Property Taxation 101

This guide is intended to describe the basics of Minnesota's property tax system. This system collected more than $7 billion in 2009 to help fund the services of schools, counties, cities, townships, and special districts and the state general fund. One of the challenges of trying to understand this system is the complex array of terms involved. As new terms are introduced in this guide, they are shown in *italics*. A glossary at the end of the guide has short definitions of these terms.

Assessment and classification

The property tax system is a continuous cycle, but it effectively begins with the estimation of property *market values* by local assessors. Assessors attempt to determine the approximate selling price of each parcel of property based on the current market conditions.

Along with the market value determination, a *property class* is ascribed to each parcel of property based on the use of the property. For example, property that is owner-occupied as a personal residence is classified as a residential homestead. The "use class" is important because the Minnesota system, in effect, assigns a weight to each class of property. Generally, properties that are associated with income production (e.g. commercial and industrial properties) have a higher classification weight than other properties.

The property classification system defines the *tax capacity* of each parcel as a percentage of each parcel's market value. For example, a $75,000 home which is classified as a residential homestead has a class rate of 1.0 percent and therefore has a tax capacity of $75,000 x .01 or $750. (A sample of the class rates are included in table A.)

[parcel market value] * [class rate] = [parcel tax capacity]

The next step in calculating the tax burden for a parcel involves the determination of each local unit of government's *property tax levy*. The city, county, school district and any special property taxing authorities must establish their levy by December 28 of the year preceding the year in which the levy will be paid by taxpayers. The property tax levy is set after the consideration of all other revenues including state aids such as *LGA*.

[city budget] - [all non-property tax revenues] = [city levy]

For cities within the seven-county Twin Cities metropolitan and on the iron range, the levies are reduced by an amount of property tax revenue derived from the metropolitan and range area *fiscal disparities programs* (see "Fiscal Disparities 101" for more information).

Local tax rates
Local governments do not directly set a tax rate. Instead, the tax rate is a function of the levy and the total tax base. To compute the *local tax rate*, a county must determine the total tax capacity to be used for spreading the levies. The *total tax capacity* is computed by first aggregating the tax capacities of all parcels within the city. Several adjustments to this total must be made because not all tax capacity is available for general tax purposes. The result of this calculation produces taxable tax capacity. Taxable tax capacity is used to determine the local tax rates.

[city levy] / [taxable tax capacity] = [city tax rate]

The city tax rate is computed by dividing the city levy (minus the fiscal disparities distribution levy, if applicable) by the taxable tax capacity. Under the current property tax system, the tax rate is expressed as a percentage. For example, the average 2009 city tax capacity rate is approximately 36.96 percent. Dramatic changes to the tax system in 2001 increased the average city rate significantly in 2002. This same calculation is completed for the county based on the county's levy and tax base, the school district and all special taxing authorities. The sum of the tax rates for all taxing authorities that levy against a single property produces the total local tax rate. This total local tax rate is then used to determine the overall tax burden for each parcel of property.

Parcel tax calculations
The property tax bill for each parcel of property is determined by multiplying the parcel's tax capacity by the total local tax rate. The tax statement for each individual parcel itemizes the taxes for the county, municipality, school district, and any special taxing authorities.

[parcel tax capacity] * [total local tax rate] = [tax capacity tax bill]

To complicate the tax calculations, voter-approved referenda levies are applied to the market value of each parcel, not tax capacity. As a result, each identically valued parcel, regardless of the property's use, pays the same amount of referenda taxes (with the exception of certain agricultural and seasonal recreational properties, which are exempted from referenda taxes). In 2009, three counties, 52 cities and 334 school districts levied market value-based levies. These communities must have a separate calculation for a market value referenda levy by the total taxable market value of each community.

[parcel market value] * [market value tax rate] = [market value tax bill]

[tax capacity tax bill] + [market value tax bill] = [total tax bill]

State property tax
New to the tax system in 2002 was a state property tax on all commercial, industrial, seasonal recreational, and utility real property. In 2009, this new tax raised $764 million statewide; the proceeds are deposited in the state general fund. Prior to 2002, the state last collected a property tax in 1968.

Property tax credits
Several tax credits for various types of properties are available in certain instances. These amounts are subtracted from the overall taxes for each parcel to determine the net tax bill for the individual owner. Minnesota also provides additional property tax relief directly to individual homeowners, cabin owners, and renters through the *circuit breaker* and the *targeting refund* programs.

Property tax intricacies

The technical details of computing property taxes mask many other intricacies of the property tax system. Many communities over the past several years have experienced situations where individual property taxes rise much faster than the increase in the levies that are certified by local units of government.

The most common factor that results in an increase in an individual parcel's tax is the change in the parcel's estimated market value. Without any change in local levies, a property owner can experience a tax increase due almost exclusively to any valuation increase.

The Legislature frequently changes the classification system. Changes to the classification system can shift property tax burdens from one type of property to another. Table A demonstrates some of the changes the Legislature has made to class rates since 1997. Commercial, industrial, and apartment properties received significant reductions in their class rates. This shifts tax burden to other classes of property that did not receive class rate reductions. In an effort to minimize the effect of these shifts, the legislature reduced school levies across the state and created the *Market Value Homestead Credit (MVHC)*. This credit reduces property taxes for homesteads by 0.4 percent of the homestead's market value up to a maximum $304 dollars. As part of the credit program, the state has reimbursed cities for the amount by which the credits reduce cities' tax receipts. The Legislature made significant reductions to the reimbursement amounts for cities in 2003 and 2004 and later extended those reductions to 2005 and 2006. The reimbursements were restored for 2007. Reimbursements were again reduced in 2008, 2009, and 2010 through the governor's use of unallotment.

Economic factors that may affect broad classes of property can also influence the overall tax changes for individual parcels of property. For example, in the early 1990s the metropolitan area experienced major declines in the valuation for commercial and industrial properties. These valuation declines shifted taxes from property classified as commercial and industrial to all other types of property. Valuation declines also may have accentuated the levy changes by local units of government.

A 2002 law change exempted agricultural and cabin property from voter-approved referenda levies. In some jurisdictions where these types of property are a significant part of the tax base, this change shifted taxes onto other classes of property.

Legislative changes in state aid programs can also affect the revenue needed to be raised from the property tax. In 2002 the legislature eliminated *HACA* and increased the other major aid program, LGA, by $140 million. In 2003, the Legislature reduced 2003 LGA by about $120 million and 2004 LGA by about $150 million. In 2005, however, the Legislature added about $48 million to the LGA program for 2006 and beyond, $4 million of which is directed to cities under 5000 via a per capita aid base. In December 2008, the governor used the unallotment authority to reduce cities' LGA and MVHC payments. Actual aid and credit payments for 2009 and 2010 have also been reduced by $64.2 million and $128.3 million, respectively, through the power of unallotment.

Levy limits also impact local levy decisions. During the 2003 session, cities that had been previously covered by levy limits lost any unused levy authority. There were no levy limits in place for 2008 but the Legislature did pass new levy limits for cities over 2500 for taxes payable in 2009, 2010, and 2011. This discussion is only a general overview of the current Minnesota property tax system. Over time, the system has become more complex and difficult for taxpayers to understand. Unfortunately, local officials must frequently explain how the system works and take the blame for the complicated features of the system. Local officials, however, can only control local levy decisions. They have no direct ability to modify the overall structure of the tax system and are at the mercy of the Minnesota Legislature.

Glossary of Terms

Circuit breaker - A state-paid property tax refund program for homeowners who have property taxes out of proportion with their income. A similar program is also available to renters.

Class rates - The percent of market value set by state law that establishes the property's tax capacity subject to the property tax. See Table A for a sample list of class rates.

Fiscal disparities programs - Local units of government in the Twin Cities metropolitan area and on the iron range participate in property tax base sharing programs. Under these two programs, a portion of the growth in commercial and industrial property value of each city and township is contributed to a tax base sharing pool. Each city and township then receives a distribution of property value from the pool based on market value and population in each city.

Homestead and agricultural credit aid (HACA) - A $200 million property tax relief program that was eliminated in 2001.

Local government aid (LGA) - A state government revenue sharing program for cities and townships that is intended to provide an alternative to the property tax. The formulae for distributing the aid payments were changed for 2004 and beyond. The 2008 Legislature implemented additional formula changes. LGA is distributed using different formulae for cities over 2,500 and cities under 2,500. Large city formula factors are: pre-1940 housing percentage, population decline over last decade, accidents per capita, average household size, metro or non-metro, and adjusted net tax capacity per capita. Small city formula factors are: pre-1940 housing percentage, population decline over last decade, commercial/industrial property percentage, and population. In 2006, a new aid base for small cities was created. Cities under 5,000 in population received base aid equal to $6 per capita. The 2008 reforms resulted in several other changes and additions to aid base. See "Local Government Aid 101: 2009 Distribution & Beyond".

Local tax rate - The rate used to compute taxes for each parcel of property. Local tax rate is computed by dividing the certified levy (after reduction for fiscal disparities distribution levy and disparity reduction) by the taxable tax capacity.

Market value - An assessor's estimate of what property would be worth on the open market if sold. The market value is set on January 2 of the year before taxes are payable.

Market value homestead credit - This credit offsets a portion of each homestead's property tax burden equal to .4 percent of the homestead's market value up to a maximum credit of $304. For taxes payable in 2010 and beyond the property tax statement must not state or imply that credits are paid by the state. See "Market Value Homestead Credit 101."

Property class - The classification assigned to each parcel of property based on the use of the property. For example, owner-occupied residential property is classified as homestead.

Property tax levy - The tax imposed by a local unit of government. The tax is established on or around December 28 of the year preceding the year the levy will be paid by taxpayers.

Targeting refund - a state paid property tax refund for homeowners whose property taxes have increased by more than 12 percent. A similar program is available to cabin owners.

Tax capacity - The valuation of property based on market value and statutory class rates. The property tax for each parcel is based on its tax capacity.

Total tax capacity - The amount computed by first totaling the tax capacities of all parcels of property within a city. Adjustments for fiscal disparities, tax increment and a portion of the powerline value are made to this total since not all tax capacity is available for general tax purposes.

Truth-in-Taxation - The "taxation and notification law" which requires local governments to set estimated levies, inform taxpayers about the impacts, and hold a separate hearing to take taxpayer input.

Table A: class rates

Property Class	Taxes Payable 2008	Local Taxes Payable 2009	State Tax Payable 2009
Residential Homestead: <$76,000[1] $76,000-$500,000 >$500,000	 1.0% 1.0 1.25	 1.0% 1.0 1.25	No state tax
Non-homestead Residential: Single unit: <$76,000[1] $76,000-$500,000 >$500,000 2-3 unit buildings	 1.0 1.0 1.25 1.25	 1.0 1.0 1.25 1.25	No state tax
Market-rate Apartments:	1.25	1.25	No state tax
Commercial/Industrial: <$100,000[2] $100,000 - $150,000 >$150,000	 1.5 1.5 2.0	 1.5 1.5 2.0	Subject to state levy (Commercial-industrial rate)
Seasonal Recreational Residential: <$76,001 $76,000-$500,000 >$500,000	 1.0 1.0 1.25	 1.0 1.0 1.25	Subject to state levy (seasonal-recreational rate)

[1]First tier limit was $72,000 for 1997, $76,000 for 2000, and $500,000 for 2002
[2]First tier limit was $100,000 for 1997, $150,000 thereafter

Resources

League of Minnesota Cities
http://www.lmc.org/page/1/property-tax-state-funding-fiscal-issues.jsp

- Local Government Aid 101: 2009 Distribution & Beyond
- Market Value Homestead Credit 101
- Fiscal Disparities 101
- State Homeowner Property Tax Relief Programs 101
- Levy Limits, http://www.lmc.org/page/1/levylimits09.jsp