STATE OF MINNESOTA

Office of Governor Mark Dayton

130 State Capitol ♦ 75 Rev. Dr. Martin Luther King Jr. Blvd ♦ Saint Paul, MN 55155-1611

May 23, 2018

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

Dear Speaker Daudt:

I have vetoed and am returning Chapter 205, House File 947, a bill related to taxation and education.

Two weeks ago, I said that I would not begin to negotiate or sign a tax bill until there was an agreement to fund Emergency School Aid. I urged the Legislature to fund $137.9 million in one-time Emergency School Aid to ensure that our schools could continue to provide the high quality educations students need and deserve. To date, at least 59 school districts across Minnesota are facing severe financial shortfalls, which will force the layoffs of hundreds of teachers and support staff, increases in class sizes and cuts to school programs. Thirty-three of the schools districts are in Greater Minnesota and twenty-six are in the metropolitan area.

Republicans misleadingly claim to provide $225 million in this bill for schools, but 80% of the funding is from existing sources that have already been allocated and budgeted for staff training and community education. The other $50 million is from the State's budget reserve. Instead of providing critical new funding, this bill simply shifts funding by allowing school districts to transfer money out of community education and professional development programs. Community education funding is crucial to meet the needs of our most at-risk preschoolers, ECFE parents and adults seeking a GED. Professional development for our teachers is critical when we need to train our teachers in school safety. With a $329 million budget surplus, it makes no sense for us to take funding away from our schools and teachers. This funding is not only inadequate, it completely misses the mark on school funding priorities our teachers and students sorely need.

Misguided Tax Priorities

Late last year, President Trump and Republicans in Congress enacted a federal tax law that overwhelmingly favored large corporations and the richest Americans. The federal tax law cut taxes by 40 percent for corporations, totaling 92 percent of the net total, or $1.35 trillion. In response to the federal tax changes, I proposed a near revenue-neutral tax bill on March 16th that would separate state income taxes from the federal tax code and cut income taxes for over 2 million Minnesota families. Unfortunately, like the federal tax bill, this bill prioritizes corporations and wealthy individuals over Minnesota families.

While there are items in the bill that align with my approach, there are significant proposals left out of the bill that would help Minnesota families. My approach would have helped low and middle-income families with the expansion of the Working Family Credit to larger families, saving 329,000 Minnesotans an average tax reduction of $160. I proposed a new Personal and Dependent Credit of $60 per person tax credit for individuals earning less than $90,000 and married tax filers earning less than $180,000 per year. For a family of four that is a tax credit of $240. About 2 million Minnesotans would have received an average tax cut of $115.

Individual Rate Cuts

The bill provides little in tax reductions to low-and middle-income families and instead prioritizes rate cuts that benefit wealthy Minnesotans the most. One in five Minnesota households do not have enough taxable income to benefit from the bill's rate reductions.

Under this bill, when comparing the tax impact of the rate cut for a married joint filer with two children:
- Earning $30,000 or less would see no tax reduction
- Earning $65,000 (state median income) would see a $92 tax reduction
- Earning $150,000 would see a $262 tax reduction
- Earning $250,000 would see a $263 tax reduction

Under my tax bill, when comparing the tax impact of the new personal and dependent credit a married joint filer with two children:
- Earning $30,000 or less would see $240 tax reduction
- Earning $65,000 (state median income) would see a $240 tax reduction
- Earning $150,000 would see a $240 tax reduction
- Earning $250,000 would see a $72 tax reduction

Corporate Rate Cuts

The bill provides a larger rate cut for corporations than for working Minnesota families. Although the conference agreement changes income tax rates for both individuals and corporations, for individuals, the bill provides a 0.2 percent second tier rate cut for taxpayers, but a 0.7 percent rate cut for corporations. That means the cut in rate for corporations (7.6 percent) is over double that for the second tier rate (2.9 percent).

For businesses, this bill provides a corporate tax rate cut of 0.7 percent costing $85 million per year when fully phased in, repeals the corporate alternative minimum tax costing $23 million, and provides full Section 179 expensing with a first full year of $85 million. All this on top of the 40 percent tax rate cut corporations already received on their federal taxes.

International Provisions

This bill shields multi-national corporations with foreign subsidiaries from $200 million in state taxes on the profits they have sheltered overseas. It provides a 100 percent subtraction for Global Intangible Low Tax Income (GILTI) of individuals and corporations. It also decouples 100 percent from Foreign Derived Intangible Income deductions for both individuals and corporations. These were tax changes made at the federal level that Minnesota should follow.

And although the bill would bring to Minnesota some of its share of deemed repatriation income, it first allows the federal preferred rate deduction and the Minnesota Dividend Received Deduction (DRD). My approach – following established Minnesota policy – allows the DRD, but not the federal preferred rate deduction. Allowing corporations to claim both of these preferential treatments for this income reduces the revenue apportioned to Minnesota even further.

Fiscal Responsibility

This tax bill also seriously jeopardizes Minnesota's future fiscal stability. The rate cuts in the bill are phased-in to hide their full costs. The personal income rate cuts cost $136 million in FY 18-19, but the full cost will be $395 million a biennium. The corporate rate cut costs $23 million in FY 18-19, but the full cost will be $170 million. These future revenue losses are in addition to the average $200 million per biennium that will be lost from freezing business property taxes last year. I will not sacrifice our state's hard-earned fiscal stability, as this bill does.

I have been very clear about my commitment to fiscal sustainability for the State of Minnesota. As I expressed in a letter to legislative leaders on April 9, the long-term fiscal stability of the state is my highest priority. I have worked over the past seven years to restore the state's fiscal stability and I will not support any bill that threatens that stability. That is why I believed we should have revisited the three items in last year's tax bill, the State General Levy Inflator, Cigarette Inflator and Premium Cigars, and Estate Tax freeze at 2.4M to promote fairness, public health, and fiscal stability

The long-term costs of the rate cuts should be considered with the revenue sources in the bill. The deemed repatriation revenue will end after 8 years. The change to the historic tax credit is a shift that brings in more revenue temporarily and is not ongoing revenue. The conforming to the disallowance of certain active pass through losses expires at the federal level after 2025. Combined, these three provisions in the bill raise $128.9 million in FY 18-19 and $204.4 million in FY 20-21. Temporary revenue should not be used to fund permanent tax cuts.

Other Issues in the Tax Bill

This bill moves the indexing of brackets, and various tax attributes, to chained CPI. This will mean that brackets will increase more slowly, increasing taxes on individuals slightly more each year. In addition, because the other credits will increase more slowly, their tax credits, property tax refunds, and other benefits will be less beneficial over time, which amounts to another tax increase. The net effect of this change is a $60 million tax increase in the next biennium compared to what Minnesotans would pay under our current inflation rules.

The bill requires an addition for distributions from a 529 savings account if the distribution is used for K-12 expenses. Under the bill, those distributions are not subject to the 529 credit or subtraction recapture tax.

I am concerned that the bill would take the stillbirth credit away from families who would be eligible under current law, specifically families that use a surrogate. This is an unfair and inequitable treatment of those families.

There are also some items that are not in this bill that I thought represented a growing consensus. I heard from Rep. McDonald, non-profits, faith communities, community centers, and others about a provision in the federal tax law that taxes nonprofit employee transportation fringe benefits. This will impose taxes on non-profits that they previously did not pay. In addition to new taxes, it would impose new administrative burdens on the non-profit sector. It is an unfair result of the federal tax law that Minnesota should not make part of its tax code.

This bill includes a provision restricting the ability of local units of government to impose taxes and fees on food and food containers. As I made clear last year, I am concerned about state legislation that pre-empts the decisions of local governments.

There are a number of tax provisions that I supported that are not included in the bill including:

- the riparian buffer credit paid for from the general fund;
- the harvest credit that will provide an incentive to harvest more timber on private lands;
- the Mille Lacs property tax abatement to help small business owners impacted by a temporary downturn;
- the Upper Harbor TIF provisions in Minneapolis, and
- the Duluth Local Sales Tax

Missed opportunity to compromise

Despite all of these concerns, I still believed that we could have reached an agreement on this vitally important issue for Minnesotans. In an effort to find common ground, I proposed a middle-path approach on May 19th that incorporated elements of my proposal along with the legislature's largest tax priorities. The Legislature never responded to this offer. You did not come back with an alternative proposal. You did not even explain what you objected to in this compromise.

I am vetoing this bill because of its misguided priorities that give tax cuts to corporations and the wealthy over the education of our children.

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 Nelson, Chief Senate Author
Representative Melissa Hortman, House Minority Leader
Representative Loon, Chief House Author
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