MINNESOTA • REVENUE

Understanding Recent Changes in Homestead Benefits

For Property Tax Purposes

What Changed?

The 2011 Legislature repealed the **Homestead Market Value Credit**, (the homestead credit), and replaced it with a new **Homestead Market Value Exclusion**. The last year of the credit is for property taxes paid in 2011 and the exclusion begins for property taxes payable in 2012.

What is a credit?		What is an exclusion?
A **credit** is a reduction in the amount of taxes due.	⇨	An **exclusion** is a reduction in the amount of value subject to tax.

The old law with the credit was as simple as: **X – Y = Z**

If your initial tax was **X**, and your credit was **Y**, then the tax you had to pay was **Z**.

Under the new law, an exclusion changes the initial tax amount (**X**), and with the credit gone, the new initial tax becomes the final tax (**X = Z**).

HOW DO HOMESTEAD BENEFITS CHANGE?

Under the old law, the credit itself equaled the homestead benefit, and its calculation **depended only on the value of the homestead**. Because the credit was subtracted from the initial tax amount, the credit **affected each taxpayer independently**.

Under the new law, the exclusion is still calculated using the value of the homestead, but the tax benefit **depends on a variety of factors other than homestead value**. Because the exclusion is a reduction in the value subject to tax, it also **affects tax rates and the taxes of all properties**.

WHY IS THIS CHANGE COMMONLY RESULTING IN TAX INCREASES?

There are four reasons why the change commonly results in increases:

1) **State money is no longer reducing total taxes.** For 2012, the state was projected to pay approximately $260 million of local taxes through the credit program. With the change, there will be no state paid credit and the entire local property tax levy will be paid by taxpayers.
2) **The reduction in taxable value increases tax rates.** With the total taxable value being reduced by the exclusion, raising the same total levy as the prior year requires a higher rate.
3) **The reduction in taxable value shifts the relative burdens of who pays.** With homestead values reduced, other property types (and homes with higher values) pay a larger share of the tax.
4) **The exclusion provides less benefit in low tax rate areas than the credit.** The computation of the exclusion and credit amounts are roughly comparable where the tax rate is close to the state average, but in lower tax rate areas the excluded value provides less benefit. High rate areas may see greater benefit.

COMPUTATION OF CREDIT AND EXCLUSION AMOUNTS

Even though the tax benefits of the credit and the exclusion are not equal, the calculation of the exclusion amount is similar to the calculation of the former credit. Both reach their maximum at $76,000 of market value ($304 for the credit; $30,400 for the exclusion). Both reduce to $0 at about $414,000 of market value.

Credit = 0.4% of the first $76,000, minus 0.09% of the value over $76,000.

Exclusion = 40% of the first $76,000, minus 9% of the value over $76,000.

Example: A house valued at $116,000.

Credit = (0.4% x $76,000) – ($40,000 x 0.09%)
= $304 – $36
= $268

Exclusion = (40% x $76,000) – ($40,000 x 9%)
= $30,400 – $3,600
= $26,800

WANT MORE DETAILS? CONSIDER THIS THEORETICAL ILLUSTRATION

Similarly computed amounts do not yield equal benefits:

AVERAGE TAX RATE ILLUSTRATION

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

LOW TAX RATE ILLUSTRATION

Tax Rate	63.486%	66.552%
Gross Tax	$736	$594
Credit	**$268**	$0
Net Tax	$468	$594

NOTE: This illustration does not reflect an actual location.

Let's say you live in a house valued at $116,000.

Under the old law the full value was taxed, but the new exclusion lowers the taxable value.

Different classes of property are taxed at different levels. The first $500,000 of homestead value has a rate of 1%. (Higher value has a rate of 1.25%.)

"Net tax capacity" is a term describing the taxable value after class rates are applied. Again, this is lower under the new law due to the exclusion.

Tax rates increase because the exclusion shrinks the taxable value. This illustration shows statewide average rates before and after the change.

The gross tax under the old law was higher because there was no exclusion, but the credit reduced the net tax. Under the new law the gross and net are the same. Here the increase is modest, but…

Tax rates affect the relative strength of the exclusion because multiplying excluded value by a low rate is less beneficial than multiplying it by a high rate. So, under a "low tax rate" example, the increase in tax is more extreme.

WHAT ELSE AFFECTS MY TAXES (IN ADDITION TO THE HOMESTEAD BENEFIT)?

Local levy decisions, including the effects of changes in state aid and local budget priorities.

Market forces can affect property taxes in two ways:

- The **value of your property** may increase or decrease.
- The **value of other properties** may increase or decrease and change the share that your property is of the total tax base, whether your property's value changed or not.

Various other changes (the **classification** or your property, eligibility for **other benefits**, and miscellaneous **law changes**) may also affect property taxes.