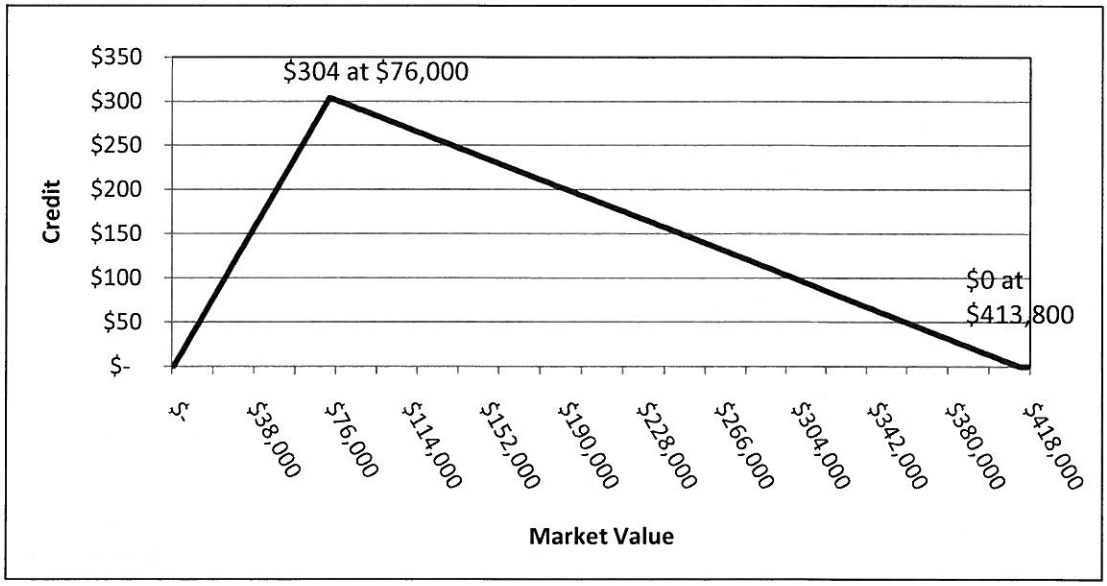
MINNESOTA · REVENUE

2011 Law Change: A New Homestead Market Value Exclusion replaces the Homestead Market Value Credit

The 2011 Legislature repealed the homestead residential Market Value Credit (the agricultural credit did not change), and enacted a similarly designed homestead Market Value Exclusion. This change is effective for taxes payable in 2012. The following synopsis is intended to help local governments understand this law change.

Expiring Law: The Homestead Residential Market Value Credit

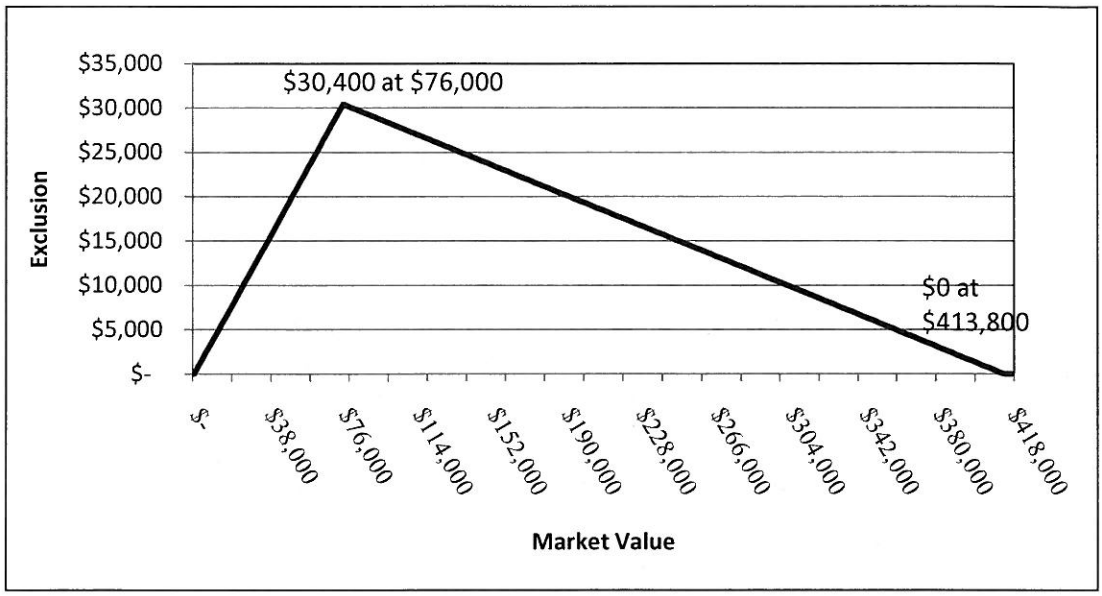
- Homesteads received a credit on their tax statements reducing their gross tax.
- As shown in the chart below, the credit equaled 0.4% of the first $76,000 in market value. It was reduced by 0.09% of the market value over $76,000 until it hit $0 at $413,800 of market value.



- The state reimbursed local governments for the sum of the market value credits granted to individual taxpayers on tax statements. As a result, some of the local governments' levy came from the state as credit reimbursement payments, and some from property tax payments.
- When the state cut its reimbursement payments, local governments had to budget for a gap between their levy and what they received. Local governments may have levied more, cut some spending or both.

New Law: The Homestead Market Value Exclusion

- A portion of homestead market value will be excluded from taxation.
- As shown in the chart on the next page, the exclusion equals 40% of the first $76,000 in market value. It is reduced by 9% of the market value over $76,000 until it hits $0 at $413,800 of market value.



- The state will no longer pay a share of the tax on homesteads, but homesteads have less value subject to taxation.
- The removal of the state spending on credits means property taxpayers, as a whole, will pay more if levies remain the same.
- The reduction in the tax base for homesteads means non-homesteads will pay a higher share of the levy, and a large share of homesteads could pay more given that exclusion amounts and other factors vary.
- Local governments will receive the full amount that they levy from their taxpayers.

How do credits and exclusions affect tax calculations?

The prior law credit was deducted from a gross tax while the exclusion will reduce the taxable value. Changing taxable value means outcomes won't be identical.

	Old Law: The Credit	**New Law: The Exclusion**
Estimated Market Value	$116,000	$116,000
Exclusions	$0	**$26,800**
Taxable Market Value	$116,000	$89,200
Class Rate	1%	1%
Net Tax Capacity	$1,160	$892
Tax Rate*	105.810%	110.920%
Gross Tax	$1,227	$989
Credit	**$268**	$0
Net Tax	$959	$989

*The tax rate change used here reflects estimated average statewide rates for 2011 under either approach, assuming no changes in levies. Levy decisions and local tax base dynamics will affect the change in rates.

How might the change impact local government levies and budgeting and property taxes?

There are three key considerations:

- Local governments will receive the full amount they levy from their taxpayers.
- Local governments do not need to plan for further state reimbursement cuts –because there is no longer a payment to cut.
- Local governments should recognize that removing $292 million of credits from the system, and changing the composition of the tax base, will create large tax increases for some properties. This may increase sensitivity by taxpayers to levy decisions.

Example: Budgeting and Tax Shift Scenario

Context for Taxes Payable in 2011. In August 2010, "City A" was planning for a 2011 levy of $2,000,000. Approximately $1,900,000 was going to be paid by taxpayers and $100,000 by the state in the form of Market Value Credit reimbursements. Local officials then learned the city would have a $50,000 cut to its MVC Reimbursements, which meant the city would only receive $1,950,000 of a $2 million levy.

City A decided to levy $2,040,000 for 2011. Officials anticipated they would make up almost $40,000 of the $50,000 cut with the levy increase, and cut their planned spending by $10,000. City A expected the levy of $2,040,000 would bring in approximately $1,990,000 (with $1,940,000 from taxpayers and $50,000 from the state).

Decisions for Taxes Payable in 2012. Because there is no longer a credit, and thus no longer a portion of the levy coming from the state, the full levy will come from taxpayers. As a starting point, eliminating the credit for 2012 means city officials will have three general approaches:

- **Constant Levy:** If City A keeps its levy constant at $2,040,000, taxpayers are actually asked to pay $100,000 more than the $1,940,000 they paid in 2011 (a 5.2% increase).
- **Constant Taxes:** Levying $1,940,000, keeps the total coming from taxpayers the same (a 0% increase), but the city loses $50,000 in revenue.
- **Constant Revenue:** Levying $1,990,000 keeps the amount of revenue constant, but the city is asking taxpayers to pay $50,000 more (a 2.6% increase).

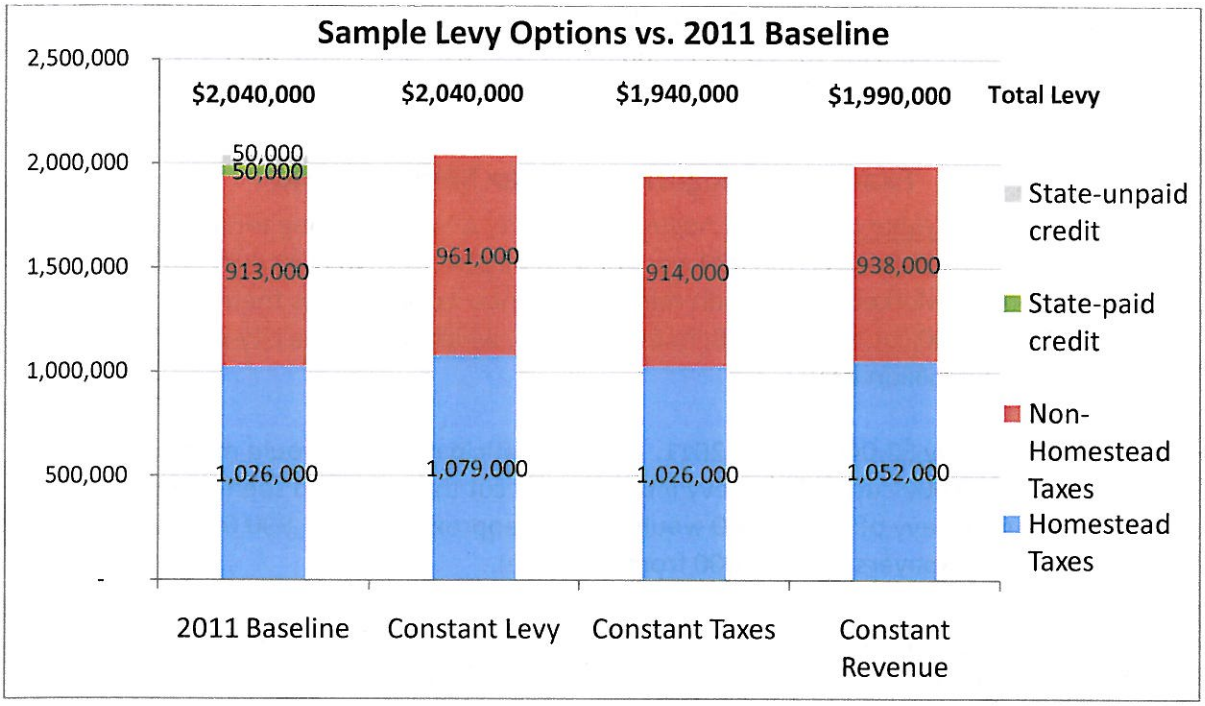
Example Assumptions

To give some perspective of the tax shifts that might enter into this decision, assume the following net tax capacity (NTC) tax base information:

	Taxes Payable 2011	Taxes Payable 2012
Total NTC tax base	$6,700,000	$6,366,384
Non-Homestead NTC	$3,000,000	$3,000,000
Homestead NTC	$3,700,000	$3,366,384
620 homes at $70,000 MV	$434,000	$260,400
644 homes at $150,000 MV	$966,000	$813,114
575 homes at $400,000 MV	$2,300,000	$2,292,870

Also assume that the city rate is 30% of the total tax rate (for allocating the credits for 2011).

Tax Shifts Under Various Options. The following chart summarizes the levy options listed above. It identifies the total size of the levy and the shares paid homesteads and non-homesteads (and the paid and unpaid state shares for the 2011 baseline). Under all of the options, even where taxpayers pay the same total amount of taxes, there will be tax increases for non-homestead properties and some homestead properties.



The tax shifts of the three alternatives can also be summarized as follows:

	2011	Constant Levy	Constant Taxes	Constant Revenue
Total Levy	$2,040,000	$2,040,000	$1,940,000	$1,990,000
Total Revenues (% chg)	$1,990,000	$2,040,000 (2.5%)	$1,940,000 (-2.5%)	$1,990,000 (0%)
City Tax Rate	30.448%	32.043%	30.473%	31.258%
Average Tax (% change)				
$70,000 home	$129.14	$134.58 (4.2%)	$127.98 (-0.9%)	$131.28 (1.7%)
$150,000 home	$385.50	$404.58 (4.9%)	$384.73 (-0.2%)	$394.67 (2.4%)
$400,000 home	$1,214.20	$1,277.77 (5.2%)	$1,215.08 (0.1%)	$1,246.45 (2.7%)
Non-Homestead Tax Change		5.2%	0.1%	2.7%

A Final Note. This example illustrates tax shifts due to the conversion from credits to the exclusion in isolation from other discussions that might affect property taxes. Aid reductions and service demands will also be a significant factor in the local budgeting calculus. These other changes will also affect a property's tax calculation.