

Contributions to Areawide Tax Base

The fiscal disparities law requires each taxing jurisdiction² to contribute 40 percent of the growth in its C/I property tax base since the 1971 assessment to an areawide pool. Even though the first year of implementation was 1975, the 1971 assessment remains the benchmark year.

C/I property includes all businesses, offices, stores, warehouses, factories, gas stations, parking ramps, and so forth. It also includes public utility property and vacant land which is zoned commercial or industrial. Although both C/I real and personal property are included in the program, most personal property is exempt from taxation.

The growth in value considered is the total net change in net tax capacity since 1971, including the effects of new construction, inflation, demolition, revaluation, appreciation, and depreciation. There is no distinction between “new” property and “old” property.

Distribution from Areawide Tax Base

The distribution of the net tax capacity from the areawide tax base is determined by a distribution index based upon relative fiscal capacity.³

For a given municipality, the index equals the municipality's population multiplied by a ratio measuring relative fiscal capacity. The ratio is the proportion which the average fiscal capacity of all municipalities for the previous year bears to the fiscal capacity of that particular municipality for the previous year.

The equation for the distribution index is as follows:

$$\text{Population of City/Town} \times \frac{\text{Average Fiscal Capacity}}{\text{City/Town Fiscal Capacity}} = \text{Distribution Index}$$

² In this report, some references are to “municipalities” (cities or towns) and others are to “governmental units or taxing jurisdictions” (counties, cities, towns, school districts, and special taxing districts). All property is located in a municipality, but pays taxes to all taxing jurisdictions encompassing the property.

³ Fiscal capacity is defined as equalized market value per capita. Equalized market value is market value adjusted by each municipality's sales ratio, which is a measure of the assessment level within the municipality.

The formula is based wholly on fiscal capacity, defined as equalized market value per capita. There is no measure of spending need in the distribution formula other than population. This means that:

- If the municipality's fiscal capacity is the same as the metropolitan average, its percentage share of the areawide tax base will be the same as its share of the area's population;
- If its fiscal capacity is above the metro average, its share will be smaller;
- If its fiscal capacity is below the metro average, its share will be larger.

Taxing Jurisdiction Levies vs. Tax Burdens

Tax-base sharing takes place before local jurisdictions levy taxes. The jurisdiction decides what amount it must levy to provide local services. In the absence of tax-base sharing, the levy would simply be spread on the tax base within the jurisdiction. With fiscal disparities, however, the tax burden on taxpayers within the jurisdiction may be more or less than the jurisdiction's levy. The jurisdiction still receives the full amount that it levied. However, if the jurisdiction is a net contributor (i.e., contributes more than it gets back), the properties within the jurisdiction will pay more tax than the jurisdiction's levy. If the jurisdiction is a net recipient (of tax base), the jurisdiction's taxpayers will pay less than the amount levied.

Impact on Individual Parcels

All property except C/I pays a property tax determined by the local tax rate, which reflects the net effect of fiscal disparities upon each taxing district's tax base.

For C/I property, a ratio is computed in each municipality by dividing that municipality's contribution net tax capacity by its total C/I net tax capacity. (Since only 40 percent of the growth over the base year is contributed, that rate will never exceed 40 percent.) This ratio represents the portion of each C/I parcel's net tax capacity that pays a tax determined by the areawide tax rate. The rest of the parcel's net tax capacity pays a tax determined by the local tax rate. Because a portion of each C/I parcel is taxed at a uniform rate, the tax burden on comparable parcels of C/I property will vary less from jurisdiction to jurisdiction than it would without fiscal disparities.

Step-by-step Calculations

The step-by-step calculations under fiscal disparities for a hypothetical city are shown on the following pages. An alternative version of the calculations is shown in appendix B. The basic mechanics are easier to understand in the alternative version, which leaves out the one-year lag that was instituted to facilitate administration of the program in light of the complexity of Minnesota's property tax system.

**Fiscal Disparities Calculations for a Hypothetical City
 (Payable 2004)**

Assumptions for City of Minnesota

2002 Population	20,000
2002 Equalized Market Value	\$500,000,000
2002 Fiscal Capacity*	\$25,000
2002 Areawide Average Fiscal Capacity**	\$30,000
2003 Payable 2004 Certified Levy	\$8,000,000
1971 Commercial-Industrial Net Tax Capacity***	\$2,500,000
2002 Payable 2003 Net Tax Capacity	
Commercial-Industrial***	\$8,000,000
Residential	10,000,000
All Other	<u>+1,000,000</u>
Total	\$19,000,000
2003 Payable 2004 Net Tax Capacity	
Commercial-Industrial***	\$8,800,000
Residential	12,000,000
All Other	<u>+ 1,400,000</u>
Total	\$22,200,000

* Fiscal Capacity = $\frac{\text{Equalized market value of all property in the municipality}}{\text{Population of municipality}}$

** Average Fiscal Capacity = $\frac{\text{Total equalized market value of all property in all municipalities}}{\text{Total population of the metropolitan area}}$

*** Commercial-industrial net tax capacity includes the tax capacity of public utility property. Since net tax capacity was not in use in the 1971 base year, it has been estimated using available market value records. The 1971 base value is adjusted each year that changes are made in C/I class rates.

Step 1: Determine the City's Contribution to Areawide Tax Base

2002 Payable 2003 Commercial-Industrial Net Tax Capacity ⁴	\$8,000,000
Less 1971 Commercial-Industrial Net Tax Capacity	<u>-2,500,000</u>
Net Growth over 1971 Base Value	\$5,500,000
Contribution Rate	<u>x 40%</u>
City's Contribution to Areawide Tax Base	\$2,200,000

Step 2: Determine the Areawide Tax Base

Net Tax Capacity Contributed from City of Minnesota	\$2,200,000
Net Tax Capacity Contributed from All Other Cities and Towns in the Metro Area	<u>\$297,800,000</u>
Total Areawide Tax Base	\$300,000,000

Step 3: Distribution Index for City of Minnesota

$$\text{Population of City/Town} \times \frac{\text{Average Fiscal Capacity}}{\text{City/Town Fiscal Capacity}} = \text{Distribution Index}$$

$$20,000 \times \frac{\$30,000}{\$25,000} = 24,000$$

Step 4: Sum of Distribution Indices for All Municipalities

	<u>Index</u>	<u>Percent</u>
City of Minnesota (step 3)	24,000	1.2%
All Other Metropolitan Cities and Towns	<u>1,976,000</u>	<u>98.8%</u>
	2,000,000	100.00%

The city of Minnesota's final distribution index is 1.2 percent of 2,000,000; therefore, it receives 1.2 percent of the areawide tax base.

⁴ Laws 1976, chapter 191, provided that the fiscal disparities contribution and distribution values and tax rates would be based on the previous year. This was done for administrative reasons. Appendix B contains an example of how the program works without the one-year lag (i.e., based on current values and rates).

Step 5: City of Minnesota's Distribution Net Tax Capacity

The city of Minnesota's distribution net tax capacity is equal to the share determined in step 4 multiplied by the areawide tax base determined in step 2.

$$1.2\% \quad \times \quad \$300,000,000 \quad = \quad \$3,600,000$$

This distribution net tax capacity is also taxable by other taxing jurisdictions (i.e., county, school district, special taxing districts) overlapping the city.

Step 6: Determine the City of Minnesota's Tax Base

2003 Payable 2004 Total Net Tax Capacity for City of Minnesota	\$22,200,000
Less Payable 2004 Contribution to the Areawide Tax Base (step 1)	<u>-2,200,000</u>
Total Payable 2004 Taxable Net Tax Capacity for City of Minnesota	\$20,000,000

Step 7: Determine Areawide Portion of City of Minnesota's Levy (also called the city's distribution levy)

Distribution Tax Capacity (step 5)	x	2002 Payable 2003 City Tax Rate	=	Areawide Portion of Levy
\$3,600,000	x	0.35 (35% of net tax capacity)	=	\$1,260,000

Step 8: Determine the Areawide Tax Levy

The auditor of the county in which the city of Minnesota is located certifies to the administrative auditor an amount of \$1,260,000 as the areawide portion of the city's levy. This is also done for all other governmental units located within the area.

City of Minnesota's Distribution Levy (step 7)	\$1,260,000
Distribution Levies from All Other Governmental Units in the Metro Area	<u>398,740,000</u>
Total Areawide Levy	\$400,000,000

Step 9: Determine the Areawide Tax Rate

The administrative auditor computes the areawide tax rate as follows:

$$\frac{\text{Total Areawide Levy (step 8)}}{\text{Total Areawide Tax Base (step 2)}} \times \frac{\$400,000,000}{\$300,000,000} = 1.333 \text{ (133.3\% of net tax capacity)}$$

This tax rate is applied to the contribution net tax capacity of all municipalities in the metro area.

The areawide tax rate is a composite rate which provides revenues for municipalities, school districts, county governments, and special taxing districts.

Step 10: County Auditor Calculates the City of Minnesota's Tax Rate

2003 Payable 2004 Total Certified Levy	\$8,000,000	
Less Portion Attributable Receivable from Areawide Tax Base (step 7)	<u>-1,260,000</u>	
2003 Payable 2004 Adjusted Levy for the City (local portion)	6,740,000	
<u>2003 Payable 2004 Adjusted Levy</u>	<u>\$6,740,000</u>	= 0.337
Taxable Net Tax Capacity (step 6)	\$20,000,000	
City Tax Rate		0.337 (33.7% of tax capacity)

The city's tax rate of 0.337 is added to the tax rates for the appropriate county, school district, and special taxing districts. That total rate is applied to all taxable property in the city of Minnesota except the fiscal disparities portion of C/I property (see step 11).

Step 11: Property Tax Computation on C/I Parcel

The fiscal disparities contribution net tax capacity of \$2,200,000 is equal to 25 percent of the total assessment district's payable 2004 C/I net tax capacity of \$8,800,000. Therefore, 25 percent of the net tax capacity of each parcel of C/I property in the city is subject to the areawide tax. The remaining 75 percent of the net tax capacity of each C/I parcel is subject to the local tax rate.

The payable 2004 property tax computation for a parcel of C/I property located in the city of Minnesota with a market value of \$300,000 (net tax capacity of \$5,250) is shown on the following page.

Areawide Portion of Tax (Contribution Tax)	Local Portion of Tax										
<p>25% of \$5,250 net tax capacity of the C/I parcel is taxed at the areawide rate of 1.333.</p> <p style="text-align: center;">$0.25 \times \\$5,250 \times 1.333 = \\$1,750$</p>	<p>Remaining 75% of net tax capacity of the C/I parcel is subject to local tax rates of all jurisdictions where the parcel of property is located.</p> <p style="text-align: center;"><u>Local Tax Rates</u></p> <table style="margin-left: auto; margin-right: auto;"> <tr> <td>City of Minnesota</td> <td style="text-align: right;">0.337</td> </tr> <tr> <td>School District</td> <td style="text-align: right;">0.256</td> </tr> <tr> <td>County</td> <td style="text-align: right;">0.433</td> </tr> <tr> <td>Special Taxing District</td> <td style="text-align: right;"><u>0.074</u></td> </tr> <tr> <td>Total Local Tax Rate</td> <td style="text-align: right;">1.100</td> </tr> </table> <p style="text-align: center;">$0.75 \times \\$5,250 \times 1.100 = \\$4,331$</p>	City of Minnesota	0.337	School District	0.256	County	0.433	Special Taxing District	<u>0.074</u>	Total Local Tax Rate	1.100
City of Minnesota	0.337										
School District	0.256										
County	0.433										
Special Taxing District	<u>0.074</u>										
Total Local Tax Rate	1.100										
Total Payable 2004 Tax of C/I Parcel											
Areawide Portion of Tax	\$1,750										
Local Portion of Tax	4,331										
State Property Tax $(5.250 \times 0.541)^5$	<u>2,840</u>										
Total Tax	\$8,921										

Step 12: Property Tax Settlement of the Areawide Levy

The county treasurer collects the \$8,921 from the taxpayer of the C/I parcel in step 11 and the C/I tax from all other taxpayers with C/I property within the county.

The treasurer compares the sum of the total amount of the contribution levies (e.g., areawide portions of the tax) from all C/I parcels within the county to the sum of the total amount of the distribution levies which all of the taxing districts within the county are entitled to receive from the areawide pool.

If the total contribution levy exceeds the total distribution levy, the county treasurer will remit a check to the administrative auditor for the difference (i.e., amount owed). If the total contribution levy is less than the distribution levy, the county treasurer will receive a check from the administrative auditor.

⁵ The state property tax was enacted in 2001 as part of a major overall property tax reform (see page 19).

Administrative Aspects of the Program

The fiscal disparities program requires additional administrative tasks to be performed annually by property tax administrators. The county officials meet regularly to establish timelines, coordinate data collection and reporting, and to decide how to handle situations brought about by changes in general property tax laws, unique property situations, etc. Department of Revenue staff annually determine the fiscal capacity for each city and town. The administrative auditor (from Anoka County, as elected by the other metropolitan auditors) determines the distribution indices and the areawide tax rate.

For counties that are not subject to fiscal disparities, the county auditor simply determines each taxing jurisdiction's local tax rate by dividing its property tax levy by its total net tax capacity. However, for counties that are subject to fiscal disparities, the county auditor must also do the following:

- Determine each taxing district's taxable net tax capacity, which is the actual tax base located within its boundaries minus its contribution to the areawide base
- Apportion the levy of each taxing district into an areawide portion and a local portion (The distribution tax capacity times the previous year's local tax rate equals the areawide portion of the levy. The remaining amount of the taxing district's levy is considered its local portion.)
- Determine the local tax rate for each jurisdiction by dividing the local portion of the levy by its taxable net tax capacity

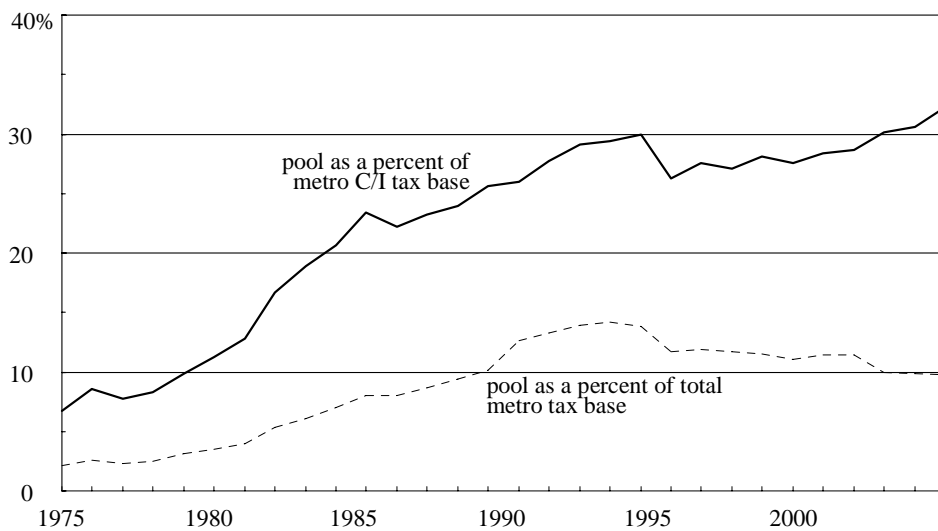
Growth in the Fiscal Disparities Program

Areawide Tax Base Growth

Figure B shows that the fiscal disparities areawide tax base has increased steadily and significantly relative to the total metro C/I tax base and the total metro tax base over the life of the program. From 1995 to 2004 the percentage of C/I property in the areawide pool has increased steadily from 26 percent to 32 percent—a fairly high number considering that 40 percent is the maximum amount of C/I tax base that could be in the areawide pool.

Translating this to the tax burden for a typical parcel of C/I property, roughly 20 percent to 25 percent of the tax is based on the areawide rate, while another 30 percent to 35 percent is based on the state tax rate, leaving roughly 40 percent to 45 percent determined by the local tax rate. This guarantees that the variation in C/I taxes between municipalities will be substantially less than it would be if taxes were based solely on local tax rates.

Figure B:
**Percentage of Total Metro Tax Base and Total Metro C/I Tax Base
Comprised by the Areawide Pool, 1974-2004**

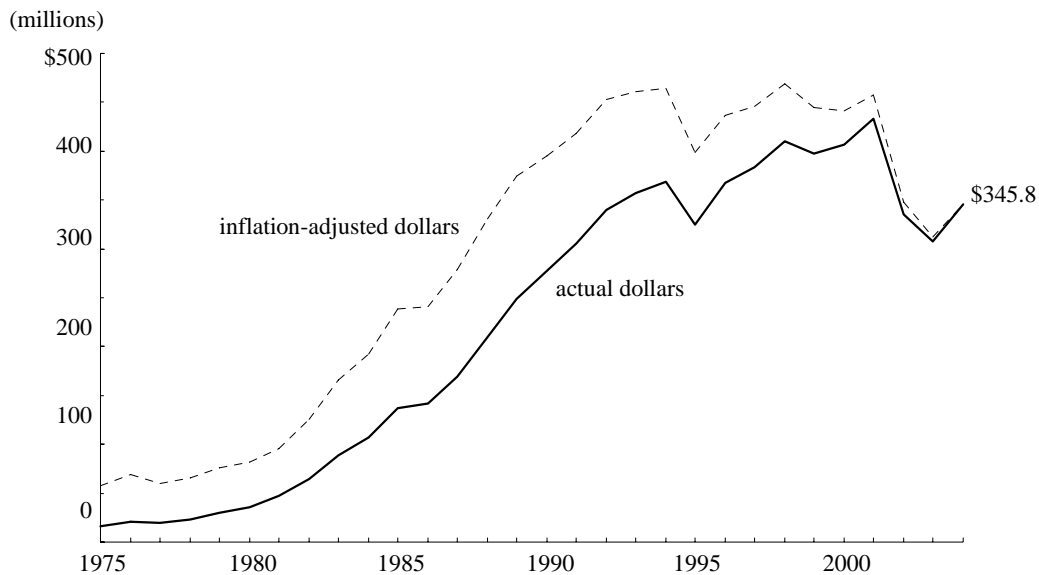


Historical data for growth in the areawide tax base is presented in Appendix C.

Growth in Distribution Tax

Figure C shows that the total areawide tax has grown significantly since the program began. The program's growth from 1982 through 1994 was remarkable; in most of the years annual increases in the areawide tax were greater than 10 percent. A slump in C/I real estate values in the early to mid-1990s put a stop to the rapid growth. In the late 1990s the legislature embarked on a program of "class rate compression" to reduce the disparity in effective tax rates between C/I property and other types of property, which dampened growth in that period. Then, in 2001 the legislature initiated a major overhaul of the property tax system. The most significant result of the overhaul was the state takeover of financial responsibility for basic educational expenses, transit, and a portion of voter-approved school levies (see pages 19 to 21).

Figure C:
Metro Fiscal Disparities Distribution Tax, 1975-2004



Historical data for growth in the distribution tax amount is presented in Appendix D.

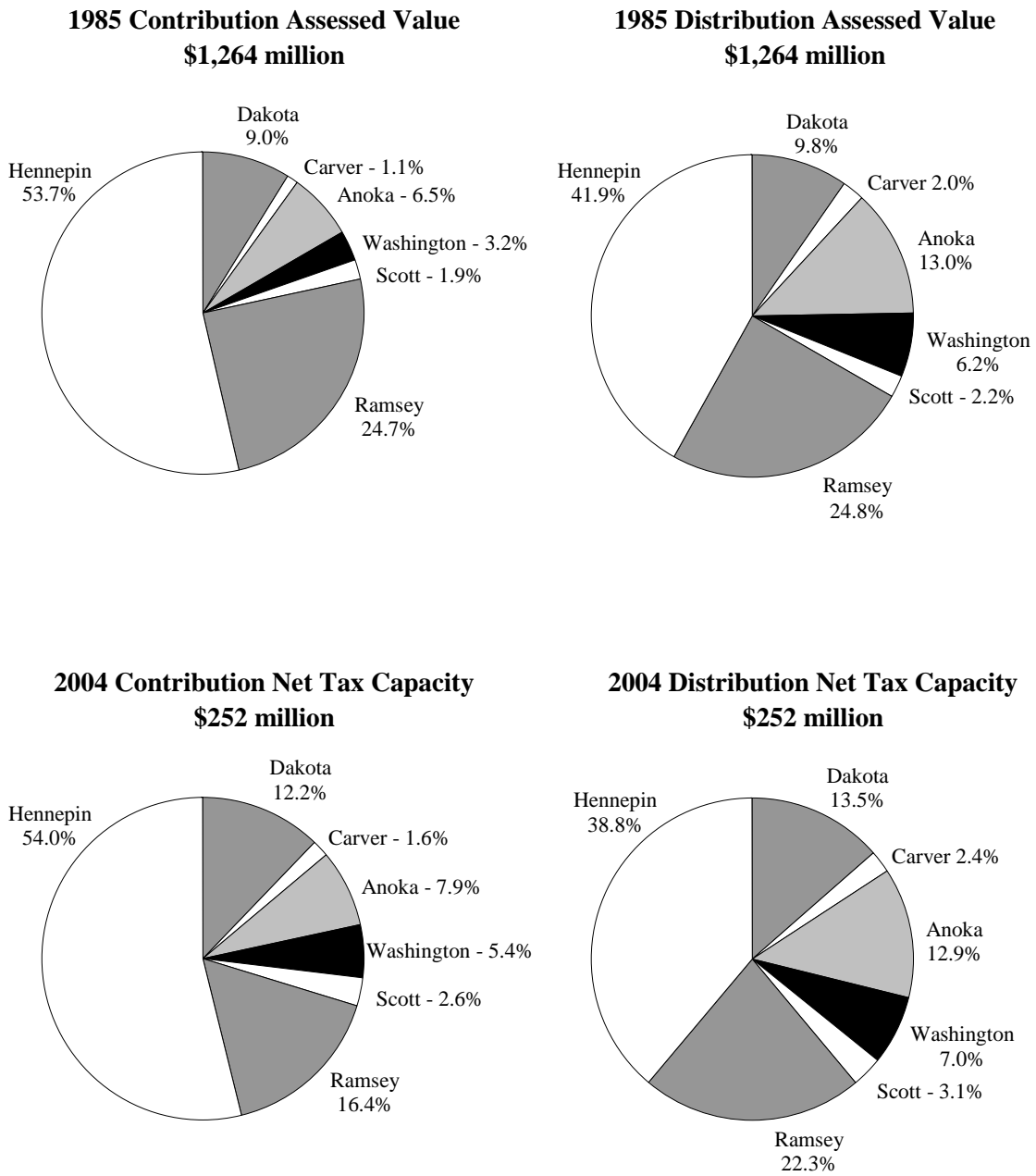
Changes in Contribution and Distribution Amounts Over Time

The pie charts on the following page show the redistributive effect of the fiscal disparities program by county at two “snapshots” in time, taxes payable in 1985 and 2004. There is nothing particularly significant about 1985; it is just used as an historical reference point.

Figure D shows that in 2004, Hennepin County is the only net contributor, contributing 54 percent of the net tax capacity in the areawide pool, and receiving about 39 percent back. By contrast, Anoka County contributes 8 percent and gets back 13 percent; Ramsey County contributes 16 percent and gets back 22 percent.

The percentages for 1985 and 2004 are somewhat similar, except that Ramsey County's net gain increased considerably over the period, while Hennepin County's net loss also increased considerably. The other five (outlying) counties both contribute and receive higher percentages of the pool in 2004, reflecting their rapid growth over the period.

**Figure D:
 Payable 1985 and 2004 Metro Contribution
 and Distribution Values by County**



2001 Property Tax Reform

In 2001, the state adopted the most comprehensive set of changes in the property tax system since the “Minnesota Miracle” of 1971. The major thrust of the reform was to improve accountability within the property tax system. There were two major aspects to the reform:

- A realignment of state-local fiscal relations. For basic education and transit services, state funds were provided to replace local property tax dollars, while for basic municipal services, state aids were reduced allowing local property tax dollars to fill in the gap.
- Class rate reform. The contribution of C/I property and multi-family housing to the local tax base was reduced, bringing their shares closer to their proportions of overall property value.

Elements of the reform

Class rate compression. Class rates, which define the contribution that each type of property's market value makes to the local tax base, generally varied from 1.0 percent (on the first “tier” of homestead property) to 3.4 percent (on upper-tier C/I property) before the 2001 reform. Within classes, there was also significant variation: rates on homesteads ranged from 1 percent to 1.65 percent, while C/I rates ranged from 2.4 percent to 3.4 percent. The governor and the legislature had been taking steps to reduce the variation, or “compress,” the rates dating back to 1991, when the range had been from 1 percent (on first-tier homestead property) to 5.06 percent (on upper-tier C/I property).

Under the reformed system, all rates⁶ were compressed into a range from 1 percent (on most homestead value) to 2 percent (on most C/I value). The purpose of class rate compression was to increase accountability by reducing the ability to “export” the costs of local services to nonresidents, primarily C/I property taxpayers, and to create a more direct link between homeowner taxes and the levies approved by local officials. Besides reducing the differential between C/I property and homesteads, the reform also greatly reduced the tax differential between homesteads and residential rental properties.

Education levy takeovers. The state took over the general education levy, providing all of the funding for basic school operating expenses. Before reform, general education was funded through a statewide uniform tax rate on all property in all districts, with state aid making up the difference between each district's “need” and its ability to fund the need from its own tax base. Besides the general education takeover, the reform also called for the state to take over funding of a portion of each school district's referendum levy, which had also been funded by an equalization formula based on each district's relative property wealth.

⁶ Excluding rates for agricultural property, some of which are below 1 percent. Agricultural property is not discussed here because it represents a small fraction of total property value in the metropolitan area where the fiscal disparities program operates.

Transit levy takeover. The state took over the portion of the operating costs of the metro transit system that had been funded by a levy on all metro property taxpayers. The takeover was funded through a dedication of revenue from the state sales tax on motor vehicles. Besides the takeover of the metro transit system, a portion of the motor vehicle sales tax was also set aside to replace property tax levies for transit systems in greater Minnesota.

State property tax. The class rate changes and the general education takeover would have resulted in considerably lower property taxes on C/I property and seasonal-recreational property. To provide more modest relief to these classes of property and to provide funding for other elements of the reform, a new state property tax was instituted to offset the changes in the composition of the local tax base. About 6 percent of the state property tax is borne by seasonal-recreational property, with the remaining 94 percent borne by C/I property. The state tax constitutes approximately one-third of the total tax burden on C/I and seasonal-recreational properties.

State aid changes. State aids to nonschool local governments were reduced and partially reformed, primarily through the elimination of homestead and agricultural credit aid (HACA) for all types of local governments except counties. HACA was generally regarded as untargeted aid when compared to aid programs that consider local service needs and the adequacy of the local tax base to meet those needs.

HACA reductions forced towns and special taxing districts to increase levies or reduce spending. But cities, which collectively lost almost \$200 million in HACA, were given approximately \$140 million in the more targeted program known as local government aid (LGA). Some individual cities, primarily suburbs, were net losers of aid, while some individual cities, primarily larger nonmetro cities, were net gainers.

Fiscal Disparities Impact

Class rate compression causes the areawide pool to be smaller than it otherwise would have been. Generally speaking, compression causes the C/I share of the total tax base to shrink, so the relative relationship between the areawide pool and the total metro tax base is also shrinking. However, compression does not affect the relationship between the size of the areawide pool and the size of the total metropolitan area C/I tax base. Figure B (page 15) and appendix C show that the areawide pool declined from 11.4 percent of the total metro tax base in 2001 to 10 percent in 2002 directly due to the 2001 tax reform. Moreover, the pool had encompassed roughly 13 percent of the total metro tax base in the early 1990s before the general movement toward compression got underway. However, the pool's share of the total metro C/I base increased from 28.7 percent in 2001 to 30.1 percent in 2002, and in fact has continued to climb to 32.3 percent in 2004.

Eliminating the general education and transit levies, and partially eliminating school referendum levies, caused the overall level of local taxes to be reduced by 21.7 percent in the metro area between pay 2001 and pay 2002. Because of the way fiscal disparities is calculated, this caused

a corresponding reduction in the overall size of the fiscal disparities levy by 22.7 percent. However, it is misleading to think of this drop as a reduction in the amount of redistribution taking place in the program, because for the most part the portion of the fiscal disparities levy allocated to the general education levy did not result in redistribution. If the fiscal disparities program had not existed, general education aid would have been distributed more heavily to school districts that are beneficiaries under fiscal disparities, making the fiscal disparities redistribution superfluous.⁷

⁷ This observation has been written about in previous versions of this report. See for example *Minnesota's Fiscal Disparities Programs: Twin Cities Metropolitan Area and Iron Range*, February 2000.

Impact of Fiscal Disparities on Tax Burdens

Most fiscal disparities discussions focus on tax base—on how much is being redistributed and how much tax base equalization is achieved. However, it is possible to go one step further and analyze the actual impact on tax burdens using property tax simulation.

The Simulation

The question of greatest interest is: how would tax burdens be different if the fiscal disparities program had never been enacted? That question is impossible to answer because even though the fiscal disparities calculations can be “undone,” there is no way to measure, or undo, the effect the fiscal disparities program has had on property values, local government spending and levy decisions, and business location decisions.

Setting those issues aside, the premise of the simulation for this exercise is not that the fiscal disparities program never existed, but rather that it is suddenly eliminated. The simulation is based on taxes payable in 2004. At the time of the simulation, final levies for taxes payable in 2004 were not yet available, but all of the fiscal disparities data and most of the other actual data was available. The simulation uses preliminary levies (also known as truth-in-taxation levies), augmented with data on school district referendum levies that passed after certification of preliminary levies.

The local government aid (LGA) formula was modeled for aids payable in 2004 under two scenarios. The first scenario used the actual tax capacity measures employed in determining 2004 aid distributions, but the LGA formula was run in its “pure” form, ignoring any phase-in components designed to minimize LGA changes for a given city from one year to the next. The second scenario used tax capacities as they would be without fiscal disparities, also using a pure formula with no phase-in components. The LGA change between the two scenarios was used for the simulation, with levy increases offsetting aid reductions and vice-versa. County program aids were modeled in the same way, even though the formula for county program aid does not come into play until taxes payable in 2005. School aids were modeled under the “no fiscal disparities” alternative as well; however, since the major property tax reform of 2001, most school aids and levies are not related to the size of a district’s tax base,⁸ so the effect on school levies was fairly minimal.

⁸ Under the reformed property tax system, school district referendum levies are highly “equalized,” meaning that the levy is tied to the size of a district’s tax base, but school district referendum levies are based on an alternate tax base known as “referendum market value,” and there is no redistribution of this tax base under fiscal disparities.

Results

The simulation shows that property taxes would increase slightly in aggregate throughout the state (\$10.2 million, or 0.2 percent) if the fiscal disparities program was eliminated (see Table 3). This impact is the result of three different effects, some of which offset each other.

First, some of the tax base in the fiscal disparities pool would be captured by tax increment financing (TIF) in the absence of fiscal disparities. Tax revenues from that tax base would not be available to pay the general government levy, so other property taxpayers would have to pay more. This is the case for any TIF district established after 1979 containing C/I property, if the municipality had elected to have the TIF district make its own fiscal disparities contribution. Approximately \$12.5 million of the \$254 million of net tax capacity in the fiscal disparities pool would be captured by TIF districts. This means that TIF levies, as well as overall property taxes, would be \$17 million higher if the fiscal disparities program did not exist.

The second effect contributing to the change in the overall tax burden statewide is \$5 million of additional tax payable to the Metropolitan Council's livable communities program. This program is unique in that it is funded solely from fiscal disparities rather than partly from fiscal disparities and partly from regular property tax levies. The simulation assumes that this levy would not exist in the absence of fiscal disparities, leading to an overall tax reduction of \$5 million.

Finally, state aid to school districts for capital improvement projects increases by \$2 million, causing school levies to be \$2 million lower without fiscal disparities.

Regional Impacts

The TIF phenomenon also leads to another unlikely result, namely that because the metro area as a whole essentially "loses" tax base when the fiscal disparities program is eliminated, metro area cities are in the aggregate slightly needier, as measured by the LGA formula. This result causes LGA to be higher by \$9.1 million in the metro area and \$9.1 million lower in greater Minnesota, with corresponding effects on levies. This phenomenon also occurs within the new county aid program known as "County Program Aid," but here the impact only moves about \$400,000 in aid from greater Minnesota to the metro area.

Table 3:
**Factors Contributing to Tax Impacts
 if Fiscal Disparities were Eliminated**

(in millions)

	Metro	Greater Minnesota	Statewide
TIF effect	\$16.6	\$0.7	\$17.4
Metro livable communities levy	-5.0	0	-5.0
School capital improvement aid effect	-2.0	0	-2.0
LGA effect	-9.1	9.1	0
County aid/levy effect	-0.4	0.4	0
Miscellaneous effects	-0.2	0.1	-0.2
Total tax change	\$-0.1	\$10.3	\$10.2

Overall Impact by Type of Property

Probably the most interesting result is that for the metro area as a whole, taxes on C/I property (including public utilities) were reduced by \$52.5 million, or 3.7 percent. Average tax burdens on other property types increased from 2 percent to 4 percent; the average increase for residential homesteads was 2.6 percent. In the abstract, this result would not be expected because “moving” C/I tax base around from one jurisdiction to another would not be expected to lower the tax on C/I property in the aggregate, nor would it increase taxes on other classes in the aggregate. There are three factors that contribute to the reduced overall tax burden on C/I property:

- The first factor is that in the aggregate, the C/I tax base is redistributed from municipalities where tax rates are lower to municipalities where tax rates are higher, so that the average rate of tax levied against C/I property would decrease without fiscal disparities.
- The second factor arises from how the market value tax enters into the equation. For the most part, the market value tax exists outside the realm of fiscal disparities—it is paid by the property physically located in the district levying the tax. However, in 1993 a provision was enacted calling for the tax rates used in fiscal disparities calculations to include the market value tax. This increases the burden on C/I property, since C/I property pays its full share of the market value tax in the jurisdiction where the property is located, but then essentially pays a little more when the levies are also imposed on the fiscal disparities pool.
- Third, there is the explicit \$5 million levy for the Metropolitan Council’s tax base revitalization account that is borne exclusively by C/I property through the areawide pool. The simulation assumes that this levy would not exist in the absence of fiscal disparities.

Countywide Average Impacts

On a countywide average basis, homestead taxes increase from 3 percent to 10 percent in the counties that are net recipients of fiscal disparities, and are reduced by only 0.3 percent in Hennepin County, the only net contributor (see Table 4). C/I taxes, on the other hand, would be reduced from 1 percent to 8 percent in every county if fiscal disparities were eliminated, even in those counties that are large net recipients. The best example is Anoka County, which sees an average tax rate increase of 9.3 percent and an average homestead tax increase of 9.5 percent, yet sees a 3.1 percent overall reduction in C/I taxes. This result occurs because even though city and county tax rates are increased due to the lost tax base, the areawide tax rate is considerably higher than the local rate, and the areawide rate accounts for roughly one-third of the local portion of the C/I tax.

Table 4:
Countywide Tax Impacts if Fiscal Disparities were Eliminated
(Taxes Payable in 2004)

County	Average Total Local Tax Rate ⁹			Average Tax Change if Fiscal Disparities Eliminated	
	With Fiscal Disparities	Without Fiscal Disparities	Tax Rate Change	Residential Homestead	Commercial/Industrial
Anoka	112.5	121.8	9.3	9.5 %	(3.1)%
Carver	132.2	136.8	4.6	3.6	(1.5)
Dakota	111.5	114.5	3.0	3.4	(8.2)
Hennepin	134.1	133.8	(0.3)	(0.3)	(3.7)
Ramsey	127.6	133.6	6.0	5.2	(1.2)
Scott	118.6	122.0	3.4	3.6	(6.3)
Washington	112.4	117.4	5.0	4.5	(3.8)

The results for property types other than homesteads and C/I (primarily rental housing) are similar to those for homesteads, but generally slightly smaller in magnitude. The percentage effect on homesteads is slightly more pronounced because the market value homestead credit does not change when the gross tax changes, and also because the elimination of fiscal disparities would increase the market value tax relative to the net tax capacity tax, and the market value tax falls more heavily on homes than does the net tax capacity tax.

⁹ In this table and in other tables throughout the report portraying total tax rates, the market value tax rate has been converted and added to the net tax capacity tax rate to arrive at a single tax rate for each municipality. The conversion is accurate for residential property valued under \$500,000. For other types of property, a different conversion rate would be more accurate.

Effects on Individual Cities

Effects are more pronounced when smaller geographic areas are considered. Table 5 shows what the impact would be in Minneapolis and St. Paul, and in the six cities (over 10,000 population) with the greatest impact, in either direction. Homeowners in cities that are major recipients under fiscal disparities would face tax increases between 10 percent and 13 percent; homeowners in cities that are major contributors would see reductions of 2.5 percent to 5 percent. Consistent with the countywide results, C/I properties would face lower taxes in most places, varying from 2 percent to 5 percent in net recipient cities, and from 5 percent to 10 percent in net contributor cities. C/I taxes would actually be higher in municipalities that are currently net recipients, and that would have a relatively high tax rate without fiscal disparities. This effect can be seen for the cities of Minneapolis, St. Paul, and South St. Paul in Table 5.

Table 5:
**Tax Impacts for Selected Cities if Fiscal Disparities were Eliminated
 (Taxes Payable in 2004)**

City	Average Total Local Tax Rate			Average Tax Change if Fiscal Disparities Eliminated	
	With Fiscal Disparities	Without Fiscal Disparities	Tax Rate Change	Residential Homestead	Commercial/Industrial
Minneapolis	158.6	161.8	3.2	2.2 %	2.6 %
St. Paul	130.4	140.3	9.9	8.8	2.7
Six largest net recipients:					
Andover	105.5	118.2	12.7	13.1	(2.1)
South St. Paul	127.8	139.4	11.6	10.5	2.7
Coon Rapids	109.9	120.9	11.0	11.6	(2.9)
East Bethel	100.3	110.8	10.5	12.0	(4.8)
Ramsey	117.3	127.8	10.5	10.0	(2.0)
Anoka	121.7	132.2	10.5	9.9	(0.8)
Six largest net contributors:					
Bloomington	122.4	116.2	(6.2)	(5.5)	(9.0)
Golden Valley	145.0	139.6	(5.4)	(3.2)	(5.3)
Minnetonka	125.6	120.8	(4.8)	(3.8)	(9.5)
Eden Prairie	121.1	116.5	(4.6)	(4.0)	(9.6)
Plymouth	119.4	116.4	(3.0)	(2.4)	(9.7)
Edina	113.3	110.9	(2.6)	(2.7)	(9.4)

It is common to assume that a municipality's net fiscal disparities distribution tax capacity (distribution minus contribution) determines whether or not it is a "winner" or "loser" under fiscal disparities, and by how much. Looking at those net tax capacity changes alone can be misleading. Some cities that lose tax base through fiscal disparities still benefit when total property taxes are considered, and vice-versa. This effect occurs when a city is located in a county whose net tax base impact is opposite that of the city, i.e., the city is a winner and the county is a loser or vice-versa. (Occasionally the school district effect can cause this result as well.) The county effect is just as important as the city effect in terms of tax burdens on individual property owners. An example of this phenomenon is the city of Fridley (not shown in table), which is a net contributor, yet its homeowners' tax burdens would be 6.2 percent higher, on average, without fiscal disparities.

Tax Rate Equalization

One interesting question to ask is whether the fiscal disparities program narrows the range of tax rates between communities in the metro area. Using the standard deviation as a measure of the range of distribution, the table below shows that the range of tax rates is not really impacted by fiscal disparities. When looking at all cities there is a slightly lower standard deviation with fiscal disparities, but that difference disappears when the universe is limited to cities over 2,500.

[**Note:** The tables in this tax base equalization section of the report show data for the "without fiscal disparities" scenario first, while data for the "with fiscal disparities" scenario (current law) is shown second. This is opposite from the way the two scenarios are depicted in the other sections of the report. The results are shown this way to more clearly show the direct impact that the fiscal disparities program has on the property tax system absent the program.]

Table 6:
Total Tax Rate Comparison under Fiscal Disparities
(Taxes Payable in 2004)

	Number of cities	Without Fiscal Disparities		With Fiscal Disparities (Current Law)	
		Mean	Standard deviation	Mean	Standard deviation
All cities*	137	126.69%	19.36%	123.07%	18.46%
Cities over 2,500 population	97	127.25	15.92	123.51	15.75
Cities over 5,000 population	76	127.78	15.52	123.81	15.63
Cities over 10,000 population	58	128.83	15.70	124.81	15.62

* Excluding the cities of Hilltop and Landfall, whose tax rates are well outside of the normal range due to high concentrations of manufactured homes in their respective tax bases.

Table 7 shows the eight cities (over 10,000 population) with the highest and lowest tax rates without fiscal disparities, and what happens to their tax rates when fiscal disparities enter the picture. Somewhat surprisingly, the fiscal disparities program actually causes tax rates to be lower than they otherwise would be in five of the eight low-tax-rate cities shown in Table 7. Things are more as one would expect at the high end of the range, where seven of the eight high-tax-rate cities have lower tax rates with fiscal disparities than they would without, although the differences are fairly modest.

Table 7:
Tax Rate Impacts for Selected Cities under Fiscal Disparities
(Taxes Payable in 2004)

	Without Fiscal Disparities	With Fiscal Disparities (Current Law)	Rate Change due to Fiscal Disparities
Cities with lowest tax rates without fiscal disparities:			
Mendota Heights	89.6	89.8	0.2
Eagan	103.4	102.9	(0.5)
Forest Lake	104.0	100.4	(3.6)
West St. Paul	104.2	102.7	(1.5)
Ham Lake	108.3	98.5	(9.8)
Shakopee	109.6	110.6	0.9
East Bethel	110.8	100.3	(10.5)
Edina	110.9	113.5	2.7
Cities with highest tax rates without fiscal disparities:			
Brooklyn Center	168.7	162.7	(6.0)
Minneapolis	161.8	158.6	(3.2)
New Hope	158.1	154.8	(3.3)
Robbinsdale	154.1	149.0	(5.1)
Crystal	151.5	147.1	(4.4)
Hopkins	151.2	152.2	1.0
Chanhassen	147.8	144.2	(3.6)
Brooklyn Park	146.8	141.7	(5.0)

These results raise some questions about one of the presumed purposes of the program, which is to reduce the range of tax rate disparities across the area. It suggests that some communities that the fiscal disparities program seems to regard as “needy” would have low tax rates even without fiscal disparities. For instance, Ham Lake would have a relatively low tax rate of 108.3 percent without fiscal disparities; its rate with fiscal disparities is an incredibly low 98.5 percent. That may call into question whether redistribution of tax base is necessary to keep tax rates from climbing in low-tax-base areas, and from dropping ever lower in high-tax-base places.

Local Government Aid Effect

One reason that fiscal disparities may not have as large a tax impact as one would expect is the mitigating effect of the LGA formula. Under the new formula adopted in 2001, LGA amounts are now sensitive to the size of a city's tax base. So cities that would lose tax base if fiscal disparities were eliminated receive more LGA, which can be almost enough to offset the tax-base loss. Conversely, a city that gains tax base through fiscal disparities elimination receives less LGA, thus offsetting somewhat the tax-base gain. The table below shows a few examples of this phenomenon.

Table 8:
LGA Offset of Fiscal Disparities Effect
 (in thousands)

	Tax Revenue Gain/Loss if Fiscal Disparities Eliminated	LGA Gain/Loss if Fiscal Disparities Eliminated	Net Revenue Effect if Fiscal Disparities Eliminated
St. Paul	\$(8,328)	\$5,901	\$(2,427)
Richfield	(982)	680	(302)
Columbia Heights	(771)	523	(247)
Cottage Grove	(1,002)	0	(1,002)
Minneapolis	(1,728)	(2,169)	(3,897)
Fridley	226	(222)	4

In the table, the second column is derived by multiplying the net fiscal disparities tax base gain or loss by the city tax rate. In the first three cities shown, the LGA gain offsets a significant portion of the revenue loss. The fourth case, Cottage Grove, has a significant revenue loss of over a million dollars, yet there is no offsetting LGA increase because Cottage Grove has enough tax base to meet its revenue "need," as measured by the LGA formula, even without fiscal disparities.

The city of Minneapolis demonstrates yet another outcome. Although the city would lose tax revenue because it is a net recipient of fiscal disparities tax base, it would actually get less LGA if the program was eliminated because of some other factors at work in the LGA formula.¹⁰

Finally, Fridley is the general rule at work in the opposite situation—here a city that gains tax base through elimination of fiscal disparities loses almost enough LGA to offset its revenue gain. It should be noted that most cities that gain tax base under fiscal disparities elimination do not lose LGA to offset the gain, because they receive little or no LGA under current law.

¹⁰ It is the same reason that greater Minnesota cities that do not participate in fiscal disparities still lose LGA under this simulation. See page 23.

Changes in the Fiscal Disparities Program

There have been few changes in the fiscal disparities program since its implementation in 1975. This section summarizes the two most significant changes made and also describes a proposed change passed by the 1995 Legislature but vetoed by the governor.

Mall of America Surcharge (1986)

In 1986, the legislature made a significant change to the fiscal disparities program for development of the Metropolitan Stadium site in Bloomington (now the location of the Mall of America). Laws 1986, chapter 391, provides that for property taxes payable in 1988 through 1999, the city of Bloomington annually receives an amount from the pool in addition to its “normal” fiscal disparity distribution. The supplemental amount is equal to the amount of interest paid on the bonds that were sold by the city for highway improvements for the mall site. The law requires Bloomington to repay the supplemental distributions over the ten-year period from 2006 to 2015.¹¹ Approximately one-tenth of the amount will be repaid in each of those years. The repayments will be achieved by artificially increasing Bloomington’s contribution value by converting the repayment amount into additional contribution value.

Livable Communities Fund Surcharge (1995)

Laws 1995, chapter 255, article 2, sections 11 to 13, provide that the Metropolitan Council will annually receive a special distribution from the fiscal disparities areawide tax base to finance the tax-base revitalization account within the metropolitan livable communities fund, which is available to municipalities that elect to participate in the local housing incentives program established under the law. This annual “surcharge” on the areawide pool is equal to the amount by which the current level of the Bloomington highway bond interest distribution (see above) is less than the payable 1988 distribution, up to \$5 million. This surcharge was \$4.3 million in 1996, and is \$5 million in each year after that.

A Vetoed Provision: Including Certain Residential Property in the Areawide Tax Base (1995)

A proposal to expand tax-base sharing was passed in 1995 by the House and Senate but vetoed by the governor. H.F. 431 (sponsored by Rep. Myron Orfield) would have captured the growth in value of all residential homestead property over \$200,000 market value and put it into the areawide tax base to be shared by all municipalities in the region. Under the current fiscal disparities law, the areawide tax base is composed solely of C/I value.

¹¹ The 1986 law provided that the repayments would be made from 2000 to 2009, but Laws 1995, chapter 255, article 2, section 10, delayed the start of the repayment period by six years.

Policy Issues

Public debate over fiscal disparities covers many issues: should the program continue to exist; should the areawide tax base be used to fund other programs; should other types of property be added to the areawide tax base; and should the program be extended beyond the seven-county area?

There are several narrower issues—changes best described as fine-tuning—that some argue would make the program operate more as originally intended. This section discusses four of these ideas.

1. Adjusting for Assessment Levels

In property tax terminology, assessment level refers to the deviation between the assessor's estimate of market value and "true" market value. Because the size of a jurisdiction's tax base is a factor in the distribution of aid under state aid programs, assessors' estimates of market value are usually first "equalized" for differences among assessment levels. Each jurisdiction's tax base is divided by its sales ratio, which is a statistically determined measure of the assessment level in the jurisdiction.

The fiscal disparities program does not adjust for assessment level. The contribution from each taxing jurisdiction is computed using assessors' estimated values. Therefore, a jurisdiction with a high sales ratio contributes more tax base to the areawide pool than a jurisdiction with a lower sales ratio. This creates an apparent inequity and discourages assessors from raising assessment levels in their jurisdictions.

Whether to adjust for assessment levels is complicated by some administrative issues. First, there are multiple measures of assessment levels to choose from. Each has some methodological shortcomings. Second, there would be questions on how to adjust the 1971 base values. Third, there would be questions about which year's sales ratios to use since current ones aren't available and having to use older data would then be another source of controversy.

2. Eliminating the Exemptions

Two kinds of property are exempt from fiscal disparities contributions: (a) property in certain TIF districts; and (b) property located at the Minneapolis-St. Paul International Airport.

(a) Pre-1979 Tax Increment Financing Districts

TIF is a public development financing mechanism that uses the increased property taxes resulting from a development's increased value to pay for a portion of its development costs. In general, the value of C/I property in TIF districts must be included in a municipality's total C/I

value to determine its fiscal disparities contribution. When each TIF district is created, municipalities elect either (a) to limit the tax increment to taxes derived from value which is not contributed to fiscal disparities, or (b) to allow the TIF district to receive all taxes derived from the property, thereby requiring that a higher percentage of C/I value in the rest of the municipality be contributed.

However, property located in Housing and Redevelopment Authority (HRA) districts established before August 1, 1979, is disregarded in computing fiscal disparities contributions regardless of when the actual development occurs. Some argue this exemption is unfair because it allows some municipalities to experience C/I growth without any portion being contributed to the areawide pool.

(b) Minneapolis-St. Paul International Airport

Airport property is taxed by the Metropolitan Airports Commission (MAC), Hennepin County, and various special taxing districts. The airport has always been excluded from participation in fiscal disparities. Some question its exclusion because its roughly \$4.8 million in C/I net tax capacity would increase the pool by nearly \$2 million.

While airport property would seem to be an appropriate tax base for regional sharing, its unique circumstances make its inclusion in fiscal disparities problematic. First, its tax rate is not comparable to that of other jurisdictions because the property pays no school district or municipal taxes. Second, under current law, the airport would receive no distribution from the pool because it has no population. If the airport was required to contribute to the pool, it would not get anything back, unless some alternative formula for determining its distribution were established.

3. Eliminating the 1971 Base Value Subtraction

Some argue the subtraction of 1971 base C/I value before determining the fiscal disparities contribution itself constitutes an unfair exemption. The charge of unfairness stems from the notion that the fiscal disparities program discriminates against those areas that have experienced most of their development since 1971, compared to those largely developed before 1971. Apparently, this subtraction was a legislative compromise to allow jurisdictions to retain the value they had before the program began. Thirty-four years after initial enactment, some ask if this feature of the program is still appropriate.

4. Need-based Distribution Formula

The fiscal disparities distribution formula is based on a single factor: each municipality's aggregate property value per capita compared to the areawide average property value per capita. Some people regard this formula as "need-based," since it looks at a municipality's relative need for tax base to make it more equal to that of other jurisdictions. Others have argued that the distribution formula should try to measure relative needs between jurisdictions more

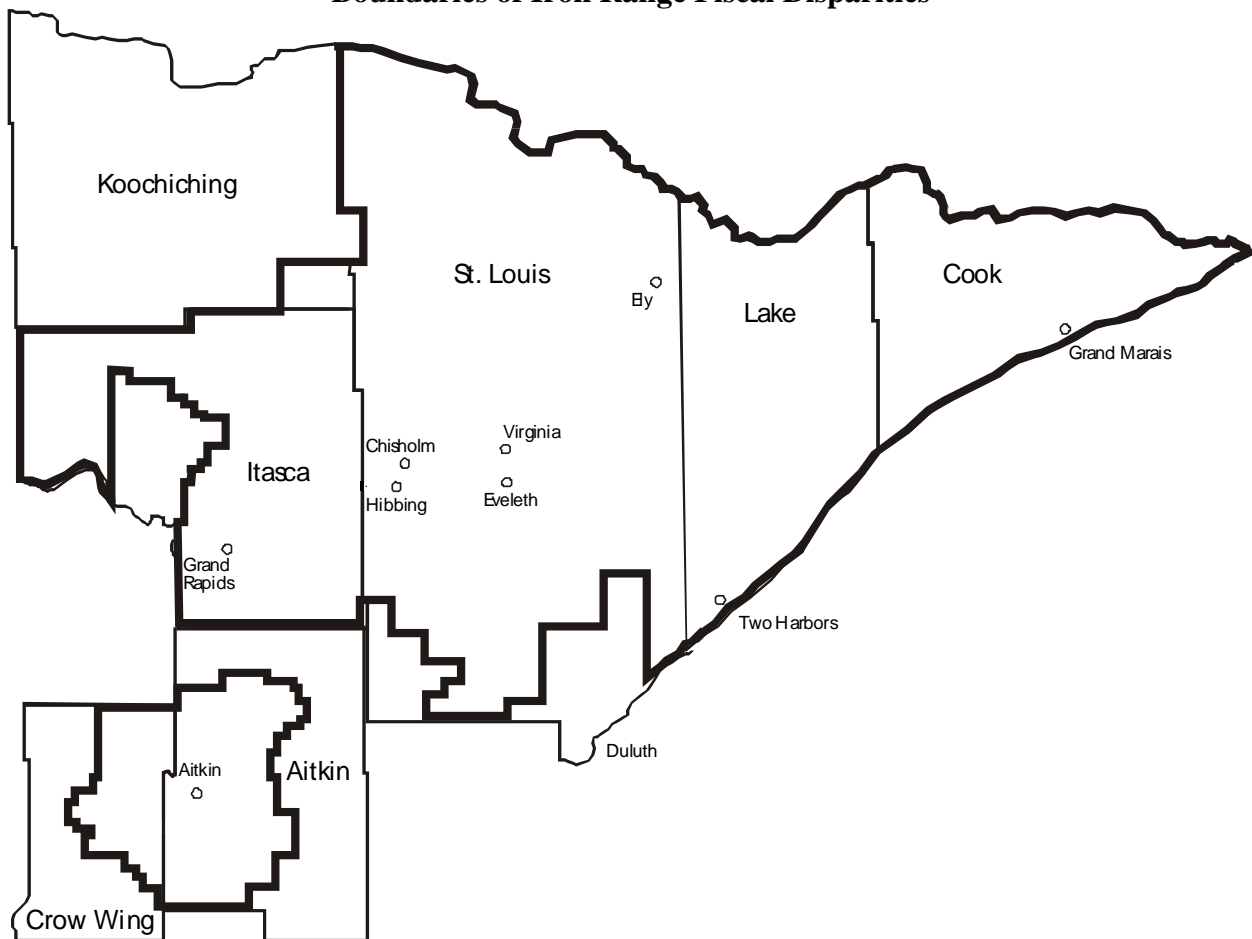
thoughtfully than simply looking at property wealth. For instance, they would argue that even though the cities of Minneapolis and Farmington have very similar property value per capita, their spending needs per capita are quite dissimilar. Some have argued for inclusion of demographic factors such as crime rates, poverty rates, age of a municipality's housing stock, and so forth, in the distribution formula. Proponents of adopting a need-based distribution formula face an uphill battle, since they must first persuade legislators that a need-based formula is a good idea, and then achieve consensus on what the formula should be.

Since the fiscal disparities program affects all types of local taxing jurisdictions, from counties to cities to school districts, a further complication is that need might be defined differently for each type of jurisdiction. For instance, crime rates may be a relevant factor for municipal distributions, but are probably not relevant in the distribution of school district tax base. It actually is possible to design different distribution formulas for each level of taxing jurisdiction, but doing so would increase the complexity of the program.

Iron Range Fiscal Disparities Program

In 1996, a new fiscal disparities program was established on the Iron Range in northern Minnesota. The boundaries for the new program are known as the “taconite relief area” (see map, below). Mechanically, the program was set up to work exactly the same way as the program in the metropolitan area, except using 1995 as a base year. The first year of implementation was for taxes payable in 1998. The program is codified in Minnesota Statutes, chapter 276A.

Figure E:
Boundaries of Iron Range Fiscal Disparities



Why Iron Range Tax-Base Sharing?

Unlike the metropolitan area program, there is no purpose section in the law governing the Iron Range program, nor was there a “blue ribbon commission” that spelled out the need for the program, so it is somewhat speculative to provide a rationale for sharing C/I tax base within this area. While some of the conditions are similar to those in the metropolitan area, there are more differences than similarities.

Differences Between Metropolitan Area and Iron Range Area

From a regional growth and development perspective, the situation on the Iron Range is immensely different from the metro area in two ways.

- First, the geographic area encompassed does not constitute an integrated regional economic sphere. In fact, the area is not even contiguous, meaning that there is territory between parts of the area that is not a part of the area. And the area excludes the city of Duluth, which is the largest city in northeast Minnesota.
- Second, there is no governing agency with authority to plan and implement regional systems such as sewers, transportation, and housing, as there is in the metropolitan area, making it harder to rationalize the program on a regional planning basis. The Arrowhead Regional Development Commission (ARDC) has some responsibility for regional planning, but its planning area encompasses some areas that are outside the taconite tax relief area (most notably, the city of Duluth and its suburbs), and the taconite area encompasses some area that is not within the ARDC's purview (Aitkin and Crow Wing counties).

Apparent Rationale

The clearest rationale for sharing tax base within the taconite tax relief area is that there is already some tax sharing occurring within this area in the distribution of taconite tax revenues. The taconite industry is not subject to ad valorem taxation. Rather, taconite mines and processing plants are subject to a production tax based on the tonnage produced. These revenues are then apportioned through a number of different taconite aid programs, each with its own distribution formula. There is little or no relationship between where the taconite is produced and where the revenues are distributed.

Because of the sharing of taconite revenues within the area, proponents of Iron Range tax-base sharing argued that it was also appropriate to share C/I property tax revenues. Underlying the proponents' advocacy was the feeling that C/I development was flourishing in some portions of the region that had little or no taconite activity, and it was fundamentally unfair that these areas got to share in taconite revenues but did not have to share their C/I “wealth.” Conversely, many of the areas most heavily impacted by taconite mining had become fairly stagnant in terms of C/I growth, causing them to look enviously upon their neighbors getting both taconite and C/I revenues.

Similarities Between Metropolitan Area and Iron Range

Some of the purposes underlying the metro area program described on pages 5 and 6 also apply to the Iron Range. The possibility of low-tax base, high-tax rate areas having difficulty attracting C/I development, leading to ever higher local tax rates, applies to both programs. The generally desirable goal of tax-base sharing reducing competition between municipalities for C/I development also applies to both areas equally. The argument that tax-base sharing may make jurisdictions more willing to accept low-tax-yield regional facilities such as parks may also hold true on the Iron Range, even in the absence of strongly coordinated regional planning.

Growth in Program

Because the program on the Iron Range is so new, not much can be said about growth to date. However, because of the way the program is structured, rapid growth can be expected in the first few years of the program (the areawide tax in the metro program grew by at least 18 percent each year in all but one of the first 11 years of the program's existence). The rapid growth results from a growing base with a fixed subtraction. The hypothetical example below shows how relatively modest growth in C/I property value of about 5 percent per year results in high growth rates in the size of the areawide pool (33 percent to 100 percent).

The example assumes:

- base year C/I net tax capacity of \$20,000
- C/I net tax capacity increases by \$1,000 per year

	C/I Net Tax Capacity (NTC)	Growth in C/I NTC over base	Areawide pool = 40% of growth	Pct. change in areawide pool
Base year	\$20,000	--	--	--
First year	21,000	\$1,000	\$400	--
Second year	22,000	2,000	800	100%
Third year	23,000	3,000	1,200	50%
Fourth year	24,000	4,000	1,600	33%

The Iron Range program first took effect for taxes payable in 1998. Table 9 below shows the growth in the areawide tax base in the first seven years.

Table 9:
Growth of Areawide Iron Range Tax Base

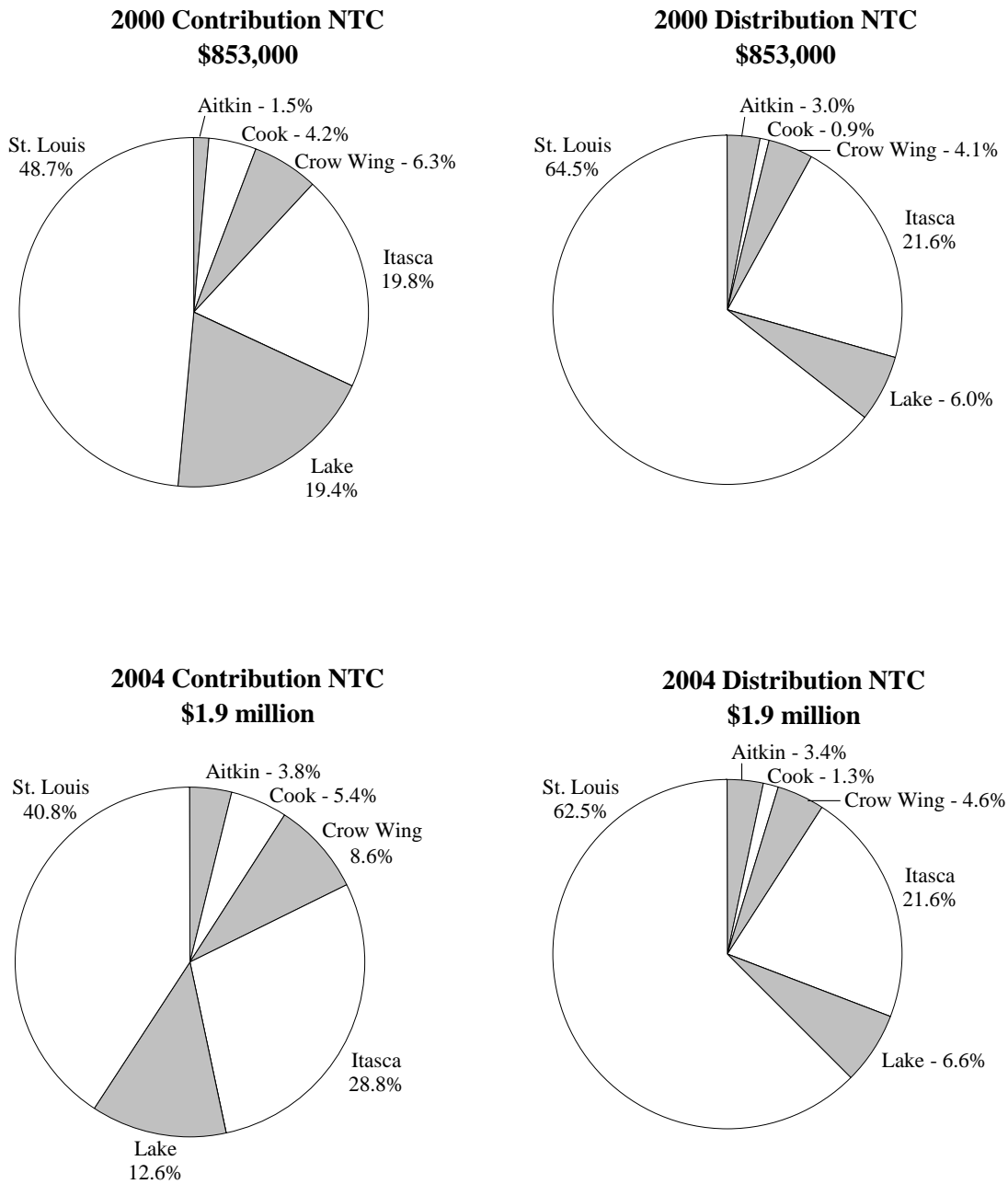
Taxes Payable Year	Total Tax Base in Areawide Pool (thousands)	Total Taconite Area C/I Tax Base (thousands)	% of Total C/I Tax Base in Areawide Pool	Total Taconite Area Tax Base (thousands)	% of Total Tax Base in Pool
1998	\$441	\$34,961	1.26%	\$98,078	0.45%
1999	449	31,774	1.41	96,984	0.46
2000	853	32,023	2.66	100,694	0.85
2001	1,191	35,504	3.35	115,355	1.03
2002	877	22,194	3.95	95,020	0.92
2003	1,413	22,171	6.37	104,214	1.36
2004	1,898	24,026	7.90	117,169	1.62

Table 10 shows the growth in the areawide tax and tax rate over the first seven years of the program.

Table 10:
Iron Range Areawide Tax Rate and Growth in Areawide Tax

Payable Year	Areawide Tax Rate	Total Areawide Tax	
		Amount (thousands)	% Change
1998	143.258	\$631	—
1999	150.219	675	6.9%
2000	162.710	1,388	105.6
2001	157.974	1,849	33.2
2002	206.418	1,824	-1.6
2003	157.901	2,226	22.0
2004	161.856	3,026	35.9

Figure F:
**Iron Range Contribution and Distribution Net Tax Capacity (NTC)
 by County¹² for Pay 2000 and Pay 2004**



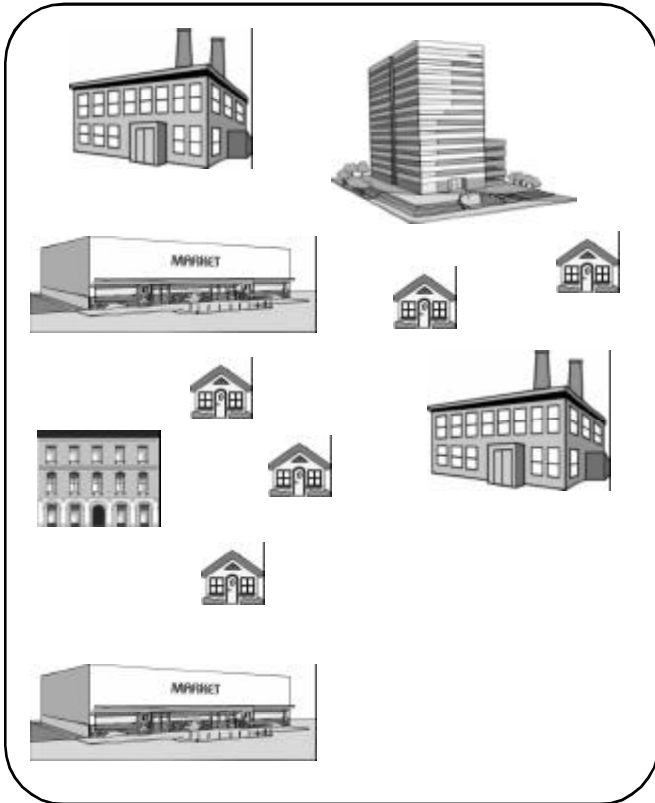
House Research Graphics

¹² Koochiching County contribution and distribution NTCs are less than 0.1 percent of the total.

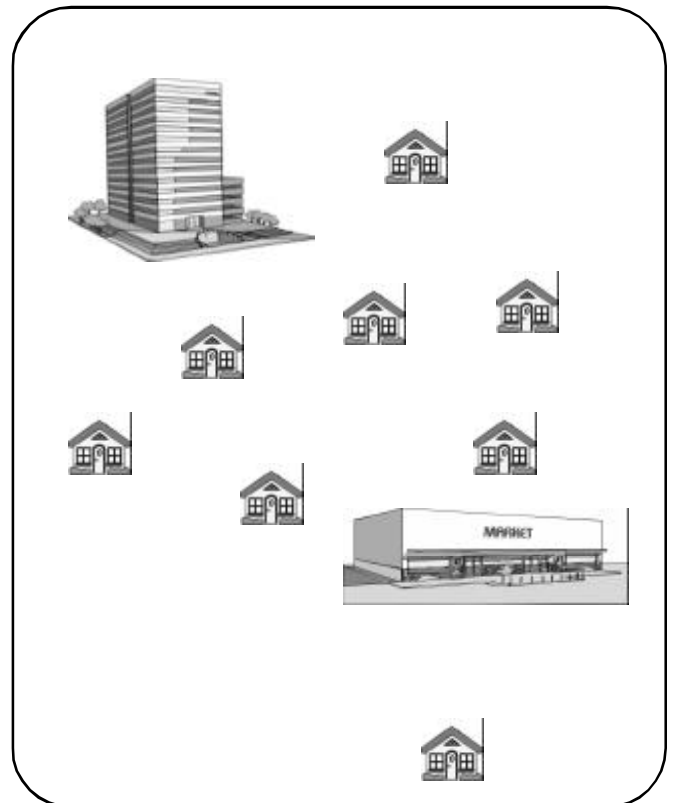
Appendix A: Pictorial Illustration of Fiscal Disparities

1. Actual location of properties

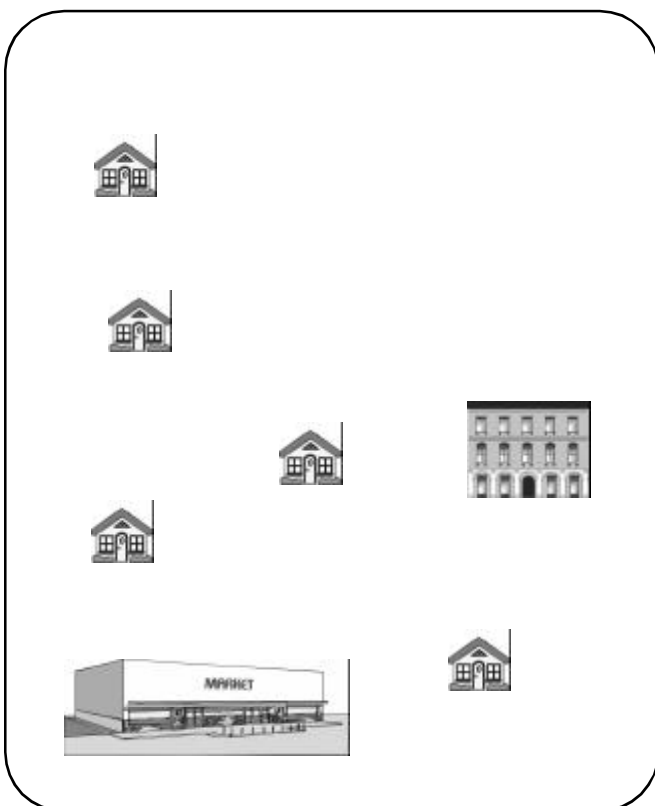
CITY A



CITY B

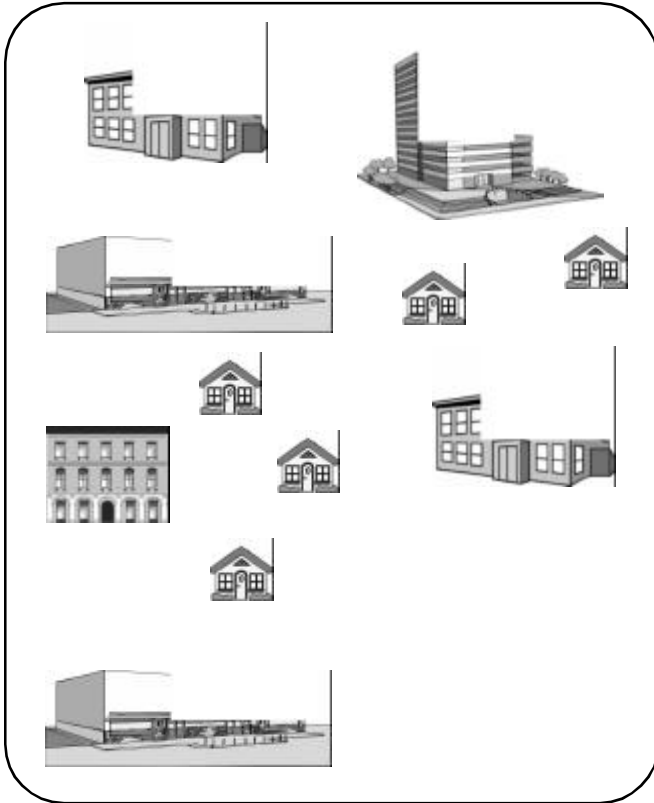


CITY C

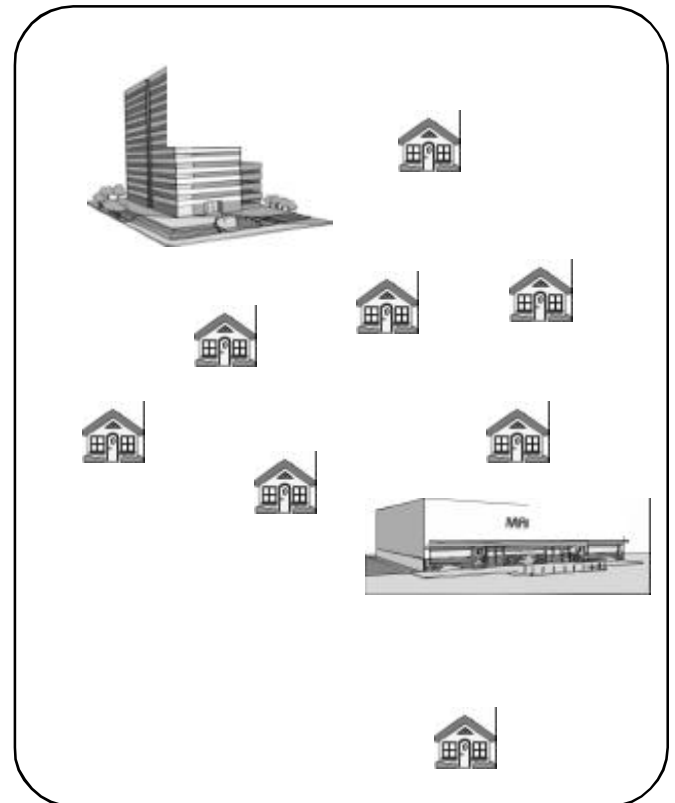


2. After fiscal disparities contributions

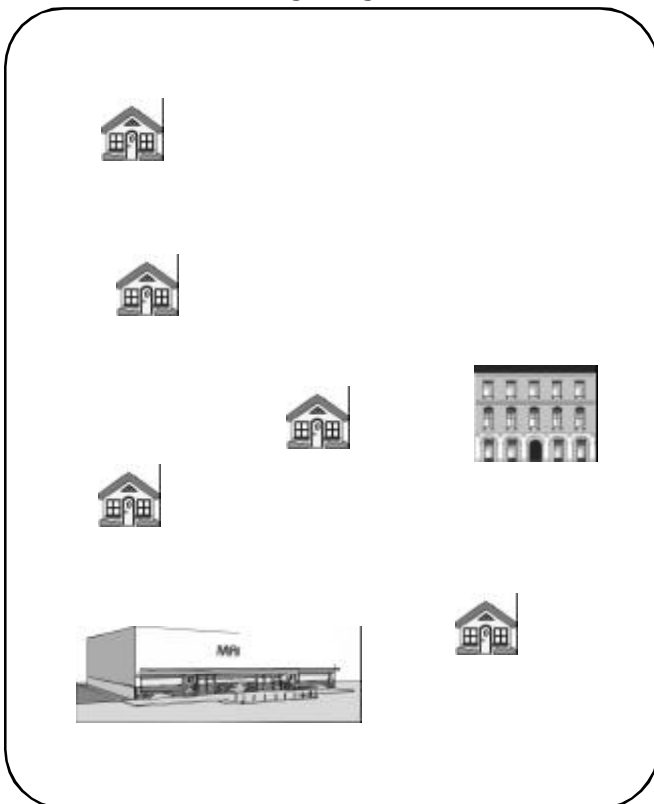
CITY A



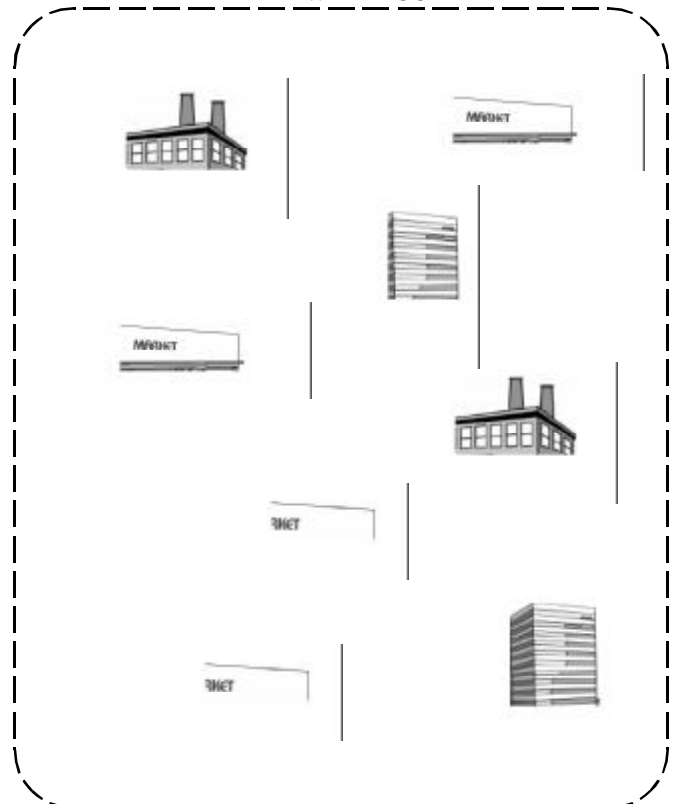
CITY B



CITY C

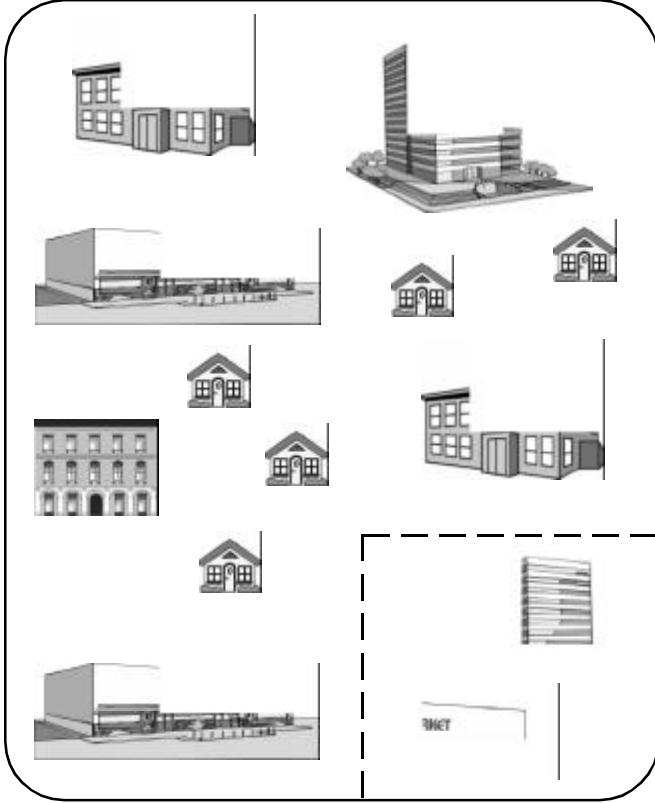


AREAWIDE POOL

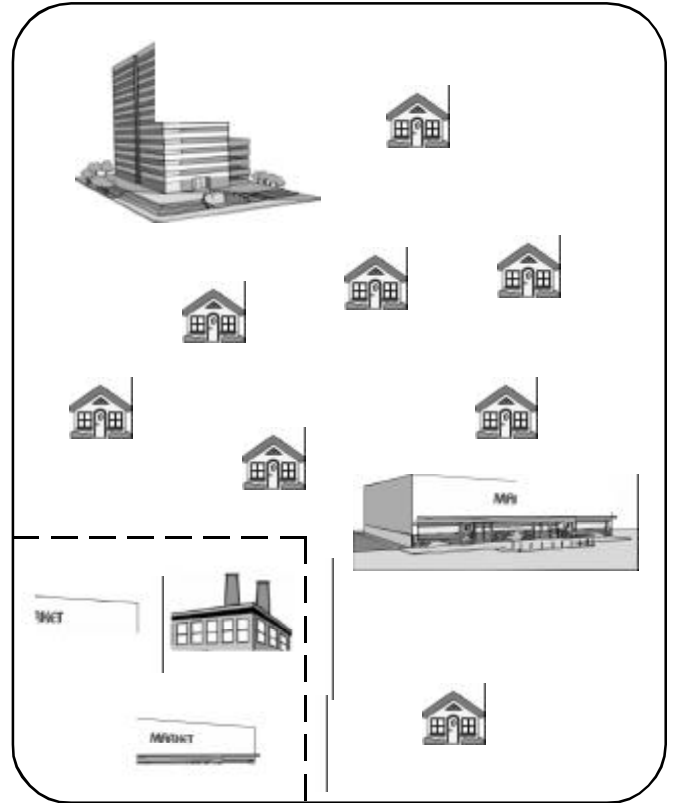


3. After fiscal disparities distributions

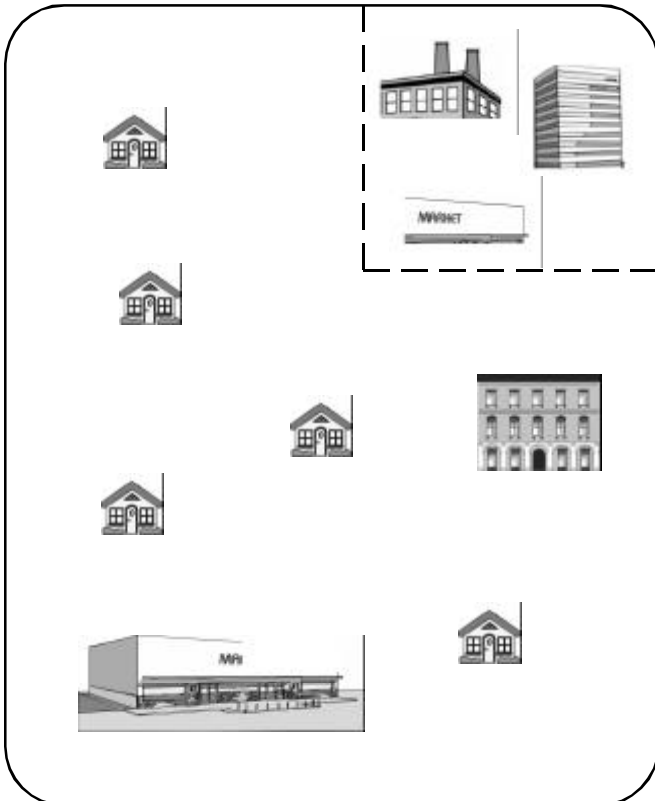
CITY A



CITY B



CITY C



Appendix B: Fiscal Disparities Calculations for a Hypothetical City Without the One-Year Lag

(Payable 2004)

Assumptions for City of Minnesota

2002 Population	20,000
2002 Equalized Market Value	\$500,000,000
2002 Fiscal Capacity*	\$25,000
2002 Areawide Average Fiscal Capacity**	\$30,000
2003 Payable 2004 Certified Levy	\$8,000,000
1971 Commercial-Industrial Net Tax Capacity***	\$2,500,000
2002 Payable 2003 Net Tax Capacity	
Commercial-Industrial***	\$8,800,000
Residential	12,000,000
All Other	+1,400,000
	<hr/>
Total	\$22,200,000

* Fiscal Capacity = $\frac{\text{Equalized market value of all property in the municipality}}{\text{Population of municipality}}$

** Average Fiscal Capacity = $\frac{\text{Total equalized market value of all property in all municipalities}}{\text{Total population of the metropolitan area}}$

*** Commercial-industrial net tax capacity includes the tax capacity of public utility property. Since net tax capacity was not in use in the 1971 base year, it has been estimated using available market value records. The 1971 base value is adjusted each year that changes are made in C/I class rates.

Step 1: Determine the City's Contribution to Areawide Tax Base

2003 Pay 2004 Commercial-Industrial Net Tax Capacity	\$8,800,000
Less 1971 Commercial-Industrial Net Tax Capacity	<u>-2,500,000</u>
Net Growth over 1971 Base Value	\$6,300,000
Contribution Rate	<u>x 40%</u>
City's Contribution to Areawide Tax Base	\$2,520,000

Step 2: Determine the Areawide Tax Base

Net Tax Capacity Contributed from City of Minnesota (step 1)	\$2,520,000
Net Tax Capacity Contributed from All Other Cities and Towns in the Metro Area	<u>\$297,480,000</u>
Total Areawide Tax Base	\$300,000,000

Step 3: Distribution Index for City of Minnesota

$$\text{Population of City/Town} \times \frac{\text{Average Fiscal Capacity}}{\text{City/Town Fiscal Capacity}} = \text{Distribution Index}$$

$$20,000 \times \frac{\$30,000}{\$25,000} = 24,000$$

Step 4: Sum of Distribution Indices for All Municipalities

	<u>Index</u>	<u>Percent</u>
City of Minnesota (step 3)	24,000	1.2%
All other Metropolitan Cities and Towns	<u>1,976,000</u>	<u>98.8%</u>
	2,000,000	100.00%

The city of Minnesota's final distribution index is 1.2 percent of 2,000,000; therefore, it receives 1.2 percent of the areawide tax base.

Step 5: City of Minnesota's Distribution Net Tax Capacity

The city of Minnesota's distribution net tax capacity is equal to the share determined in step 4 multiplied by the areawide tax base determined in step 2.

$$1.2\% \quad \times \quad \$300,000,000 \quad = \quad \$3,600,000$$

This distribution net tax capacity is also taxable by other taxing jurisdictions (i.e., county, school district, special taxing districts) overlapping the city.

Step 6: Determine the City of Minnesota's Tax Base

2003 Payable 2004 Total Net Tax Capacity for City of Minnesota	\$22,200,000
Plus Payable 2004 Distribution from the Areawide Tax Base (step 5)	3,600,000
Less Payable 2004 Contribution to the Areawide Tax Base (step 1)	<u>-2,520,000</u>
Total Taxable Net Tax Capacity of City	\$23,280,000

Step 7: County Auditor Calculates the City of Minnesota's Tax Rate

2003 Payable 2004 Certified Levy	\$8,000,000
Total Taxable Net Tax Capacity (step 6)	\$23,280,000
City Tax Rate	0.3436 (34.36% of tax capacity)

The city's tax rate of 0.3436 is added to the tax rates for the appropriate county, school district, and special taxing districts. The total tax rate is applied to all taxable property in the city of Minnesota except the fiscal disparities portion of C/I property (see step 11).

Step 8: Determine Areawide Portion of City of Minnesota's Levy (also called the city's distribution levy)

Distribution Tax Capacity	x	2003 Payable 2004 City Tax Rate	=	Areawide Portion of Levy
\$3,600,000	x	0.3436 (34.36% of net tax capacity)	=	\$1,237,000

Step 9: Determine the Areawide Tax Levy

The auditor of the county in which the city of Minnesota is located certifies to the administrative auditor an amount of \$1,237,000 as the areawide portion of the city's levy. This is also done for all other governmental units located within the area.

City of Minnesota's Distribution Levy (step 8)	\$1,237,000
Distribution Levies from All Other Governmental Units in the Metro Area	<u>398,763,000</u>
Total Areawide Levy	\$400,000,000

Step 10: Determine the Areawide Tax Rate

The administrative auditor computes the areawide tax rate as follows:

$$\frac{\text{Total Areawide Levy (step 9)}}{\text{Total Areawide Tax Base (step 2)}} \times \frac{\$400,000,000}{\$300,000,000} = 1.333 \text{ (133.3\% of net tax capacity)}$$

This tax rate is applied to the contribution net tax capacity of all municipalities in the metro area.

The areawide tax rate is a composite rate which provides revenues for municipalities, school districts, county governments, and special taxing districts.

Step 11: Property Tax Computation on C/I Parcel

The fiscal disparities contribution net tax capacity of \$2,520,000 is equal to 28.6 percent of the total assessment district's payable 2004 C/I net tax capacity of \$8,800,000. Therefore, 28.6 percent of the net tax capacity of each parcel of C/I property in the city is subject to the areawide tax. The remaining 71.4 percent of the net tax capacity of each C/I parcel is subject to the local tax rate.

The payable 2004 property tax computation for a parcel of C/I property located in the city of Minnesota with a market value of \$300,000 (net tax capacity of \$4,000) is shown on the following page.

Areawide Portion of Tax (Contribution Tax)	Local Portion of Tax										
<p>28.6% of \$5,250 net tax capacity of the C/I parcel is taxed at the areawide rate of 1.333.</p> <p style="text-align: center;">$\\$5,250 \times .286 \times 1.333 = \\$2,001$</p>	<p>Remaining 71.4% of net tax capacity of the C/I parcel is subject to local tax rates of all jurisdictions where the parcel of property is located.</p> <p style="text-align: center;"><u>Local Tax Rates</u></p> <table style="margin-left: auto; margin-right: auto;"> <tr> <td>City of Minnesota</td> <td style="text-align: right;">0.3436</td> </tr> <tr> <td>School District A</td> <td style="text-align: right;">0.2562</td> </tr> <tr> <td>County A</td> <td style="text-align: right;">0.4332</td> </tr> <tr> <td>Special Taxing District</td> <td style="text-align: right;"><u>0.0740</u></td> </tr> <tr> <td>Total Local Tax Rate</td> <td style="text-align: right;">1.1070</td> </tr> </table> <p style="text-align: center;">$0.714 \times \\$5,250 \times 1.1070 = \\$4,150$</p>	City of Minnesota	0.3436	School District A	0.2562	County A	0.4332	Special Taxing District	<u>0.0740</u>	Total Local Tax Rate	1.1070
City of Minnesota	0.3436										
School District A	0.2562										
County A	0.4332										
Special Taxing District	<u>0.0740</u>										
Total Local Tax Rate	1.1070										
Total Payable 2004 Tax of C/I Parcel											
Areawide Portion of Tax	\$2,001										
Local Portion of Tax	4,150										
State Property Tax (\$5,250 x 0.541)	<u>2,840</u>										
Total Tax	\$8,991										

Step 12: Property Tax Settlement of the Areawide Levy

The county treasurer collects the \$8,991 from the taxpayer of the C/I parcel in step 11 and the C/I tax from all other taxpayers with C/I property within the county.

The treasurer compares the sum of the total amount of the contribution levies (e.g., areawide portions of the tax) from all C/I parcels within the county to the sum of the total amount of the distribution levies which all of the taxing districts within the county are entitled to receive from the areawide pool.

If the total contribution levy exceeds the total distribution levy, the county treasurer will remit a check to the administrative auditor for the difference (i.e., amount owed). If the total contribution levy is less than the distribution levy, the county treasurer will receive a check from the administrative auditor.

Appendix C: Growth of Metro Areawide Tax Base

Growth of Metro Areawide Tax Base					
Taxes Payable Year	Total Tax Base in Areawide Pool (millions)	Total Metro C/I Tax Base (millions)	% of Total C/I Tax Base in Areawide Pool	Total Metro Tax Base (millions)	% of Total Tax Base in Pool
	(A)	(B)	(C) = (A)/(B)	(D)	(E) = (A)/(D)
1975-1988:					
Assessed Value*					
1975	\$137	\$2,044	6.7	\$6,403	2.1
1980	328	2,930	11.2	9,363	3.5
1985	1,264	5,394	23.4	15,710	8.0
1990-2004:					
Net Tax Capacity					
1990	265	1,019	26.0	2,097	12.6
1991	291	1,052	27.7	2,185	13.3
1992	293	1,007	29.1	2,103	13.9
1993	289	984	29.4	2,039	14.2
1994	277	923	30.0	2,004	13.8
1995	241	917	26.3	2,065	11.7
1996	260	941	27.6	2,184	11.9
1997	275	1,015	27.1	2,351	11.7
1998	264	941	28.1	2,286	11.5
1999	253	917	27.6	2,273	11.1
2000	278	980	28.4	2,439	11.4
2001	314	1,094	28.7	2,745	11.4
2002**	214	710	30.1	2,130	10.0
2003	232	757	30.6	2,337	9.9
2004	252	781	32.3	2,569	9.8

* The property tax system was restructured in 1988; 1989 was a transition year between the old and new system. Under the old system, tax base was assessed value. Under the current system, tax base is net tax capacity. The fact that net tax capacities are significantly smaller than assessed values does not affect the overall level of tax burdens.

** Because of property tax reform enacted in 2001, net tax capacity data for payable 2002 and thereafter is not necessarily comparable to 1990-2001.

Appendix D: Metro Areawide Tax Rate and Growth in Areawide Tax

Metro Areawide Tax Rate and Growth in Areawide Tax			
Payable Year	Areawide Tax Rate*	Total Areawide Tax	
		Amount (in 000's)	% Change
1975	121.490	\$16,666	NA
1980	110.552	36,266	**
1985	108.743	137,396	**
1990	104.578	277,106	**
1991	104.970	304,946	10.0
1992	116.127	340,004	11.5
1993	123.488	356,998	5.0
1994	133.229	369,072	3.3
1995	134.799	325,284	-11.9
1996	141.441	367,122	12.9
1997	139.376	383,388	4.4
1998	155.082	409,697	6.9
1999	157.373	397,438	-3.0
2000	146.134	406,882	2.4
2001	137.987	433,572	6.6
2002	156.497	335,329	-22.7
2003	132.885	307,915	-8.2
2004	137.107	345,835	12.3

* Areawide tax rates prior to 1990 are expressed in mills. Beginning with 1990, tax rates are expressed as percentages of net tax capacity.

** Not computed since the table contains five-year time periods through 1990.

For more information about fiscal disparities, visit the property taxes area of our web site, www.house.mn/hrd/issinfo/tx_prop.htm. To see a simulation that shows how property tax burdens would change in each city and town in the metro area if the fiscal disparities program were eliminated, go to www.house.mn/hrd/issinfo/csim4B1.pdf. (Note: This is a 1,158 KB PDF file; it is 189 pages long).