

**Taxing Business:**  
**Taxes Received versus Cost of Services Provided**  
**by State and Local Government in Minnesota**

**Minnesota Taxpayers Association**

**April 2007**



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Aaron Twait and Lynn Reed are the authors of this report. Questions about this study should be directed to Mr. Reed.

### **About the Minnesota Taxpayers Association**

Since 1926 the Minnesota Taxpayers Association has been an independent voice for good government and sound tax policy. MTA is a non-profit, non-partisan organization and membership is statewide, open to all, and representative of every category of taxpayer. MTA provides state and local policy makers with objective non-partisan research about the impacts of tax and spending policies; and advocates for the adoption of rational public fiscal policy.

The Association is supported by membership dues. For information about membership call  
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### **About the Minnesota Center for Public Finance Research**

The Minnesota Center for Public Finance Research, previously known as the Minnesota Tax Foundation, is the 501c3 supporting research and education organization for the Minnesota Taxpayers Association. The Center's mission is to provide objective research and analysis on state and local tax and spending issues in support of effective, efficient, and accountable government. The Center seeks to equip citizens to be influential voices for good government and sound fiscal policies by increasing public understanding of what government does. For access to the Center's publications on line, visit our website at [www.mntax.org/cpfr](http://www.mntax.org/cpfr). The Center did not receive any funding for, nor participate in, the production of this report.



## Table of Contents

<b>I.</b>	<b>EXECUTIVE SUMMARY .....</b>	<b>I</b>
<b>II.</b>	<b>BACKGROUND AND POLICY PROBLEM.....</b>	<b>5</b>
	BACKGROUND .....	5
	<i>Recovering Government Costs from Businesses</i> .....	5
	<i>Regressivity of Business Taxes</i> .....	5
	<i>Using Fees</i> .....	6
	POLICY PROBLEM—WHY THIS STUDY?.....	6
	<i>Problems with “Fee-Only”</i> .....	6
	<i>Goal of This Study</i> .....	6
<b>III.</b>	<b>METHODOLOGY.....</b>	<b>9</b>
	REVENUES .....	9
	<i>Calculation of Tax Shares</i> .....	9
	EXPENDITURES .....	12
	<i>Rationale for “Splitting”</i> .....	13
<b>IV.</b>	<b>DETAILED ANALYSIS AND INTERPRETATION.....</b>	<b>15</b>
	CALCULATION OF TAX AND EXPENDITURE SHARES: INDIVIDUALS VERSUS BUSINESSES.....	15
	RATIOS OF REVENUES RECEIVED TO COST OF SERVICES PROVIDED—INDIVIDUALS AND BUSINESSES .....	16
	<i>State and Local Ratio Detail</i> .....	17
	<i>What Does This Mean?</i> .....	17
<b>V.</b>	<b>CONCLUSIONS .....</b>	<b>19</b>



<b>I. Executive Summary</b>
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**Background and Policy Problem**

- Sound tax policy argues for taxing businesses primarily on the basis of recovering costs of government services provided directly to businesses, a practice known as the “benefit principle.”
- To make primary use of the benefits principle as a philosophy of business taxation helps guard against overly subsidizing voters in a way that encourages them to “over use” government services, so that the level of government services, something to be arrived at through consensus by regular elections, will be determined in a manner as economically neutral as possible.
- Taxes on businesses are regressive, when their incidence is determined (their “final resting place”).
- There remains little theoretical argument against taxing businesses on a cost-recovery fee basis, rather than through general taxation.
- A “fee only” approach is not always possible, because unlike vendor sales to businesses, a particular business’s use of a specific government service is not necessarily immediately apparent.
- William H. Oakland, former professor of economics at Tulane University, and William A. Testa, Vice President of the Federal Reserve Bank of Chicago, have experimented with a method for estimating governments’ costs for services provided to businesses, as well as how much businesses are paying to governments for those services.
- The purpose of this study is to apply their methodology to more recent Census data only for Minnesota, supplementing it with information not available to them from the Tax Incidence study of the Department of Revenue cited previously.
- This report provides the basis for discussing the implications of our findings and drawing conclusions regarding the taxation of business in Minnesota.

**Methodology of the Study**

- Because this study is only for Minnesota and because of availability of new Minnesota-specific research not available to Oakland and Testa at the time of their study, we did not rely primarily on their methodology for splitting taxes between individuals and businesses.
- For splitting tax revenues between individuals and businesses, we have used the Minnesota Department of Revenue’s (MDOR) Tax Incidence Study.
- Oakland and Testa classified spending categories into four different groups, after subtracting fee and intergovernmental revenue from spending so as to exclude both revenues and spending already based primarily on the benefits principle or financed by a different level of government. We used their methodology in nearly every case, as follows:

## Background and Policy Problem

### Portion of State and Local Government Spending by Census Expenditure Category with Portions Assumed to Provide Services to Businesses versus Individuals

Expenditure Category	Business Share	Individual Share
<b>Group 1—Government services assumed to be provided exclusively to individuals</b>		
Education	0%	100%
Libraries	0%	100%
Welfare	0%	100%
Health and Hospitals	0%	100%
Veterans Affairs	0%	100%
Parks and Recreation	0%	100%
Housing and Community Development	0%	100%
Unemployment Insurance	0%	100%
<b>Group 2—Government services assumed to be provided exclusively to businesses</b>		
Water Transport/Terminals	100%	0%
Natural Resources - Agriculture	100%	0%
Natural Resources - NEC <sup>1</sup>	100%	0%
<b>Group 3—Government services assumed to be provided equally to businesses and individuals</b>		
Fish and Forestry	50%	50%
Air Transportation	50%	50%
Transportation Subsidies	50%	50%
Highways	50%	50%
Parking	50%	50%
Fire Protection	50%	50%
Police Protection	50%	50%
Corrections	50%	50%
Judicial	50%	50%
Protective Inspection and Regulation	50%	50%
Sewerage	50%	50%
Solid Waste	50%	50%
<b>Group 4—Government services assumed to be provided at varying percentages to businesses and individuals based on components of Groups 1-3</b>		
Legislative	Prorated	Prorated
Financial Administration	Prorated	Prorated
General Public Buildings	Prorated	Prorated
General Interest on Debt	Prorated	Prorated
All Other and Unallocable	Prorated	Prorated

- One of the most difficult methodological problems of the study is regarding the identification of services that should be considered beneficial to business. As Oakland and Testa state elsewhere regarding their philosophy of designating government services as a benefits to business versus individuals: “it is widely accepted that education leads to a more productive work force. It is tempting to conclude, therefore, that the business community should share in the costs of public education. However, under the market system, individuals are compensated according to their productivity. To tax the business community for educational costs is to make them pay twice. This example suggests that business benefit taxation be confined to those services that are provided to it directly, rather than to labor or other resources that it uses in its operations.”<sup>2</sup>
- The same argument could be made regarding healthier individuals, those who are housed, etc. This is the rationale behind allocating 100% of costs of broad categories of state spending to

<sup>1</sup> NEC = Not Elsewhere Classified

<sup>2</sup> “How Should Businesses Be Taxed?”, by William H. Oakland, Chapter 2 in *State Taxation of Business, Issues and Policy Options*, edited by Thomas F. Pogue, Praeger Publishers, Westport, Connecticut, 1992, p. 28.

individuals. The benefits from these services are widely diffused throughout all of society and are not specifically focused on servicing businesses.

**Detailed Analyses and Interpretation**

- There is some difference in the ratio between taxes and spending at the state and local levels. Local business tax revenues matched local government spending on services to businesses more closely than the same comparison for state government.
- The summary findings of this analysis are shown in the table below:

**Ratios of Revenues Paid to Services Received by Level of Government, FY 2002**

Level of Government	Individuals			Businesses		
	1 Revenues Received	2 Cost of Services Provided	Ratio of Column 1 to Column 2	3 Revenues Received	4 Cost of Services Provided	Ratio of Column 3 to Column 4
State	\$10,713.9	\$16,232.4	0.660	\$4,654.8	\$1,746.6	2.665
Local	3,576.5	6,112.9	0.585	3,710.9	1,842.8	2.014
State & Local	\$14,290.4	\$22,345.3	0.640	\$8,365.7	\$3,589.4	2.331

- Several points regarding the interpretation of these results are relevant:
  - *It is possible to estimate the tax to benefits ratio of business taxes to direct government services provided to businesses.*
  - *Businesses pay significantly more than their “fair share” of total tax burden.*
  - *Even doubling businesses’ share of expenditures that benefit businesses would still result in a tax-to-benefit ratio that is higher than one, at both the state and local levels of government in Minnesota.*
  - *Having businesses bear a disproportionate share of state and local government costs does not improve its tax system regarding the ability to pay principle.*

**Conclusions**

- Sound tax policy argues for taxing businesses primarily on the basis of recovering costs of government services provided directly to businesses, a practice known as the “benefit principle.”
- To make primary use of the benefits principle as a philosophy of business taxation helps guard against overly subsidizing voters in a way that encourages them to “over use” government services, so that the level of government services, something to be arrived at through consensus by regular elections, will be determined in a manner as economically neutral as possible.
- Taxes on businesses that are used to subsidize services to individuals make the overall state and local tax system more regressive than it otherwise would have to be.
- Minnesota’s state and local tax system would be well-served by a shifting of taxes away from businesses to direct taxes on individuals, while paying close attention to the ability to pay principle. There would be several improvements in Minnesota’s state and local tax system resulting from such a shifting:
  - It would be based more on ability to pay.
  - It would present a more accurate price of government to individual voters.
  - It would improve Minnesota’s competitive stance regarding business taxes.

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## II. Background and Policy Problem

### Background

#### *Recovering Government Costs from Businesses*

Sound tax policy argues for taxing businesses primarily on the basis of recovering costs of government services provided directly to businesses, a practice known as the “benefit principle.” Typical of this argument is a quote from one of the staff papers of the Final Report of the Minnesota Tax Study Commission published in 1986:

If a corporation’s decisions affect the cost of provision of public services, e.g., if an expansion of a plant puts increased pressure on the public roads, the police force, etc., the firm ought to pay for the extra costs created by its actions on efficiency grounds. Otherwise, the corporation would make more intensive use of public services than would be appropriate. User fees ought to be charged wherever possible. User fees are very difficult to administer, however. The best alternative to them is to tax some aspect of the firm’s behavior which is closely related to its demands on public services.<sup>3</sup>

The above author’s concern is that businesses would use more services than would be appropriate if they were not charged the full price for those services. That same concern can be applied to individuals as well, and it is another reason to tax businesses from the benefits received principle. If businesses pay *more* for services they receive from government than those services cost, so that individuals pay *less* than the cost of services to them, individuals may make “more intensive use of public services than would be appropriate,” as the author stated regarding businesses.

To make primary use of the benefits principle as a philosophy of business taxation helps guard against overly subsidizing voters in a way that encourages them to “over use” government services, so that the level of government services, something to be arrived at through consensus by regular elections, will be determined in a manner as economically neutral as possible. Individual taxpayers, from whom the pool of voters is derived, will understand as nearly as possible the cost of government services they desire, as expressed through their votes. Businesses, which have no vote other than through the individual owners and workers, will pay for their government services as nearly as possible according to cost. To the extent businesses pay more in taxes than the cost of direct government services to them, the cost of services to individuals is hidden from voters as part of the price of products, lower wages, or smaller returns on investment.

#### *Regressivity of Business Taxes*

Another reason to tax businesses in a manner that seeks primarily to recover the cost of direct government services provided to them is the growing awareness that taxes on businesses are regressive. Recent studies from the Minnesota Department of Revenue have shown that when the taxes imposed by statute on businesses are shifted to their “final resting place,” or incidence, such taxes fall more heavily on lower income households than on higher income households. Data from the latest such incidence study from the Department of Revenue reveal that all state taxes legally imposed on businesses in Minnesota, when shifted to the households actually paying those taxes, comprise 8% of household income for households with less than \$8,400 of income, but only 1.7% of income for households with more than \$102,000 of income.<sup>4</sup> The incidence of local business taxes are not shown separately, but all local taxes are shown to be similarly regressive in the report.

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<sup>3</sup> “A Critical Look at Formula Apportionment”, Roger H. Gordon, *Final Report of the Minnesota Tax Study Commission, Volume 2, Staff Papers*, Butterworths Publishers, St. Paul, MN, 1986, p. 211.

<sup>4</sup> Table 2-5 “2002 Population Deciles - Effective Tax Rates”, in the *2005 Minnesota Tax Incidence Study (Using February 2005 Forecast), An Analysis of Minnesota’s Household and Business Taxes*, Minnesota Department of Revenue, March 2005 (Revised July 20, 2005), p. 31.

## Background and Policy Problem

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### *Using Fees*

With sound theory supporting the adage that “businesses do not pay taxes; people do”; and empirical data revealing that the poor pay disproportionately more as a percent of their income in business taxes than higher income people, there remains little theoretical argument against taxing businesses on a cost-recovery fee basis, rather than through general taxation. The advantage of user fees are those associated with private markets, namely: “Private market transactions with agreed-upon prices tend to allocate resources where they are most highly valued, and to maximize value creation more generally.”<sup>5</sup>

### **Policy Problem—Why This Study?**

#### *Problems with “Fee-Only”*

While sound theory is clear on the rationale for collecting from businesses only those costs government incurs for services it provides to businesses, and doing so primarily through fees, there are several practical problems with the theory’s application.

A “fee only” approach is not always possible, because unlike vendor sales to businesses, a particular business’s use of a specific government service is not necessarily immediately apparent. Also, charging only fees to businesses, and only for the services they use, can be cost prohibitive to administer in some cases as well, as stated above.

Besides these mostly technical and administrative objections, another common complaint is that it is nearly impossible to determine what government services are provided to business, and what those services cost.

William H. Oakland, former professor of economics at Tulane University, and William A. Testa, Vice President of the Federal Reserve Bank of Chicago, have experimented with a method for estimating governments’ costs for services provided to businesses, as well as how much businesses are paying to governments for those services. In their working paper cited previously, they say:

In the discussion to follow, we do create estimates of both business taxes and of public service costs, which suggests that a benefits principle would be practical. We estimate both the business-related expenditures and taxes of state-local governments in U.S. states for the latest date for which comparable data are available, 1995. We believe that these measures are useful approximations, though greater accuracy could surely be achieved if state-specific state-unique data sources were to be used in constructing such estimates.<sup>6</sup>

#### *Goal of This Study*

Their comment regarding greater accuracy using state-specific data was a key motivation for conducting this study. A full application of Oakland and Testa’s methodology using original state and local budget data is beyond the scope of this study. We were able to use Minnesota-specific data from the Census to update Oakland and Testa’s work from the 1995 Census for Census data from 2002, the most recent available for Minnesota’s local governments at the time of this writing.

The purpose of this study is to apply their methodology to more recent Census data only for Minnesota, supplementing it with information not available to them from the Tax Incidence study of the Department of Revenue cited previously. Our goal of the study is to answer three basic questions regarding the current taxation of businesses in Minnesota:

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<sup>5</sup> *Can the Benefits Principle Be Applied to State-local Taxation of Business?*, William H. Oakland and William A. Testa, Working Papers Series, Research Department, Federal Reserve Bank of Chicago, 1998 Working papers, number 16, p. 3.

<sup>6</sup> Oakland and Testa, *op. cit.*, p. 4.

1. What adjustments are needed when Oakland and Testa's methodology is applied to more recent Minnesota-specific Census data on state and local government revenues and expenditures?
2. What is the relationship between reasonable estimates of the costs of government services provided to businesses and revenue collected from them?
3. What are the implications of this relationship for Minnesota's state and local tax system?

The answers to these three questions provide the basis in this report for discussing the implications of our findings and drawing conclusions regarding the taxation of business in Minnesota.

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### III. Methodology

#### Revenues

Oakland and Testa conducted their research in the late 1990s when the latest available Census data for state and local government revenues and expenditures were for fiscal year 1995. They were also exploring how business taxes relate to the cost of government services to businesses for several states. Because this study is only for Minnesota and because of availability of new Minnesota-specific research not available to Oakland and Testa at the time of their study, we did not rely primarily on their methodology for splitting revenues between individuals and businesses.

For splitting tax revenues between individuals and businesses, we have used the Minnesota Department of Revenue's (MDOR) Tax Incidence Study, which is produced biennially and provides detail on what portion of various taxes are initially paid by businesses and individuals. We believe that since the assumptions made by Revenue are based on a thorough analysis of Minnesota-specific data, calculations of the household and business shares of taxes paid will be more accurate using this dataset than calculations using the Oakland/Testa data and methodology.

Because we are also interested in examining the relationship between the cost of government services provided to individuals versus taxes paid by individuals, we have added the following primarily individual tax sources to this study that were not included in Oakland and Testa's research:

*Not included in Oakland and Testa's study, but included in this study:*

- estate tax
- alcoholic beverage and cigarette and tobacco excise taxes
- gambling tax
- MinnesotaCare tax
- property taxes imposed on cabins and homes

We used MDOR's Tax Incidence Study for these revenue sources as well.

Fee revenue is excluded from this analysis, under the assumption that fees that are charged are related to the cost of services provided.

#### ***Calculation of Tax Shares***

We calculated tax shares as initially paid by businesses legally liable for the tax, before any shifting to individuals. For those revenue sources included in the Tax Incidence Study, this was a relatively straightforward process: we multiplied total tax collections for each tax (found in column 1 on Table 1-2 of the relevant study, reproduced in Table 1 on the next page from the 2005 study for tax year 2002) by the aggregate individual and the business percentages found on the same table. We aggregated resident and nonresident individuals under the assumption that nonresidents who pay Minnesota taxes are benefiting from the public services paid by those taxes. (Note: Table 1 shows revenue amounts from the Department of Revenue's Tax Incidence study for tax year 2002. We do not use those *amounts*, but merely the individual versus business *share* of revenues paid, applying the share to the Census of Governments' revenue numbers for Fiscal Year 2002 for Minnesota.)

## Methodology

**Table 1: Table 1-2 from the MN DOR Tax Incidence Study, Used for Allocating Taxes to Businesses & Households  
2002 State and Local Tax Collections by Type of Tax and Taxpayer Category**

Tax Category	Percent of Total	Percentage by Taxpayer Category			
		Households		Businesses	Total
		Resident	Nonresident		
<b>State Taxes</b>					
<b>Taxes on Income</b>					
Individual income tax	31.5%	96.7%	3.3%		100.0%
Corporate franchise tax <sup>1</sup>	3.3%			100.0%	100.0%
Estate tax	0.6%	100.0%	2.9%	9.2%	100.0%
<b>Total Income and Estate Taxes</b>	<b>35.3%</b>	<b>87.8%</b>	<b>2.9%</b>	<b>9.2%</b>	<b>100.0%</b>
<b>Taxes on Consumption</b>					
Total sales tax	25.8%	53.1%	3.3%	43.6%	100.0%
General sales/use tax	22.3%	51.0%	3.8%	45.2%	100.0
Sales tax on motor vehicles	3.5%	66.3%		33.7%	100.0
<i>Motor fuels excise taxes</i>	3.7%	43.9%	16.2%	40.0%	100.0%
<i>Alcoholic beverage excise taxes</i>	0.4%	89.7%	10.3%	0.0%	100.0%
<i>Cigarette and tobacco excise taxes</i>	1.0%	96.9%	3.1%	0.0%	100.0%
<i>Insurance premiums taxes</i>	1.2%	57.8%	0.0%	42.2%	100.0%
<i>Gambling taxes</i>	0.3%	96.8%	3.2%	0.0%	100.0%
<i>MinnesotaCare taxes</i>	1.1%	97.0%	3.0%	0.0%	100.0%
<b>Total Consumption Taxes</b>	<b>33.5%</b>	<b>55.9%</b>	<b>4.7% 2.5%</b>	<b>39.4% 56.6%</b>	<b>100.0%</b>
<b>Taxes on Property</b>					
Residential recreational	0.2%	80.2%	19.8%		100.0%
Commercial	2.1%			100.0%	100.0%
Industrial	0.7%			100.0%	100.0%
Utility	0.4%			100.0%	100.0%
<b>Total Property Taxes</b>	<b>3.4%</b>	<b>3.8%</b>	<b>0.9%</b>	<b>95.3%</b>	<b>100.0%</b>
<b>Other Taxes</b>					
Motor vehicle registration tax	2.8%	81.0%		19.0%	100.0%
Mortgage and deed taxes	1.5%	63.7%		36.3%	100.0%
Solid waste management taxes	0.3%	39.8%		60.2%	100.0%
<b>Total Other Taxes</b>	<b>4.7%</b>	<b>72.4%</b>		<b>27.6%</b>	<b>100.0%</b>
<b>Property Tax Refunds</b>					
Homeowners	-0.8%	100.0%			100.0%
Renters	-0.8%	100.0%			100.0%
<b>Total Property Tax Refunds</b>	<b>-1.6%</b>	<b>100.0%</b>			<b>100.0%</b>
<b>Total State Taxes</b>	<b>75.4%</b>	<b>61.9%</b>	<b>2.5%</b>	<b>35.5%</b>	<b>100.0%</b>
<b>Local Taxes</b>					
Property taxes (Pay 2002)	23.7%	49.2%	0.4%	50.4%	100.0%
Gen. prop. tax (gross-credits)	23.3%	50.0%	0.4%	49.6%	100.0%
Homeowners (gross of PTR)	11.3%	100.0%			100.0%
Residential recreational	0.5%	80.2%	19.8%		100.0%
Commercial <sup>2</sup>	5.1%			100.0%	100.0%
Industrial	1.7%			100.0%	100.0%
Farm (other than residence) <sup>3</sup>	1.2%			100.0%	100.0%
Rental housing	2.4%			100.0%	100.0%
Utility	1.1%			100.0%	100.0%
Minerals <sup>4</sup>	0.0%			100.0%	100.0%
Mining production taxes (taconite)	0.4%			100.0%	100.0%
Local sales taxes <sup>5</sup>	0.7%	51.0%	3.8%	45.2%	100.0%
Local gross earnings taxes <sup>6</sup>	0.3%			100.0%	100.0 %
<b>Total Local Taxes</b>	<b>24.6%</b>	<b>48.8%</b>	<b>0.5%</b>	<b>50.7%</b>	<b>100.0%</b>
<b>Total State and Local Taxes</b>	<b>100.0%</b>	<b>58.7%</b>	<b>2.0%</b>	<b>39.3%</b>	<b>100.0%</b>

<sup>1</sup>Includes taconite/iron ore occupation tax.

<sup>2</sup>Includes resorts and railroads.

<sup>3</sup>Farm includes timber.

<sup>4</sup>Minerals does not include the aggregate material production tax.

<sup>5</sup>Allocated to business/consumer in the same proportions as general sales tax.

<sup>6</sup>For cities with annual receipts greater than \$500,000.

Source: MN Department of Revenue Tax Incidence Study for 2005, 2002 tax year; 2001 study 1998 tax year for numbers in italics. See Table 3.

*A Note about Consumption Taxes*

The Tax Incidence Study assigns shares of tax revenue according to the entity legally responsible for payment of the tax to the state. However, statutory changes prompted Revenue to revise the study between the 2001 and 2005 editions, changing the allocation of the taxes paid in 2002 that are shown in italic font in Table 1 on the previous page from various business/individual splits to allocating them entirely to business.

Oakland and Testa define “business tax” as “any general tax that, in the absence of tax shifting, would reduce the business’s bottom line”<sup>7</sup>, and they specifically exclude individual sales and excise taxes on a business sector’s products. These taxes are considered to be passed along to consumers. Therefore, rather than allocating the revenues for tax types shown in italics in Table 1 100% to business, we carry forward the allocation percentages used in the 2001 study for taxes paid in 1998. We believe this is a reasonable assumption given that the individual/business shares of almost all other tax types remained constant during this period.

*A Note about the Individual Income Tax*

Although the Tax Incidence Study assigns the individual income tax entirely to individuals, it is important to note that certain sole proprietors and other small business operators include business operating income on the individual income tax return. Although Oakland and Testa do not address this subject, we estimated the portion of the individual income taxes earned as part of a business. To calculate this estimate, we relied on the 2002 *Statistics of Income* (SOI) bulletin produced by the Internal Revenue Service. Using Table 2,<sup>8</sup> we compared statewide adjusted gross income (AGI) with total statewide “business or professional net income (less loss)”. Based on that data, we allocated 3.07% of individual income tax collections to business for tax year 2002 (\$3,567 million business or professional net income divided by \$116,040 million AGI).

*Calculation of Tax Shares for Taxes Reported Through the Census Bureau*

Three categories of revenue were not reported through the Tax Incidence Study, and instead were taken from *State and Local Government Finance* data compiled by the Census Department’s Governments Division for 1997-98 and 2001-02. Those revenue categories are:

- Utility and Business Licenses
- Unemployment Insurance
- Miscellaneous “Fees” (mostly licenses such as drivers’ and sporting, that are fees but not necessarily set regarding a specific cost recovery amount. General fee revenue was excluded).

In the case of these three revenue sources, we did follow the methodology of Oakland and Testa who included utility and business licenses and unemployment insurance revenues as taxes allocated entirely to business, with one exception. We slightly altered their methodology for miscellaneous fees by allocating the category of fees from “licenses to drive” 19% to business and 81% to individuals, using the Department of Revenue’s business to individual split for motor vehicle registration fees. We split the “other fees” category equally between business and individuals, consistent with Oakland and Testa.

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<sup>7</sup> *Can the Benefits Principle be Applied to State-local Taxation of Business?*, p. 9.

<sup>8</sup> Titled “Individual Income Tax Data, by State and Size of Adjusted Gross Income”, for tax years 1998 and 2002. The business income to total income (in billions) was \$3.3 to \$103.1 for 1998 and \$3.6 to \$116.0 for 2002.

## Methodology

### Expenditures

Oakland and Testa classified spending categories into four different groups, after subtracting fee and intergovernmental revenue from spending so as to exclude both revenues and spending already based primarily on the benefits principle or financed by a different level of government.

Some spending is considered to provide government services only to individuals or only to businesses exclusively—two of the spending groups. A third group of spending is considered to be “shared”, meaning that the expenditures provide government services to individuals and businesses equally. The fourth group is spending that is pro-rated between individuals and businesses based on the shares of the first three groups. Table 2 shows the categories of spending and how spending in them is assumed to be allocated for the cost of government services provided either to businesses or individuals.

**Table 2: Portion of State and Local Government Spending by Census Expenditure Category with Portions Assumed to Provide Services to Businesses versus Individuals**

Expenditure Category	Business Share	Individual Share
<b>Group 1—Government services assumed to be provided exclusively to individuals</b>		
Education	0%	100%
Libraries	0%	100%
Welfare	0%	100%
Health and Hospitals	0%	100%
Veterans Affairs	0%	100%
Parks and Recreation	0%	100%
Housing and Community Development	0%	100%
Unemployment Insurance	0%	100%
<b>Group 2—Government services assumed to be provided exclusively to businesses</b>		
Water Transport/Terminals	100%	0%
Natural Resources - Agriculture	100%	0%
Natural Resources – NEC*	100%	0%
<b>Group 3—Government services assumed to be provided equally to businesses and individuals</b>		
Fish and Forestry	50%	50%
Air Transportation	50%	50%
Transportation Subsidies	50%	50%
Highways	50%	50%
Parking	50%	50%
Fire Protection	50%	50%
Police Protection	50%	50%
Corrections	50%	50%
Judicial	50%	50%
Protective Inspection and Regulation	50%	50%
Sewerage	50%	50%
Solid Waste	50%	50%
<b>Group 4—Government services assumed to be provided at varying percentages to businesses and individuals based on components of Groups 1-3</b>		
Legislative	Prorated	Prorated
Financial Administration	Prorated	Prorated
General Public Buildings	Prorated	Prorated
General Interest on Debt	Prorated	Prorated
All Other and Unallocable	Prorated	Prorated

\*NEC—not elsewhere classified.

The only instance of our assumptions differing from those of Oakland and Testa were for the “Fish and Forestry” spending category, in that they assumed that government services from that spending were provided only to individuals. We assumed expenditures in this category were “shared” with an even split between individuals and businesses in order to reflect any government services provided for commercial fishing, logging, and other natural resource based industries.

### ***Rationale for “Splitting”***

Oakland and Testa offer little by way of explanation regarding the rationale they employed to divide categories such as highways, police and fire protection, corrections, sewerage and others equally between business and individuals, except to say “we believe this errs on the side of parsing too much benefit to the business sector”.<sup>9</sup> In an earlier paper, however, William Oakland does give additional background rationale for how to assume state and local government costs are to be allocated to businesses versus individuals:

*General Services.* Implementation of taxes to support general business services is far more problematic [than firm-, industry-, or location-specific services]. First, benefits of some government services are very difficult to quantify. For examples, benefits from the legal system, police protection, public health, and so forth are impossible to measure; therefore, allocation of benefits to specific firms becomes quite a chancy business. The best that can be expected under such circumstances is a rough application of the benefit principle. A second problem concerns the identification of services that should be considered beneficial to business. For example, it is widely accepted that education leads to a more productive work force. It is tempting to conclude, therefore, that the business community should share in the costs of public education. However, under the market system, individuals are compensated according to their productivity. To tax the business community for educational costs is to make them pay twice. This example suggests that business benefit taxation be confined to those services that are provided to it directly, rather than to labor or other resources that it uses in its operations.<sup>10</sup>

#### *Group 1 Services*

A significant portion of state spending was allocated as costs for providing services exclusively to individuals, including education costs. Repeating part of the quote from the Oakland chapter cited previously focuses the discussion regarding the allocation of costs of state services to businesses versus individuals:

It is tempting to conclude, therefore, that the business community should share in the costs of public education. However, under the market system, individuals are compensated according to their productivity. To tax the business community for educational costs is to make them pay twice. This example suggests that business benefit taxation be confined to those services that are provided to it directly, rather than to labor or other resources that it uses in its operations.

There is no doubt that all businesses benefit from many services provided by state government, just as all individuals do. State government services that provide widespread benefits to all of society, however, as opposed to specific services provided to specific businesses, should not be attributed to businesses. As mentioned in the Oakland chapter, businesses pay higher prices for more highly educated (and presumably more productive) individuals. The same argument could be made regarding healthier individuals, those who are housed, etc. In other words, state services in these large Group 1 categories benefit individuals that indirectly benefit businesses, many of which they pay for through higher wages. This is the rationale behind allocating 100% of costs of broad categories of state spending to individuals. The benefits from these services are widely diffused throughout all of society and are not specifically focused on servicing businesses.

#### *Group 2 Services*

It is likely that services are provided to some individuals in these three spending categories, but since farming is considered business under the Oakland and Testa methodology, and since most spending on water transportation and terminals is logically associated with servicing businesses, the conservative estimate is to keep their allocation of 100% of these costs to business.

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<sup>9</sup> *Can the Benefits Principle be Applied to State-local Taxation of Business?*, page 11.

<sup>10</sup> “How Should Businesses Be Taxed?”, by William H. Oakland, Chapter 2 in *State Taxation of Business, Issues and Policy Options*, edited by Thomas F. Pogue, Praeger Publishers, Westport, Connecticut, 1992, p. 28.

## Methodology

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### *Group 3 Services*

The difficulties with assumptions about splitting state expenditure categories are two-fold. Since they cannot be allocated entirely to either individuals or businesses, one must first develop reasonable proxies for measuring individual versus business services provided by these funds. Secondly, one must obtain the necessary data. While, for instance, police or fire departments may track internally how many of their man-hours are spent on-site at homes versus businesses, such information is generally not published.

Oakland states that for fire services, property values can be an appropriate approximation for paying for the services in a way that roughly matches the benefit received for those services. Indeed, many local services are somewhat associated with property (other than education—see above), so business versus residential property values can be used as an alternate check of Oakland and Testa’s estimates of allocation of government costs for the Group 3 categories. It seemed reasonable to assume that properties “consume” public services in roughly equivalent proportion to their share of overall market value.

An analysis of taxable market values for property taxes payable between 1998 and 2002 indicates that property used in the conduct of business<sup>11</sup> is generally worth about 35% of the overall valuation. Under the assumption above, we would expect the cost of government services to business properties (and therefore, businesses themselves) to comprise about 35% of government spending in these spending areas mentioned in the paragraph above. Table 3 below provides more detail about the portion of total market value attributable to business uses.

**Table 3: Statewide Taxable Market Value Attributed to Business or Households, Property Taxes Payable 1998 - 2002**

<b>Taxes Payable Year</b>	<b>Total Taxable Market Value</b>	<b>Business Share of Value</b>	<b>Individual Share of Value</b>
1998	\$202,875,382,659	35.54%	64.46%
1999	\$219,034,138,639	35.68%	64.32%
2000	\$237,387,124,627	35.55%	64.45%
2001	\$260,679,384,015	35.09%	64.91%
2002	\$288,122,487,520	34.61%	65.39%

Based on these percentages, it seems safe to agree with Testa and Oakland that assigning 50% of these Group 3 expenditures to the business category is a conservative and defensible approach.

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<sup>11</sup> Properties included are farm, timber, apartment, seasonal recreational commercial, commercial, industrial, utility, mineral, other class 5, and railroad. Excludes cabin and residential properties.

## Taxing Business Minnesota Taxpayers Association

### IV. Detailed Analysis and Interpretation

#### Calculation of Tax and Expenditure Shares: Individuals versus Businesses

Using the allocation methods described previously, Table 4 shows what portion of state and local government taxes are estimated to have been collected from individuals versus businesses using Census data for Fiscal Year 2002 for Minnesota. The tax shares resemble those featured in other studies, notably an April 2005 Council on State Taxation report co-authored by Robert Cline. That report indicated that the business share of all Minnesota state and local taxes in 2004 was 39.3%, compared to a business share of 36.9% in this report for 2002.

**Table 4: FY 2002 Minnesota State-Local Revenue Attributed to Business or Individuals (millions)**

Census Revenue Category	State					Local				
	Total State	Estimated to be paid by Individuals		Estimated to be paid by Businesses		Total Local	Estimated to be paid by Individuals		Estimated to be paid by Businesses	
		Amount	Share	Amount	Share		Amount	Share	Amount	Share
Individual Income Tax	\$5,443.4	\$5,443.4	100.0%	\$ 0.0	0.0%	\$ 0.0	\$ 0.0	100.0%	\$ 0.0	0.0%
Death & Gift Tax	66.3	66.3	100.0%	0.0	0.0%	0.0	0.0	100.0%	0.0	0.0%
Corporation Net Income Tax	538.5	0.0	0.0%	538.5	100.0%	0.0	0.0	0.0%	0.0	100.0%
Total General Sales Taxes	3,741.4	2,102.7	56.2%	1,638.7	43.8%	40.9	23.0	56.2%	17.9	43.8%
Other Selective Sales Taxes	954.2	536.3	56.2%	418.0	43.8%	40.4	22.7	56.2%	17.7	43.8%
Amusement Tax	55.9	31.4	56.2%	24.5	43.8%	0.0	0.0	56.2%	0.0	43.8%
Motor Fuels Sales Tax	620.2	372.1	60.0%	248.1	40.0%	0.0	0.0	60.0%	0.0	40.0%
Insurance Premium Tax	163.1	94.3	57.8%	68.8	42.2%	0.0	0.0	57.8%	0.0	42.2%
Alcoholic Beverage Sales Tax	57.5	57.5	100.0%	0.0	0.0%	0.0	0.0	100.0%	0.0	0.0%
Tobacco Sales Tax	173.5	173.5	100.0%	0.0	0.0%	0.0	0.0	100.0%	0.0	0.0%
Pari-mutuels Tax	1.3	1.3	100.0%	0.0	0.0%	0.0	0.0	100.0%	0.0	0.0%
Motor Vehicle License	493.5	399.7	81.0%	93.8	19.0%	3.5	2.8	81.0%	0.7	19.0%
Documentary & Stock Trans Tax	230.4	155.7	67.6%	74.6	32.4%	0.0	0.0	67.6%	0.0	32.4%
Alcoholic Beverage License Tax	1.0	0.0	0.0%	1.0	100.0%	0.0	0.0	0.0%	0.0	100.0%
Amusement License Tax	0.4	0.0	0.0%	0.4	100.0%	0.0	0.0	0.0%	0.0	100.0%
Public Utilities Tax	0.1	0.0	0.0%	0.1	100.0%	69.2	0.0	0.0%	69.2	100.0%
Public Utility License Tax	0.0	0.0	0.0%	0.0	100.0%	0.0	0.0	0.0%	0.0	100.0%
Occup & Business License, NEC	248.3	0.0	0.0%	248.3	100.0%	0.0	0.0	0.0%	0.0	100.0%
Unemployment-Contribution	333.1	0.0	0.0%	333.1	100.0%	0.0	0.0	0.0%	0.0	100.0%
Unemployment-Interest Revenue	31.6	0.0	0.0%	31.6	100.0%	0.0	0.0	0.0%	0.0	100.0%
Unemployment-Federal	73.8	0.0	0.0%	73.8	100.0%	0.0	0.0	0.0%	0.0	100.0%
Property Tax	305.6	0.0	0.0%	305.6	100.0%	0.0	0.0	0.0%	0.0	100.0%
Property Tax	0.0	0.0	49.6%	0.0	50.4%	4,909.2	2,434.9	49.6%	2,474.2	50.4%
Special Assessments	0.0	0.0	49.6%	0.0	50.4%	275.9	136.8	49.6%	139.0	50.4%
Hunting & Fishing Licenses	51.2	35.7	69.7%	15.5	30.3%	0.0	0.0	49.1%	0.0	50.9%
Motor Vehicle Operators Lic	31.1	21.7	69.7%	9.4	30.3%	0.0	0.0	49.1%	0.0	50.9%
Other License Tax	33.7	23.5	69.7%	10.2	30.3%	0.0	0.0	49.1%	0.0	50.9%
Taxes, NEC	0.0	0.0	69.7%	0.0	30.3%	169.3	83.1	49.1%	86.2	50.9%
Property Sale - Comm Devel	0.0	0.0	69.7%	0.0	30.3%	0.0	0.0	49.1%	0.0	50.9%
Property Sale Other	0.1	0.1	69.7%	0.0	30.3%	82.2	40.3	49.1%	41.9	50.9%
Interest Earnings	470.6	328.1	69.7%	142.5	30.3%	922.0	452.5	49.1%	469.5	50.9%
Fines & Forfeits	45.9	32.0	69.7%	13.9	30.3%	1.0	0.5	49.1%	0.5	50.9%
Rents	3.9	2.7	69.7%	1.2	30.3%	49.5	24.3	49.1%	25.2	50.9%
Royalties	9.8	6.9	69.7%	3.0	30.3%	0.0	0.0	49.1%	0.0	50.9%
Donations From Private Sources	363.4	253.3	69.7%	110.1	30.3%	0.0	0.0	49.1%	0.0	50.9%
Net Lottery Revenue	129.8	90.5	69.7%	39.3	30.3%	0.0	0.0	49.1%	0.0	50.9%
Misc General Revenue NEC	696.1	485.2	69.7%	210.8	30.3%	724.4	355.5	49.1%	368.9	50.9%
<b>Total</b>	<b>\$15,368.7</b>	<b>\$10,713.9</b>	<b>69.7%</b>	<b>\$4,654.8</b>	<b>30.3%</b>	<b>\$7,287.4</b>	<b>\$3,576.5</b>	<b>49.1%</b>	<b>\$3,710.9</b>	<b>50.9%</b>

Note: For local property, business property = C/I, Utility, Residential Rental, Non-homestead Farm; Individual property = residential homestead and cabins.

For estimating what portion of state and local government spending was attributable to services to individuals versus services to businesses, the assumptions from Table 2 on page 10 were used. The results of these allocations are shown in Table 5 below. (Note that some spending categories shown in Table 5 are negative, indicating that a combination of estimated intergovernmental revenues and charges for services in an enterprise-type fund for a spending category exceed costs for that category.)

**Table 5: FY 2002 Minnesota State-Local Expenditures Attributed to Business or Individuals (millions)**

Expenditure Category	State Spending					Local Spending				
	Total	Estimated Cost of Services Provided for:				Total	Estimated Cost of Services Provided for:			
		Individuals	Individual Share	Businesses	Business Share		Individuals	Individual Share	Businesses	Business Share
<b>Group 1—Government services assumed to be provided exclusively to individuals</b>										
Education	\$6,477.1	\$6,477.1	100.0%	0.0	0.0%	\$2,396.3	\$2,396.3	100.0%	0.0	0.0%
Libraries	0.3	0.3	100.0%	0.0	0.0%	168.7	168.7	100.0%	0.0	0.0%
Welfare	3,795.4	3,795.4	100.0%	0.0	0.0%	464.8	464.8	100.0%	0.0	0.0%
Health and Hospitals	305.7	305.7	100.0%	0.0	0.0%	429.2	429.2	100.0%	0.0	0.0%
Veterans Affairs	7.8	7.8	100.0%	0.0	0.0%	0.0	0.0	100.0%	0.0	0.0%
Parks & Recreation	94.3	94.3	100.0%	0.0	0.0%	422.7	422.7	100.0%	0.0	0.0%
Hous. & Com. Dev.	34.3	34.3	100.0%	0.0	0.0%	212.6	212.6	100.0%	0.0	0.0%
Unemployment Ins.	777.5	777.5	100.0%	0.0	0.0%	0.0	0.0	100.0%	0.0	0.0%
<b>Group 2—Government services assumed to be provided exclusively to businesses</b>										
Water Trans./Term.	\$ 0.0	\$0.0	0.0%	\$ 0.0	0.0%	\$ 1.4	0.0	0.0%	\$ 1.4	100.0%
Nat. Res. /Agric.	155.8	0.0	0.0%	155.8	100.0%	0.0	0.0	0.0%	0.0	100.0%
Nat. Res. - NEC	69.0	0.0	0.0%	69.0	100.0%	126.0	0.0	0.0%	126.0	100.0%
<b>Group 3—Government services assumed to be provided equally to businesses and individuals</b>										
Fish and Forestry	124.3	\$ 62.2	50.0%	62.2	50.0%	0.0	0.0	50.0%	0.0	50.0%
Air Transportation	-61.6	-30.8	50.0%	-30.8	50.0%	346.9	173.5	50.0%	173.5	50.0%
Transport. Subsidies	116.1	58.1	50.0%	58.1	50.0%	96.7	48.4	50.0%	48.4	50.0%
Highways	1,140.0	570.0	50.0%	570.0	50.0%	1,067.9	534.0	50.0%	534.0	50.0%
Parking	0.0	0.0	50.0%	0.0	50.0%	3.5	1.7	50.0%	1.7	50.0%
Fire Protection	0.0	0.0	50.0%	0.0	50.0%	265.4	132.7	50.0%	132.7	50.0%
Police Protection	177.9	89.0	50.0%	89.0	50.0%	840.7	420.4	50.0%	420.4	50.0%
Corrections	335.3	167.6	50.0%	167.6	50.0%	313.4	156.7	50.0%	156.7	50.0%
Judicial	240.8	120.4	50.0%	120.4	50.0%	281.3	140.6	50.0%	140.6	50.0%
Protect. Insp. & Reg.	162.2	81.1	50.0%	81.1	50.0%	87.6	43.8	50.0%	43.8	50.0%
Sewerage	0.5	0.3	50.0%	0.3	50.0%	-0.5	-0.2	50.0%	-0.2	50.0%
Solid Waste	32.0	16.0	50.0%	16.0	50.0%	54.7	27.4	50.0%	27.4	50.0%
<b>Group 4—Government services assumed to be provided at varying percentages to businesses and individuals based on components of Groups 1-3</b>										
Legislative	51.2	46.3	90.3%	5.0	9.7%	0.0	0.0	0.0%	0.0	0.0%
Fin. Administration	297.9	269.0	90.3%	28.9	9.7%	304.1	274.5	90.3%	29.5	9.7%
Gen. Public Bldgs.	24.8	22.4	90.3%	2.4	9.7%	227.0	205.0	90.3%	22.1	9.7%
Gen. Int. on Debt	354.4	319.9	90.3%	34.4	9.7%	1,100.3	993.4	90.3%	106.9	9.7%
All Oth. & Unalloc.	3,265.9	2,948.6	90.3%	317.3	9.7%	-1,255.0	-1,133.1	90.3%	-121.9	9.7%
<b>Totals</b>	<b>\$17,979.0</b>	<b>\$16,232.4</b>	<b>90.3%</b>	<b>\$1,746.6</b>	<b>9.7%</b>	<b>\$7,955.6</b>	<b>\$6,112.9</b>	<b>76.8%</b>	<b>\$1,842.8</b>	<b>23.2%</b>

*Note: Some spending categories shown are negative, indicating that a combination of estimated federal revenues and charges for services in an enterprise-type fund for a spending category exceed costs for that category.*

### Ratios of Revenues Received to Cost of Services Provided—Individuals and Businesses

Once revenues have been allocated as paid by individuals or businesses, and expenditures allocated as having been for services provided to individuals or businesses, a simple ratio of revenues paid to services received can be calculated. By dividing the revenues paid to government divided by the expenditures for the services provided to either individuals or businesses, we arrive at a “revenues paid to services provided” ratio for both individuals and businesses. Because state and local governments in Minnesota have considerably different tax and fee systems and deliver significantly different types of services, these ratios were calculated separately for the state and local level of

governments for this analysis. Oakland and Testa combined state and local governments for their analysis.

***State and Local Ratio Detail***

There is some difference in the ratio between taxes and spending at the state and local levels. Local business tax revenues matched local government spending on services to businesses more closely than the same comparison for state government. At the state level, the FY2002 services to business ratio was nearly 2.7, while the local ratio was only just over 2. In other words, businesses pay 2.7 times (or 170%) more in taxes and fees to state government than they receive from state government in services. At the local level, businesses pay about 2 times (or 100%) more in taxes and fees than they receive in government services. For both state and local governments combined, businesses pay 2 1/3 times more (or 133%) in taxes than they receive in services, according to the assumptions used for this analysis. The summary findings of this analysis are shown in Table 6 below.

**Table 6: Ratios of Revenues Paid to Services Received by Level of Government, FY 2002**

Level of Government	Individuals			Businesses		
	1 Revenues Received	2 Cost of Services Provided	Ratio of Column 1 to Column 2	3 Revenues Received	4 Cost of Services Provided	Ratio of Column 3 to Column 4
State	\$10,713.9	\$16,232.4	0.660	\$4,654.8	\$1,746.6	2.665
Local	3,576.5	6,112.9	0.585	3,710.9	1,842.8	2.014
State & Local	\$14,290.4	\$22,345.3	0.640	\$8,365.7	\$3,589.4	2.331

***What Does This Mean?***

While it may not come as a surprise to those with more than a passing knowledge of public policy that businesses pay more in taxes than they receive in services, it may be somewhat surprising to see any attempt to quantify the magnitude of the disparity, such as in this short paper. It may also be surprising to see the estimated magnitude of the disparity, with businesses paying an estimated two to two and two-thirds times more in taxes than they receive in services.

Though this analysis is not intended to be an exhaustive research project that delves deeply into an evaluation of the benefits principle of taxation regarding state and local taxes on business, it does provide some perspective on how state and local governments tax businesses and how those taxes relate to services provided. Several points regarding the interpretation of these results are relevant:

- *It is possible to estimate the tax to benefits ratio of business taxes to direct government services provided to businesses.* Even though tax policy theory is solid on the desirability of taxing businesses according to the benefits received principle, one of the reasons cited for not doing so more consistently is the difficulty of estimating the cost of services provided to businesses. As Oakland and Testa stated in their 1998 working paper: “In the discussion to follow, we do create estimates of both business taxes and of public service costs, which suggests that a benefits principle would be practical.” They also state even better estimates could be derived “if state-specific state-unique data sources were to be used in constructing such estimates.”<sup>12</sup> This short paper has adapted their methodology using “state-specific state-unique data sources” not available to Oakland and Testa, which continue to show that estimating the costs of government

<sup>12</sup>*Can the Benefits Principle Be Applied to State-local Taxation of Business?*, William H. Oakland and William A. Testa, Working Papers Series, Research Department, Federal Reserve Bank of Chicago, 1998 Working papers, number 16, p. 3.

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services provided to businesses is not impossible or unworkable. A better staffed effort using more detailed cost data could yield even more reliable information, though probably not significantly different from the results using the general assumptions in this paper.

- *Businesses pay significantly more than their “fair share” of total tax burden.* Under the assumptions used in this short paper, businesses pay 133% more in state and local taxes than they receive in direct state and local government services. Local governments tax businesses “only” twice as much as the cost of their services, a ratio that is remarkably close to the relationship of business property taxes to residential property taxes at the local level. This means that local government taxes on businesses could be brought very close to the cost of local government services provided to businesses simply by eliminating Minnesota’s property classification system at the local level, that favors residential and farm property over all other classes of property. State taxes are nearly 270% higher on businesses than the value of state government services provided to businesses, according to the estimates in this report. This means that it would take more than a simple change like eliminating Minnesota’s preferential property tax classes to bring business taxes more in line with the cost of services provided to them at the state level. There needs to be a careful re-examination of the way businesses are taxed in Minnesota, especially at the state level, in order to promote a government pricing structure that is more accountable to the voters.
- *Even doubling businesses’ share of expenditures that benefit businesses would still result in a tax-to-benefit ratio that is higher than one, at both the state and local levels of government in Minnesota.* Readers may disagree with significant assumptions made by the authors of this report. As the assumptions are reviewed, however, fairly large changes could be made to the assumptions of what portions of services are provided to businesses without changing the overall result—businesses are taxed more heavily than the benefits principle would recommend.
- *Having businesses bear a disproportionate share of state and local government costs does not improve its tax system regarding the ability to pay principle.* A possibly intuitive reaction to exposing the fact of high taxes on businesses related to services provided to them is that such a policy ensures that those less fortunate in society are protected from excessive taxation. This is directly counter to the facts. Business taxes have been repeatedly shown to be regressive in their incidence through the Minnesota Department of Revenue’s *Tax Incidence Study*, cited earlier. Any state that attempts to shift more of its tax costs directly onto individuals does not automatically abandon the “ability to pay” principle by doing so. In fact, depending on what taxes are used to make up for reductions in business taxes in such a shift, the overall state and local tax system could be made even more closely aligned with ability to pay than the current system. Shifting taxes initially paid by businesses to the individual income tax, for instance, would increase the overall progressivity of Minnesota’s state and local tax system, while minimizing taxes hidden from voters in the cost of doing business.

**V. Conclusions**

This short report provides a rationale for taxing businesses and offers a first look at the implications of how Minnesota chooses to tax businesses in this state. Principles of sound tax policy, the data and other sources examined, and the methodology used in this analysis, all provide support for several conclusions:

- Sound tax policy argues for taxing businesses primarily on the basis of recovering costs of government services provided directly to businesses, a practice known as the “benefit principle.”
- To make primary use of the benefits principle as a philosophy of business taxation helps guard against overly subsidizing voters in a way that encourages them to “over use” government services, so that the level of government services, something to be arrived at through consensus by regular elections, will be determined in a manner as economically neutral as possible.
- Taxes on businesses that are used to subsidize services to individuals make the overall state and local tax system more regressive than it otherwise would have to be.
- Minnesota’s state and local tax system would be well-served by a shifting of taxes away from businesses to direct taxes on individuals, while paying close attention to the ability to pay principle. There would be several improvements in Minnesota’s state and local tax system resulting from such a shifting:
  - It would be based more on ability to pay.
  - It would present a more accurate price of government to individual voters.
  - It would improve Minnesota’s competitive stance regarding business taxes.

This report shows that the costs of government services provided directly to businesses are not impossible to estimate. As long as assumptions are clearly stated, and policy makers come to a reasoned and open consensus regarding methodology, there should not be significant technical barriers to moving Minnesota’s state and local tax system closer to one in which businesses pay taxes more nearly in line with the cost of direct services provided to them, while individuals pay the remainder, with strong reliance on the ability to pay principle.

