STATE OF MINNESOTA

Office of Governor Mark Dayton

130 State Capitol ♦ 75 Rev. Dr. Martin Luther King Jr. Boulevard ♦ Saint Paul, MN 55155

May 15, 2017

The Honorable Kurt Daudt
Speaker of the House
State Office Building, Room 463
100 Rev. Dr. Martin Luther King, Jr. Blvd.
Saint Paul, Minnesota 55155

Dear Mr. Speaker:

I have vetoed and am returning Chapter 66, House File 4, a bill relating to the omnibus tax bill.

When I took office in 2011, Minnesota faced a $6.2 billion budget deficit. Now, after six years of making tough, responsible choices, Minnesota is finally on sound fiscal footing. Our state has $1.5 billion on its bottom line and nearly $2 billion in reserves to protect Minnesota from future economic downturns. This bill prioritizes unsustainable tax cuts now and into the future over investments in prekindergarten, higher education and economic development that will grow opportunities for hard working Minnesotans in our state.

This bill will cost the state $1.1 billion this biennium and $1.4 billion in the next and grow in the future, setting the state up for fiscal uncertainty. That is because items like eliminating the inflator on the state general levy and the indexing on tobacco taxes grow significantly beyond what you have shown on the bill's spreadsheet. The levy freeze will cost over $1 billion over 10 years. The tobacco tax cuts will cost nearly $300 million over ten years.

In addition to the irresponsible size of the tax bill, the composition represents misplaced priorities. The bill prioritizes tax relief to some of the most fortunate in our state, large businesses, and special interests while ignoring those in Minnesota who have not yet benefitted from the recovery and those who rely on essential government services.

Education tax credit provisions
The education foundation tax credit will provide those who can afford to make significant donations to foundations with tax credits on top of the existing tax deduction for charitable donations. Individuals are free, of course, to provide donations to charities of their choosing – many provide significant public good. But this provision provides additional significant incentives to a select group of foundations, while other worthy charities across Minnesota are not provided with this same significant treatment.

I have repeatedly stated my intention to veto any bill that provides public funds to private education in the form of vouchers or other mechanism. Expansion of existing education subtraction, expansion of the existing education credits to include tuition, and creation of a new credit for contributions to foundations related to scholarships, will divert public resources to private schools. As I have made clear, I intend to veto any bill that includes vouchers.

My budget prioritized Minnesota's students by investing in our public schools. It would expand voluntary pre-K by doubling the enrollees from 3,300 to 8,300 in FY 18, invest over $600 million more dollars to provide better schools for students and families everywhere in Minnesota, and as part of that increase our investment in special education by $40 million as well as many other investments that will improve education in Minnesota.

Estate tax cut

The estate tax cut, which costs $162 million in FY 18-19, will mean that nearly all of the wealthiest 1,000 estates in Minnesota each year will no longer pay any estate tax, significantly reducing the work we have done in Minnesota to make our tax system more progressive. It will do nothing to help family farms and business, because they are already exempt from the estate tax up to $5 million when they pass on their businesses to their heirs. It will only help the super wealthy to avoid paying their fair share of taxes.

Cigarette tax reductions

Among the most egregious provisions in the tax bill is the elimination of the inflator on cigarette taxes. The purpose of the cigarette tax increase and inflator in 2013 was to make strategic investments in health care, education and jobs, and to reduce smoking in Minnesota, in particular among its youth. Each year, more than 6,300 Minnesotans die from smoking-related illnesses, and smoking costs Minnesotans more than $3 billion in excess health care cost. Since the increase took effect, smoking has declined, most notably among high school students.

Eliminating the inflator on these taxes will make cigarettes and moist snuff more affordable for our youth, who are more price sensitive, years down the road. Removing the inflator will lower the cost of cigarettes and snuff over time in real dollars.

Furthermore, without any public testimony in conference committee and in the dark of the night, the tax conference committee snuck in a new premium cigar tax cut for the tobacco industry that puts their profits ahead of people's health.

The legislature should look at ways to prevent youth from smoking and help current smokers quit, not ways to make tobacco products more affordable to hook the state's next generation to these dangerous products.

The cost of this proposal is a significant concern as well. It will cost $10 million in this biennium but grow to $36 million in the FY20-21 biennium, and will continue to grow more after that. For these reasons, I have criticized this proposal in the past and continue to oppose it.

Business tax cuts
Of the over $1.1 billion spent in this bill, the business and estate tax cuts in this bill total over $500 million in FY18-19, primarily benefiting the largest corporations in the state. In the near term, the C/I levy changes will allow all businesses to reduce their property taxes with the exclusion of the first $150,000 of value.

But the freeze to the levy amount, over time, will disproportionally benefit large building owners like the IDS and the Mall of America. These two tax cuts alone will cost the state's budget over $1.7 billion over the next ten years. The changes to section 179 expensing and R&D credit expansion will cost an additional $190 million in the next biennium.

These business tax cuts undermine our state's long-term economic well-being. Instead of providing needed investments in E-12 and higher education across the state, this bill funds the priorities of powerful special interest groups. These tax cuts are short changing the long term prosperity of Minnesota by failing to fund our state's future workforce. As we face a workforce shortage, businesses most pressing issue is finding and retaining skilled workers. We need to invest in more opportunities to create the workforce of the future, not fewer.

Social Security
The concern around the Social Security provisions relate to their cost and who benefits from them. This expensive item needs to be evaluated in light of the fact that in 2014, only 35 percent of social security benefits received by Minnesotans were taxable. Nearly half of all Minnesota households with Social Security income paid no tax on any of that income and would receive no benefit from this proposal. In addition, other seniors who have teachers, police, or nurse pensions would not have the same benefits available. Large tax cuts will disproportionately shift the costs of government to young families and the next generation.

Higher education
HF 4 also creates a credit for taxpayers paying back students loans and a credit and subtraction for contributions to 529 college savings plans. Ensuring that Minnesotans can afford to go to college and don't graduate with significant debt is important, but this credit isn't the best solution to that problem, nor is a non-refundable tax credit with a maximum of $500 likely to attract recent graduates to move to Minnesota. The money for these provisions would be better utilized on the front end by helping students avoid taking on the debt for which these credits are meant. Bigger investments in need based aid such as the State Grant program would have a more significant impact. That would also help ensure that the benefit from the state was going to those that truly needed it, rather than taxpayers who are already investing in 529 college savings plans.

Private Letter rulings and assessment limitations
The provisions in article 8 on private letter rulings and assessment limitations will have significant effects on how the Department of Revenue currently works with customers.

Instead of the Department's focus on providing all taxpayers with the information and tools they need to comply with their obligations under Minnesota law, this bill would create a specialized guidance program – at a significant cost to the state – that only serves those who can afford it. It will increase burdens during audit and result in longer audits, more document reviews, and more auditors in more business locations disrupting the ongoing business activities. It creates unfairness by treating those who file and pay on time the same as those who file and pay late.

Failing to help Minnesota families and communities
HF 4 provides significant benefits to the wealthiest in Minnesota, businesses and special interests while leaving behind those that need relief most -- families across the state working hard and struggling to pay the rent, buy groceries and raise their kids. It is unfortunate that this bill ignores the expansion of the Working Family Credit I proposed in January. This credit helps working families across Minnesota pay for basic needs and is a proven tool to fight poverty. This credit has enjoyed bipartisan support at the federal level and in Minnesota since studies have shown it is one of our most effective methods of reducing poverty and improving outcomes for families. Children who grow up in homes with more economic stability do better in school. Minnesota's economy depends on its most valuable asset – our people – we need to invest in all of them across all areas of the state to ensure our future prosperity.

Taconite Production Tax
HF 4 includes language adjusting the distribution of taconite production tax revenues that was inserted in the tax bill without receiving a public hearing. The language will cause instability in the distribution of revenues and increase funding to the taconite industry at the expense of economic development in the region.

Instead of providing funding for essential government services provided by cities and counties, the bill micromanages local decision making. Local government aid and county program aid provide stable funding sources for first responders, roads, street maintenance, plowing and essential services. We need to fund local government aid and include ongoing funding to provide stability for local governments.

Counties also need resources to help implement the state's buffer law. The Riparian Aid provided in my tax bill will ensure they have needed resources. It is also unfortunate that a program to smooth the transition for the buffer requirements in current law – buffer compensation payments for farmers– was not included.

Rather than funding local government work, this bill contains several proposals taking decision making power away from local governments, or penalizing them based on how they choose to spend their money. These provisions place limitations on the local budgeting decisions of cities, counties, and the Destination Medical Center, creating a potential barrier to infrastructure and job growth. This includes prohibiting imposing fees or taxes on merchant-provided bags, disallowing any public money for a zip rail project between Rochester and the Twin Cities, and reducing LGA for cities that allow for defendants to enter into diversion programs for minor offenses.

This bill targets the city of Minneapolis by cutting library debt service aid, reneging on a deal made by the state in 2013. This bill unnecessarily micromanages local governments and takes decisions out of their hands.

There are a number of additional provisions contained in the bill and provisions that are missing from it that are of great concern to me. The Commissioner's testimony and letters dated March 29, 2017, and April 4, 2017, have identified many of them. Ultimately, the priorities in the tax bill need to be measured against other components of the overall GOP budget. The GOP budget cuts $768 million in taxes for businesses over four years, almost three times the GOP investment in E-12 education. Instead of putting any funding in voluntary pre-kindergarten, the GOP budget cuts $53 million in taxes for the tobacco industry. The childcare assistance program receives minimal funding while the GOP budget cuts taxes for airplane fuel by $11 million. Giving an $8 million tax cut for products sold in vending machines is a larger priority in the GOP budget than increasing funding for child protection services. The GOP budget spends $65 million more on estate tax cuts for the wealthiest Minnesotans than on needed additional investments to the engines of our state, Minnesota State and the University of Minnesota.

The cost of this bill, over $1.1 billion dollars in the next biennium and $1.4 billion in the following biennium, represent a return to the irresponsible budgeting of Minnesota's past. I will not compromise on the state's hard-earned fiscal stability. I am vetoing this bill because of the bill's costs and because of the misguided represented by the provisions in this bill and the important provisions for families from my tax bill that are missing from it. I hope we can work toward a tax bill, as a component of the overall state budget that serves Minnesota families.

Sincerely,

Mark Dayton
Governor

cc: Senator Michelle L. Fischbach, President of the Senate
Senator Paul E. Gazelka, Senate Majority Leader
Senator Thomas M. Bakk, Senate Minority Leader
Senator Roger Chamberlain, Minnesota Senate
Representative Melissa Hortman, House Minority Leader
Representative Greg Davids, House of Representatives
The Honorable Steve Simon, Secretary of State
Mr. Cal R. Ludeman, Secretary of the Senate
Mr. Patrick Murphy, Chief Clerk of the House of Representatives
Mr. Paul Marinac, Revisor of Statutes