Fiscal Analysis Department
Minnesota House of Representatives

# AN OVERVIEW OF GOVERNOR TIM PAWLENTY'S FY 2006-07 BIENNIAL BUDGET RECOMMENDATIONS

**Money Matters 05.02**
**Revised March 2005**
*(Sections dated March 2005 include supplemental budget recommendations)*

***This paper provides an overall description and detail of Governor Tim Pawlenty's FY 2006-07 biennial budget recommendations. Part one is the summary section. Part two provides details organized according to the jurisdictions of the House of Representatives' fiscal committees and divisions.***



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# The Overall Budget Picture

The February 2005 forecast projects that general fund expenditures would exceed revenues by $466 million for the FY 2006-07 biennium. That forecast projects revenues of $29.7 billion and expenditures of $30.2 billion. That forecast also includes reserves of slightly over $1 billion. The February forecast for FY 2006-07 was a $234 million positive change compared to the $700 million deficit projected in the November 2004 forecast.

The Governor's recommendations would result in general fund expenditures for FY 2006-07 of $29.8 billion, $364 million or 1.2 percent lower than the projected expenditure level in the February 2005 forecast. However, the Governor's recommendation would result in FY 2006-07 general fund expenditures being $1.62 billion or 5.7 percent higher than expenditures in FY 2004-05.

General Fund revenues in FY 2006-07 in the Governor's recommendations would also be $29.8 billion, $188 million or 0.6 percent higher than the projected FY 2006-07 revenues in the February 2005 forecast. The Governor's recommendations result in revenues being $1.1 billion or 3.7 percent higher than in FY 2004-05. The Governor recommends no changes in the current budget reserve or the cash flow account, however, the Governor does recommend placing $75 million in a new federal transition reserve account.

Table 1 summarizes the general fund resources available and expenditure amounts for the current biennium, next biennium and the planning estimates for the FY 2008-09 biennium assuming the Governor's recommendations for FY 2006-07 are enacted. The rows labeled "Gov" show change in the Governor's recommendations from the base level.

**General Fund: Fiscal Years 2004-09**
**Governor's Recommendations, Change from Forecast**
Dollars in millions

| | FY 2004-05 | FY 2006-07 | Dollar Change | Percent Change | FY 2008-09 | Dollar Change | Percent Change |
|---|---|---|---|---|---|---|---|
| **Balance Forward** | **$369** | **$1,003** | | | **$1,089** | | |
| Revenues (Base) | $28,829 | $29,711 | | | $32,093 | | |
| Revenue Changes (Gov) | | $188 | | | $38 | | |
| **Current Revenues** | **$28,829** | **$29,899** | **$1,070** | **3.7%** | **$32,131** | **$2,232** | **7.5%** |
| **Total Resources Available** | **$29,198** | **$30,902** | | | **$33,219** | | |
| Expenditures & Transfers (Base) | $28,195 | $30,177 | | | $31,389 | | |
| Expenditures Change (Gov) | | ($364) | | | ($63) | | |
| **Total Expenditures** | **$28,195** | **$29,814** | **$1,619** | **5.7%** | **$31,326** | **$1,512** | **5.1%** |
| Balance Before Reserves | $1,003 | $1,089 | | | $1,894 | | |
| Reserves | $1,003 | $1,003 | | | $1,003 | | |
| Reserve Change (Gov) | | $75 | | | $75 | | |
| **Balance After Reserves** | **($0)** | **$11** | | | **$816** | | |

To look at the bigger budget picture, projected expenditures in all operating funds for FY 2006-07 in the February forecast were $49.0 billion. The Governor's recommendations for FY 2006-07 would set the total operating budget expenditures at approximately $49.1 billion, $125 million higher than in the February 2005 forecast. In the Governor's recommendations for FY 2006-07, the general fund spending of $29.814 billion is 60.7 percent of the total all funds spending.

Revenues in all funds for FY 2006-076 are $48.6 billion in the February forecast, in the Governor's recommendations those revenues are $49.2 billion.

Table 2 summarizes the all funds numbers.

**All Funds: Fiscal Years 2006-07**
**Governor's Recommendations, Change from Forecast**
Dollars in millions

| | FY 2004-05 | FY 2006-07 | Dollar Change Biennium | % Change Biennium |
|---|---|---|---|---|
| Revenues (Base) | $45,628 | $48,700 | | |
| Revenue Changes (Gov Est.) | | $583 | | |
| **Current Revenues** | **$45,628** | **$49,283** | **$3,655** | **8.0%** |
| Expenditures & Transfers (Base) | $46,292 | $49,011 | | |
| Expenditures Change (Gov Est) | | $125 | | |
| **Total Expenditures** | **$46,292** | **$49,136** | **$2,844** | **6.1%** |

## General Fund Spending Grows in FY 2006 and 2007

Table 3 (on the next page) illustrates a fiscal year by fiscal year comparison of general fund revenues and expenditures in the Governor's proposed budget for FY 2006-07 using the same format as Table 1. Under the Governor's proposal, FY 2006 expenditures would increase $111 million or 0.8 percent from the FY 2005 expenditure level and in FY 2007 expenditures would increase by $402 million or 2.7 percent over FY 2006.

**General Fund by Fiscal Year: FY 2004-07**
**Governor's Recommendations, Change from Forecast**
*(Dollars in millions)*

| | Actual FY 2004 | Gov's Rec FY 2005 | Annual Percent Change | Gov's Rec FY 2006 | Percent Change | Gov's Rec FY 2007 | Annual Percent Change |
|---|---|---|---|---|---|---|---|
| **Balance Forward** | **$369** | **$1,268** | | **$1,003** | | **$1,130** | |
| Revenues (Base) | $14,499 | $14,330 | | $14,586 | | $15,125 | |
| Revenue Changes (Gov) | | | | $247 | | -$59 | |
| Current Revenues | $14,499 | $14,330 | -1.2% | $14,833 | 3.5% | $15,066 | 1.6% |
| **Total Resources Available** | **$14,868** | **$15,598** | | **$15,836** | | **$16,197** | |
| Expenditures & Transfers (Base) | $13,600 | $14,595 | | $14,950 | | $15,227 | |
| Expenditures Change (Gov) | | | | -$244 | | -$119 | |
| **Total Expenditures** | **$13,600** | **$14,595** | **7.3%** | **$14,706** | **0.8%** | **$15,108** | **2.7%** |
| **Balance Before Reserves** | **$1,268** | **$1,003** | | **$1,130** | | **$1,089** | |
| Reserves | $404 | $1,003 | | $1,003 | | $1,003 | |
| Reserve Change (Gov) | | | | $75 | | $75 | |
| **Balance After Reserves** | **$865** | **$0** | | **$52** | | **$11** | |

## Forecast Includes Already Enacted Changes in FY 2005

The February forecast builds in about $31 million of already enacted expenditure changes in FY 2005 to deal with deficiencies in the current biennium (2005 Laws, Chapter 2). These include $7.2 million for a deficiency at the Board of Public Defense, almost $1 million to the Department of Public Safety for matching federal flood relief spending and for the gang strike force, $4.1 million for the Department of Corrections to cover costs associated with a higher than expected prison population, $13.4 million to the Department of Human Services for costs associated with housing more sex offenders, and $4.7 million to the Department of Administration for costs associated with moving the Departments of Health and Agriculture into new facilities. Many of these items were discussed but not resolved in the 2004 legislative session.

These costs were funded through the sale of the current Department of Health building and by appropriating $24.7 million from the budget reserve. The $24.7 million appropriated from the budget reserve was restored in the February forecast from a balance projected to be available at the end of FY 2005. The chart in table 4 (next page) shows the funding changes already enacted for FY 2005.

| 2005 Deficiency Bill 2005 Laws, Chapter 2 (dollars in thousands) | Total By Agency |
|---|---|
| **Appropriations** | |
| Judicial Standards Board | $199 |
| Public Defense Board | $7,681 |
| Public Safety | $986 |
| Corrections | $4,070 |
| Human Services | $13,394 |
| Veterans Affairs | $39 |
| Administration | $4,705 |
| **Total Appropriations** | **$31,074** |
| | |
| **Revenues** | |
| Human Services (fees) | $1,609 |
| Administration (Health bldg sale) | $4,853 |
| Budget Reserve | $24,700 |
| **Total Revenues** | **$31,162** |
| | |
| **Net Cost of FY 2005 Changes** | **-$88** |

## For Some Committees, FY 2006-07 Expenditures Are Above FY 2004-05 Levels

Tables 5 and 6 (next page) show changes in expenditures in the Governor's recommendations by committee. Expenditures increase substantially in the Debt Service area. The Debt Service increase is due to no major bonding bill being passed in the 2004 session and the Governor's recommendation of passing a major bill in the 2005 session. Both the House and Senate have already passed bonding bills (but the differences in those bills have not yet been reconciled by a conference committee) that would require debt service amounts at least as high as recommended by the Governor. The base level Debt Service estimates assume a major bill again in the 2006 session. Changes in the Health area and in the Agriculture, Environment and Natural Resources area are complicated by transfers of expenditures and revenues between the general fund and other funds. Refer to the summaries of those committee areas for more information.

**General Fund Expenditures - By Committee FY 2006-07**
(all dollars in thousands)

| | Feb. 05 Frcst FY 2004-05 | Base FY 2006-07 | Governor's Recs FY 2006-07 | % Change Gov. FY 2006-07 vs. FY 2004-05 | % Change Gov. vs. Base FY 2006-07 |
|---|---|---|---|---|---|
| Education | $12,044,897 | $12,012,842 | $12,404,686 | 3.0% | 3.3% |
| Higher Education | $2,559,102 | $2,752,758 | $2,773,918 | 8.4% | 0.8% |
| Taxes and Tax Aids | $2,806,775 | $2,961,484 | $2,887,829 | 2.9% | -2.5% |
| Health | $6,399,778 | $7,623,256 | $6,989,447 | 9.2% | -8.3% |
| Jobs & Economic Opportunity | $1,195,906 | $1,329,087 | $1,176,498 | -1.6% | -11.5% |
| Agriculture, Environment & Natural Resources | $405,176 | $416,193 | $369,756 | -8.7% | -11.2% |
| Public Safety | $1,449,676 | $1,586,889 | $1,666,682 | 15.0% | 5.0% |
| Transportation | $158,721 | $162,735 | $159,187 | 0.3% | -2.2% |
| State Government | $584,802 | $561,426 | $556,037 | -4.9% | -1.0% |
| Debt Service | $589,052 | $716,562 | $770,519 | 30.8% | 7.5% |
| Capital Projects | $0 | $0 | $5,082 | | |
| Dedicated Expenditures | $62,262 | $74,065 | $74,065 | 19.0% | 0.0% |
| Other | -$61,000 | -$20,000 | -$20,000 | -67.2% | 0.0% |
| **Total** | **$28,195,147** | **$30,177,297** | **$29,813,706** | **5.7%** | **-1.2%** |

*Note that certain DHS expenditures are now in the Jobs & Economic Opportunity Committee*

**General Fund Expenditures - By Committee FY 2008-09**
(all dollars in thousands)

| | Base FY 2008-09 | Governor's Recs FY 2008-09 | Percentage Change Gov. vs. Base FY 2008-09 |
|---|---|---|---|
| Education | $11,875,042 | $12,577,621 | 5.9% |
| Higher Education | $2,650,984 | $2,771,008 | 4.5% |
| Taxes and Tax Aids | $3,019,648 | $2,937,730 | -2.7% |
| Health | $8,874,084 | $7,954,907 | -10.4% |
| Jobs & Economic Development | $1,389,843 | $1,324,109 | -4.7% |
| Agriculture, Environment & Natural Res | $417,028 | $366,503 | -12.1% |
| Public Safety | $1,630,421 | $1,723,408 | 5.7% |
| Transportation | $178,990 | $175,442 | -2.0% |
| State Government | $560,513 | $567,693 | 1.3% |
| Debt Service | $739,187 | $874,020 | 18.2% |
| Dedicated Expenditures | $73,397 | $74,065 | 0.9% |
| Other | -$20,000 | -$20,000 | 0.0% |
| **Total** | **$31,389,137** | **$31,326,506** | **-0.2%** |

## Governor Recommends Revenue Increases

The Governor's budget recommendations increase net revenues to the general fund by $188.0 million in FY 2006-07. Table 7 illustrates these revenue changes on a committee basis. The single largest item in the revenue changes is $200 million of licensing revenue from gaming sources. Again, the revenue numbers in the Health area and Agriculture, Environment and Natural Resources area are complicated by transfers of expenditures and revenues between the general fund and other funds. The other revenue items are highlighted in the summary for each committee area.

**General Fund Revenue Changes - By Committee**
Dollars in thousands
(positive number indicates positive effect on general fund)

| | **Gov's Rec FY 2006-07** | **Gov's Rec FY 2008-09** |
|---|---|---|
| Education | $0 | $0 |
| Higher Education | $0 | $0 |
| Taxes - Tax Changes | $158,561 | $154,219 |
| Gaming Revenue | $200,000 | $228,000 |
| Health | -$268,624 | -$239,677 |
| Jobs & Economic Development | $32,840 | $2,136 |
| Agriculture, Environment & Natural Res | -$4,959 | -$6,008 |
| Ag, Envrt & Natural Res - Tax Revenue | -$24,613 | -$25,822 |
| Public Safety | $11,400 | $13,000 |
| Transportation | $12,368 | $12,368 |
| Transportation - Tax Revenue | $0 | -$184,230 |
| State Government | $71,076 | $83,600 |
| **Total** | **$188,049** | **$37,586** |

## Price of Government Would Increase by One Tenth of One Percent

The Governor and Legislature are required by law to adopt recommendations on the percent of personal income in Minnesota represented by the revenue projected to be raised by state and local governments. Under current law, revenue to be raised by state and local governments represents 15.7 percent of personal income for the FY 2006-07 biennium. The Governor's recommendation would increase revenue as a percent of personal income to 15.9 percent. The revenue raised by state and local governments as a percent of personal income for the current biennium (FY 2004-05) is 15.9 percent.

Table 8 (next page) show price of government information for recent years and the effects of the Governor's proposals in FY 2006-07 and FY 2008-09.

| **Price of Government**<br>(Dollars in Millions)<br>Data is from the Feb. 2005 forecast<br>Biennial basis | | | | | | |
|---|---|---|---|---|---|---|
| | **FY 1998-99** | **FY 2000-01** | **FY 2002-03** | **FY 2004-05** | **FY 2006-07** | **FY 2008-09** |
| State own source revenues: | $26,146 | $29,582 | $31,426 | $35,247 | $38,049 | $40,605 |
| Local non-school revenues: | $13,227 | $14,443 | $15,813 | $17,460 | $19,493 | $21,160 |
| Local school district revenues: | $5,282 | $4,900 | $4,235 | $3,889 | $4,484 | $5,156 |
| Total revenues: | $44,655 | $48,925 | $51,474 | $56,596 | $62,025 | $66,921 |
| Minnesota personal income: | $267,941 | $304,685 | $329,470 | $354,851 | $394,289 | $433,682 |
| State and local revenues as a percent of personal income: | 16.7% | 16.1% | 15.6% | 15.9% | 15.7% | 15.4% |
| Governor's Recommendation March 2005 | | | | | 15.9% | 15.6% |

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# Agriculture, Environment and Natural Resources Finance

The Agriculture, Environment and Natural Resource budget provides funding for the management, protection and enhancement of the natural resources of the state. Agencies funding include the Pollution Control Agency, the Department of Natural Resources, the Minnesota Conservation Corps, the Metropolitan Council Parks, the Office of Environmental Assistance, the Board of Soil and Water Resources, the MN Zoo, the Agriculture Department, the Animal Health Board, the Agriculture Utilization Research Institute, and the Science Museum of Minnesota. The Governor recommends general fund appropriations of $369.336 million dollars for FY 2006-07. (Revised March 15, 2005 to include the Governor's supplemental recommendations.)

**Agriculture, Environment and Natural Resources Finance**
**Total General Fund Spending**
(all dollars in thousands)

| **Agency / Program** | **Forecast FY 2004-05** | **FY 2006-07 Base** | **FY 2006-07 Governor's Recs** | **% Change Gov. 06-07 vs. FY 04-05** | **% Change Gov. vs. Base FY 06-07** |
|---|---|---|---|---|---|
| Pollution Control Agency | 29,643 | 29,430 | 23,528 | -21% | -20% |
| Office of Environmental Assistance | 23,439 | 23,520 | 0 | -100% | -100% |
| Zoological Garden | 12,782 | 13,114 | 13,114 | 3% | 0% |
| Natural Resources, Dept | 181,144 | 165,276 | 149,522 | -17% | -10% |
| Natural Resources, Dept(OPENS) | 34,837 | 64,840 | 59,548 | 71% | -8% |
| Water & Soil Resources Bd | 30,944 | 30,862 | 30,052 | -3% | -3% |
| Metropolitan Council Parks | | 6,600 | 6,600 | | 0% |
| MN Conservation Corps | 700 | 700 | 0 | -100% | -100% |
| Science Museum of MN | 1,500 | 1,500 | 1,500 | 0% | 0% |
| Agriculture, Dept of | 81,496 | 71,545 | 76,772 | -6% | 7% |
| Animal Health Board | 5,522 | 5,606 | 5,920 | 7% | 6% |
| Agriculture Utilization Research Instit. | 3,174 | 3,200 | 3,200 | 1% | 0% |
| **Total Expenditures:** | **405,181** | **416,193** | **369,756** | **-9%** | **-11%** |

## Pollution Control Agency (PCA)

The Governor recommends that the PCA and the Office of Environmental Assistance be merged into a new agency proposed to be called the Department of Environmental Protection. The Governor recommends a total budget of $262.7 million, of which $23.5 million is general fund dollars for this new agency. This is a recommended general fund reduction of $29.4 million dollars from the two agencies current base. Changes recommended by the Governor to the agency include the following:

- The creation of a new agency called the Department of Environmental Protection that would combine the current Pollution Control Agency and the Office of Environmental Assistance.
- Changing the allocation of the solid waste management tax receipts deposit, sending seventy percent of the receipts to the Environmental Fund. Currently 50 percent of the receipts are deposited in the Environmental Fund and 50 percent are deposited in the General Fund. This will result in an increase of revenue to the Environmental Fund of $24.6 million.
- An increase in each year of $11.7 million of Environmental Fund to the Water program is proposed for the water protection activities.
- An annual decrease in Remediation Fund appropriations to the Land programs of $11.7 million. This decrease will result in five Superfund site and 14 closed landfill program sites cleanup being postponed.
- A general fund decrease in each year of $2.95 million is proposed; $2.55 from the Waters programs and $400 thousands from Administrative Support.
- An increase in both revenue through increased fee levels, and the appropriation for Air program activities of $532 thousand in FY 2006 and $839 thousand in FY 2007.

## Office of Environmental Assistance (OEA)

The Governor recommends that the OEA be merged, along with the PCA into a new agency proposed to be called the Department of Environmental Protection. In addition to the merger the Governor recommends that:

- The activities of the OEA are to be funded through fees and taxes rather than general fund where possible. This is accomplished through an annual reduction of $ll.76 million of general fund appropriations and an increase of $11.76 million of appropriations from the Environmental Fund.
- All other revenues and appropriations currently in the OEA base would be transferred to the newly proposed agency.

## Minnesota Zoological Garden (MZG)

The Governor recommends a total budget of $34.261 million, of which $13.114 is from the General Fund. This is a recommended general fund appropriation equal to the base amount forecast for the Zoo.

The Governor also recommends appropriation of $124,000 per year to the Zoo from the Natural Resources Fund, lottery in lieu dollars.

## Department of Natural Resources(DNR)

The Governor recommends a total Department of Natural Resources budget of $636.254 million, of which $209 million is general fund dollars. This is a recommended general fund decrease of $21 million from the agency forecasted base. Some of the changes recommended by the Governor to the agency include the following items.

General Fund Changes:

- A reduction of $6.3 million from agency direct appropriation base budget amounts. This reduction is made from general cuts throughout the agency. The reductions are proposed to be made without loss of current activity due to increased efficiency and program accountability.
- Reduction of $3 million in the open appropriation for payment in lieu of tax payments(PILT) made to local units of government. This reduction would be achieved by changing to the provision of the law that allows for inflationary increases related to the increase in the value of the land.
- A reduction of $2.3 million in the appropriation to the Forestry division. This saving will be achieved due to a reduction in debt service payments on previously purchased airplanes.
- The Governor proposes to increase the fee on permits required for the use of water by once through cooling systems, industry and agriculture. The increased fees would result in new revenue of $261,000 and per year.
- The Governor recommends a surcharge be imposed in the amount of $20 dollars per million gallons of water used by local units of government to supply summer water demands. This would result in increased revenue of $660,000 and the governor proposes appropriation of these funds to be used for water planning and technical assistance.
- The Governor recommends that commissioner of DNR be given authority to issue civil citations for violations of DNR water resource program regulations.

Other funds changes:

- An increase of $250,000 per year from the Heritage Enhancement account to the Forestry division for the DNR's ecological classification system. This increase is funded through increased estimates of revenue to the account.

- An increase of $75,000 per year from the Heritage Enhancement account to the division of Fish and Wildlife to manage the gray wolf population in Minnesota.
- An increase in the appropriation from the Lottery in-Lieu of Sales Tax funds of $2.8 million to the Trails and Waterways division. These funds would be used to increase maintenance on trials and waterways.
- An increase of $614,000 from the Lottery in Lieu of Sales Tax funds to the division of Parks for increased expenditures on camping and other services.
- An increase of $6.3 million to various divisions in the DNR from the Game and Fish Fund to cover the increased costs of the current activities.
- A net increase in appropriations from the Off-Highway Vehicle accounts of $200,000. There is a decrease of $100,000 in each year from the accounts to Trails and Waterways and an increase of $200 in each year to the division of Enforcement. The increase in Enforcement funding is to be used for the OHV Safety and Conservation Grant Program.
- The Governor proposes that a total of $21.9 million from the General Fund, the Natural Resources Fund, and the Game and Fish Fund be transferred within the agency from the Administrative Support division to the other divisions. These funds are used for certain administrative service and would be redirected to operations divisions, who would then be billed for the services.
- An increase in each year of $925,000 from the Heritage Enhancement Account for additional funding of the prairie wetland restoration and monitoring.
- An increase of $650,000 in each year from the Water Recreation Account for increased public water access facility management.
- An increase of $204,000 from the Water Recreation Account for invasive species and aquatic plant management activities.
- An additional $150,000 per year from the Water Recreation Account to the division of Fish and Wildlife.
- An increase from the Natural Resources Fund of $200,000 for the non-game wildlife program.
- An increase from the Game and Fish Fund of $128,000 to increase technical assistance for stream restoration projects.
- An increase from the Game and Fish Fund of $170,000 for expansion of the Comprehensive Lake Management program.
- The Governor recommends that critical habitat match (CHM) license plates be made available for recreational vehicles. This is expected to increase revenue and proposes a corresponding appropriation of $222,000 for the RIM Fund to acquire and improve critical habitat.
- An increase of $150,000 from the Game and Fish Fund to the license center to fund the vendor transaction costs for free licenses issued.

- An increase from the Game and Fish Fund of $200,000 to increase management of the Upper Red lake fishery.
- An increase of $400,000 from the Game and Fish Fund to expand the Shoreland Habitat Management program.
- The governor recommends a new special management species (fish) application and tagging authority be initiated that would allow for revenues to be collected and appropriations be made for special species management. The first species proposed to be tagged is the lake sturgeon. A five dollar tag would be required to be purchased by anglers. The appropriation increase would be $53,000.
- A new appropriation from the Game and Fish Fund of $625,000 for establishing an electronic statewide registration of the deer harvest.
- The governor recommends that seven dedicated accounts within the Game and Fish Fund be changed to statutory appropriations. They are currently direct appropriations. The result of this is increased access to the funds by the DNR and an estimated $3 million increase in appropriations.
- The creation of an electronic burning permit system is proposed. Permits would be issued over the internet for a five dollar fee. The fee revenue and increased appropriation would be $160,000.
- The Governor recommends increasing the fee for special fuelwood permits from five dollars to $25. This would result in $6,000 of new revenue to several funds.
- The Governor recommends adding a 2.5 cent surcharge to the price of each tree seedling sold by the DNR. This will result in increased revenue of $250,000 per year. The proposal recommends appropriating the funds to the DNR for forestry education and technical assistance programs.
- The Governor recommends the certified forest management costs on Trust Fund lands be returned to the forest management Investment Account rather than to the General Fund. These costs are $3.5 million per year.
- An increased appropriation of $50,000 per year from the School Trust Fund to the Minerals division to complete an aggregate inventory on School Trust Lands.
- The Governor recommends an annual decrease of $1.5 million in the appropriation from the general fund to the Minerals division and a corresponding increase of $1.5 million in appropriations from the funds for the lands managed.
- An appropriation of $420,000 per year to fund minerals program enhancements.
- A new appropriation of $600,000 to identify ways to increase income generation from improved management of Trust lands.
- A $20,000 increase in an appropriation to cover the costs of granting road easements across state lands. This is paid for by a new application fee of $2,000 for each request for an easement.

- An appropriation of $1 million for a grant program for the improvement of water resources in vicinity of tax forfeited lands sold by the DNR.
- The governor recommends that the DNR be given the authority to waive or reduce state park entrance fees in order to vary the fee based on marketing conditions. There is also a request to change the current direct appropriation of park funding to a statutory appropriation.
- A one time appropriation of $50,000 for a study of the amount of gasoline used by all terrain vehicles. This information is used to determine the amount of gas tax funding transferred to the Natural Resources Fund.
- The cost of cross country ski passes is proposed to be increased from $3 to $5 dollars a day, or $10 to $15 for an annual pass. Increased revenue of $140,000 a year would be appropriated to the DNR for increased maintenance and grooming of ski trails.
- A recommendation to shift fishing pier maintenance current funding of $154,000 a year from the Natural Resources to the Game and Fish Fund.
- An increase of $502,000 from the Game and Fish Fund of water access sites. This is proposed due to increased funding from the Wallop-Breaux funds received from the federal government.

## Board of Soil and Water Resources (BWSR)

The Governor recommends a total BWSR budget of $32.98 million, of that amount $30.1 million is from the General Fund. This is a recommended decrease of $810,000 from the agency base forecast. Included in the recommendation are:

- A reduction of $300,000 per year from the agency administrative operations.
- A reduction of $105,000 per year from the Area II joint powers organization funding. The governor recommends program responsibilities be assumed by the DNR.

## Science Museum of Minnesota

The Governor's budget recommends an appropriation of $1.5 million to the Science Museum. This is the base level.

## Legislative Commission on Minnesota Resources (LCMR)

The Governor does not make recommendations on the funding that is statutorily the responsibility of the LCMR. The LCMR will be presenting its recommendation on the funding to the legislature.

## Department of Agriculture (MDA)

The Governor recommends a total Department of Agriculture Budget of $137 million, of which $76.4 million is General Fund Dollars. Of this $76.4 million, $34 million is for the Ethanol Producer Payments program. Changes recommended to the base budget by the Governor to the MDA include:

- An increase of $4.749 million dollars from the General Fund for the increase lease costs related to the relocation of the agency to a new building.
- The Governor recommends increases to six agronomy programs fee structures. The affected fees are pesticide, fertilizer inspection, manure lab certification, feed free sale certificates, feed tonnage fee exemptions and commercial fee late fees. These changes will result in increased revenues and expenditures of $886,000 in the Agriculture Fund.
- An increase in nursery and phytosanitary fees resulting in $152,000 per year of new revenue and expenditures from the Agriculture Fund.
- An increase in the fees charged to apiarists resulting in new revenue and expenditures of $29,000 a year from the General Fund.
- An increase of $35,000 per year in the appropriation from the Remediation Fund for the Agricultural Voluntary Investigation and Cleanup program costs.
- An increase of $50,000 per year in the appropriation from Agricultural Chemical Response and Reimbursement Account for program administrative costs.
- An increase in the fee charged is recommended to the grain buyer and storage program. The increase would result in increased revenue and appropriations of $55,000 per year from the Agricultural Fund.
- The Governor recommends establishment of a new application fee for the Agricultural Best Management Practices Program. The fee will be $50. The new fee results in $20,000 of new revenue and appropriations from the Agriculture Fund.
- An increase of $100,000 is recommended in each year for technical assistance to local governments in siting livestock operations. (March supplemental recommendation)
- A recommendation for a one time appropriation of $220,000 for contracts with the University of Minnesota for livestock operation odor control research. (March supplemental recommendation)

## Animal Health Board

The Governor recommends a total Animal Health Board budget of $7.62 million, of which $5.92 million is General Fund money. This recommendation is a general fund increase of $314,000 from base level funding. The increase of $314,000 is to cover the increased lease cost associated with the relocation to a new building.

**Agriculture Utilization Research Institute**

The Governor recommends a total AURI budget of $3.2 million dollars, all of which is General Fund money. This is equal to the General Fund base budget.

*For additional information on Agriculture, Environmental and Natural Resources Finance issues, contact Jim Reinholdz at 651.296.4281 or email: jim.reinholdz@house.mn.*

# Capital Investment

In early January the Governor proposed a capital budget for the 2005 legislative session that included $816 million in new spending. The budget is essentially a re-submission to the legislature of his 2004 capital budget with the addition of one new project and some inflationary adjustments. The finance package would require $61 million from the general fund for the upcoming biennium, $5 million in general fund cash projects and $56 million for additional debt service. The $56 million in debt service also reflects a proposal by the governor to decrease the rate of repayment on maximum effort school loans by local school districts. The request is discussed in more detail in the K-12 education section.

The proposal authorizes $744 million in general fund debt, $30 million in trunk highway bonds for building projects, and requires $37 million in of user financing. A summary of the governor's capital budget can be found on the house fiscal analysis website at http://www.house.leg.state.mn.us/fiscal/files/05bondsum.pdf .

*If you have further questions on Capital Investment issues, please contact John Walz at 296-8236 or e-mail at john.walz@house.mn.*

# Education Finance

For the FY 2006-07 biennium, the Governor recommends $12.4 billion in general fund state aid for K-12 education and early childhood and family education programs. This compares with the November forecast of current law FY 2006-07 education spending of $12.0 billion, for a total increase of $391.8 million, or 3.3 percent over current law. The Governor's FY 2006-07 budget recommendation includes $96.5 million in new property tax recognition shifts. If those shift savings are not included, the Governor's budget increase is $488.3 million or 4.1 percent over current law. For the FY 2008-09 biennium, the Governor's budget recommendations include total sate appropriations of $12.6 billion, an increase of $702.6 million from the November forecast appropriations, or 5.9 percent.

School district property tax levies in the Governor's budget recommendations would increase from current law for each year from FY 2007 to FY 2009. Property taxes for FY 2006 (the pay 2005 property taxes already being levied) increased under current law by $90.5 million from FY 2005, or 7.1 percent, to $1.4 billion. Levies for FY 2007 (payable in 2006) in the Governor's budget recommendations are estimated to increase by $311.1 million, or 22.6 percent, from FY 2006, to $1.7 billion. Compared to current law, the Governor's budget recommendations would increase property taxes for FY 2007 by $138.2 million, or 8.9 percent, for FY 2008 by $203.2 million, or 12.3 percent, and for FY 2009 by $204.5 million, or 11.5 percent.

The following summarizes the Governor's budget initiatives, with the cost expressed as a biennial total, from the general fund unless otherwise noted:

## General Education Program

- $295.3 million in additional state spending to increase the basic formula amount by 2.5 percent per year. In FY 2006, the formula is increased from $4,601 to $4,716. In FY 2007, the way that pupils are counted is changed, which results in an increase in the formula simply to neutralize those changes. As a result, the base formula for FY 2007 (the formula equivalent to the $4,716 in FY 2006) is $5,111. The $5,111 is increased by 2.5 percent for FY 2007, or $128, resulting in a formula of $5,293.

    - Beginning in FY 2007, instead of the current method of counting pupils, where pupils are weighted by grade level and pupil counts are adjusted to reduce the impact of declining enrollment from one year to the next, all pupils will be weighted as 1.0 pupil units (except for kindergarten students, which will be weighted as 0.5 pupils units). In lieu of the additional weighting for secondary students and the formula for reducing the impact of declining enrollment, the governor recommends new declining enrollment revenue of $1,310 times the loss in pupils from one year to the next, and a new secondary pupil revenue of $946 per student in grades 7-12. The new declining enrollment and secondary pupil formulas are cost neutral.

    - The Governor also recommends adjusting all other formulas and equalizing factors to eliminate the fiscal impact of the pupil counting method.

- $85.9 million in aid and $6.3 million in local levy for the QComp Alternative Compensation program (replacing the current $7.4 million appropriation, which is eliminated). This appropriation will provide funding for alternative compensation programs in school districts on a first come, first served basis. The funding will be sufficient to provide funding for approximately half of the state's students. The formula for the revenue is $260 per pupil, with the full amount coming in state aid for FY 2006. In FY 2007 and later, the revenue will be $190 per student in state aid and $70 per student in an equalized levy. QComp revenue will be provided to districts which provide multiple career paths for teachers, instructionally-based accountability, professional compensation, a new 21st century pay schedule for teachers, ongoing applied professional growth and alignment of state staff development plan and set aside funding with their performance pay plans.

- $31.1 million to add a 2.5 percent inflation factor for each year of the biennium to programs which are not tied to the general education formula (Extended Time, Shared Time and Contract Alternative revenues) and other programs which are recommended to be "de-linked" from the basic formula amounts, so that they do not increase automatically with increases in the basic formula (Compensatory, Post Secondary Enrollment Options and Sparsity revenues).

- $4.2 million for Hmong Refugee Compensatory revenue. Compensatory revenue is based on counts of students eligible for free and reduced priced lunches as of October first of the previous fiscal year. A large influx of Hmong Refugees is expected during the current fiscal year, after October first. As a result, districts which experience the increase will not receive revenue for those students until FY 2007, rather than FY 2006. The Governor is recommending that pupils that enroll between October 1, 2004 and March 15, 2005 be counted for FY 2006.

- $986,000 in state aid and $4.7 million in local levy for FY 2006 for transition revenue for school districts that had pre-Kindergarten programs prior to FY 2004. For FY 2007 and later, the revenue will continue as part of the new transition revenue.

- $2.0 million in state aid and $13.9 million in local levy for FY 2007 for a new transition revenue to guarantee school districts general education revenue in FY 2007 that equals what they would have gotten in FY 2007 under the new formulas instituted in FY 2006 plus the amount of levy certified in pay 2005 for levies eliminated in the recommendations for FY 2007 plus $232 per student.

- $100,000 in cost due to lost revenue from the elimination of the January 15th deadline for teacher contract settlements. Under current law, districts are penalized $25 per pupil if they have not settled their teacher contract for the two year period by January 15th of each even-numbered year.

- $3.1 million in savings in FY 2007 from converting Shared Time aid to a reimbursement program. The savings are one-time savings that come as the funding budgeted for FY 2006 is allocated as FY 2007 expenditures.

- $7.4 million in FY 2007 for changing the way that pension contributions by school districts are calculated. In 1997, employer contributions were reduced for school districts, and at the same time, the districts' general education allocation was reduced by the same amount. This pension reduction varies greatly among districts.

- $13.6 million in equalization aid and $38.0 million in net levy impact for FY 2007 for a new discretionary levy for school districts. The levy will include any Training and Experience revenue the district had received prior to FY 2007, and will allow districts to levy for revenue that had been generated through a variety of miscellaneous levies prior to FY 2007 (repealed levies include reemployment insurance, safe schools, judgment, ice arena, swimming pool, lost interest earnings, tree growth, building lease (only the short-term portion) and severance levies). The gross impact is $94.8 million in the new discretionary levy, with $56.8 million in levy savings from elimination of the miscellaneous levies. A portion of the added amount is subject to reverse referendum by voters in the school district.

- $4.4 million in aid savings and $6.8 million in additional levy from the elimination of Training and Experience aid, and replacing it with a new equalized Training and Experience levy.

- $1.4 million in state aid and $34.3 million in additional levy in FY 2007 from increasing the cap on school district operating referendums from 18.6 percent of the basic formula amount to 28 percent of the basic formula amount. With the current formula for FY 2005 of $4,601, the referendum cap is $866. With the Governor's projected basic formula amount and referendum cap increase for FY 2007, prior to the inflationary increase in law, the referendum cap amount would be $1,616. Second tier equalization would continue up to the new cap amount.

- $210,000 in reduced Permanent School Fund allocations to reduce General Fund general education program aid due to changes in how the Department of Natural Resources funds minerals management.

- $1.3 million in general fund general education impact due to increased student attendance from a requirement that students maintain attendance in order to receive their driver's license.

- $96.5 million in savings to the state general fund from additional property tax revenue recognition shift savings from the Governor's recommendation of higher school district property taxes. School districts are required to recognize 48.6 percent of most of their operating levies in the fiscal year in which the levy is certified. To make this early recognition of property tax levies revenue-neutral to districts, their general education aid is reduced by an equivalent amount, resulting in one-time savings to the state general fund.

- There are several formula changes that have no or minimal fiscal impact, but are still important:

- Due to the elimination of the extra pupil weighting for elementary students, there is no extra dedicated funding for class-size reduction. As a result, the Governor recommends eliminating the Learning and Development (class size reduction) revenue reserve.

- The Governor recommends recalculating the Transportation Sparsity funding formula factors for revenue for FY 2007. The factors were initially (in 1995) calculated based on the relationship between transportation costs per student and population density.

- The Governor recommends changing the way that Equity funding is calculated. Currently, districts receive equity funding based on whether they are in the seven county metropolitan area or not, and where they rank in their region in terms of their referendum amount. Districts with no referendum qualify for only the minimum amount of equity revenue ($13 per pupil). In addition, districts in cities of the first class (Minneapolis, St. Paul and Duluth) do not qualify for equity revenue. The new equity formula would rank all districts by their referendum amount, and provide equity revenue on a sliding scale to all districts with operating referendums less than 28 percent of the basic formula amount, with maximum revenue for the lowest districts of $101 per pupil.

## Other General Education Programs

- $896,000 in state aid savings and $327,000 in new levy from changing the way that abatement aid is calculated. Currently, abatement aid is calculated using preceding year levy information. The Governor recommends that abatement aid be calculated using the information for levies for the third preceding year.

- $100,000 for a new property tax levy for districts which form joint education administrative districts. The joint education administrative districts would provide administrative functions for multiple districts, while individual districts would retain control of individual school sites. Levy revenue would be used for approved retirement and severance incentives, and other start-up costs related to the joint district.

- $2.2 million in new property tax levies for districts that have busses manufacture by the Carpenter bus company in their fleet. Districts that have those busses, which have been determined to have potentially defective welds, will be allowed to levy up to $30,000 per bus to mitigate the replacement cost of those busses.

- $1.9 million for inflationary increases in Nonpublic Pupil Aid, Nonpublic Pupil Transportation and Tribal Contract aid. Similar to the changes in the general education program, the Governor recommends "de-linking" these programs so that they do not increase automatically with increases in the basic formula. In addition, the programs would be increased by 2.5 percent per year for inflation, since they are not connected to the increase in the basic formula. In addition, the Governor recommends de-linking the First Grade Preparedness program, but not providing an inflationary increase in that aid.

## Education Excellence

- $11.5 million to create a new "Get Ready, Get Credit" program, and to enhance existing Advanced Placement and International Baccalaureate (AP/IB) funding. The appropriation will allow the following: public schools can participate in the ACT Educational Planning and Assessment System for career planning, assessment, instructional support and evaluation; public school high school students can earn college credit for mastery of college level courses taken in high school, and; teachers will receive a stipend based on the number of students passing AP/IB tests.

- $1.0 million in savings from transferring Best Practices grants to the Department of Education budget, and then reducing the grant amount.

- $3.0 million for an increase in the state's existing online learning program.

- $2.0 million to create 20 model career and technical programs at junior high or middle schools in preparation for a change in the existing Career and Technical Revenue formula for FY 2009 and later.

## Special Education

- $674,000 in savings in Regular Special Education expenditures as a result of fiscal monitoring of the relationship between the Faribault public schools and the Minnesota State Academies for the deaf and blind in Faribault. The initial finding of the fiscal monitoring indicates that mainstreaming contract between the Faribault public schools and the State Academies is not being executed as designed. If, after the findings are finalized, the initial findings are accepted, the Faribault public schools will have its Special Education funding reduced. (The Governor is recommending that the budget for the Minnesota State Academies, a state agency, be increased by an amount equivalent to the lost Faribault public schools revenue to minimize the impact on the Academies.)

- $2.2 million in equalization aid and $17.5 million in levy increases in FY 2007 to allow districts to levy to fund a 4 percent increase in special education funding. The Governor recommends that districts be able to levy an additional 4 percent for FY 2008 and later. The added levy is subject to reverse referendum by voters in the school district.

- $21.9 million to increase the statewide cap on Special Education Excess Cost aid.

- In non-funding related special education recommendations, the Governor is also requesting that all but $2 million of Special Education Excess Cost funding be changed from current year funding to funding based on prior year expenditures, and that referendum revenue be excluded from the definition of general education for the purposes of calculating Special Education Excess Cost aid.

## Facilities and Technology

- $2.6 million in equalization aid and $13.6 million in local levy for FY 2007 to allow districts to levy for deferred maintenance costs. Districts will be eligible to levy for up to $50 per pupil using a sliding scale based on the ratio of the district's average building age to 35 years. This levy will be subject to reverse voter referendum. The added levy is subject to reverse referendum by voters in the school district.

- $9.1 million for school district telecommunications costs. Districts will be eligible for reimbursement of 90 percent of their telecommunications costs that are not reimbursed under the federal E-rate program, and that exceed a fixed threshold. For FY 2006 the threshold is $15 per pupil. For FY 2007 and later, the threshold is $18 per pupil.

- $692,000 in savings and $3.1 million in local levy reduction in FY 2007 from the reduction in the maximum effort school loan tax rate. The methodology for adjusting the maximum effort tax rate due to the 2001 tax classification rate changes did not account for the unique mix of property tax types in school districts with maximum effort school loans. The tax rate reduction recommended by the Governor would more accurately reflect the mix of property types in those districts. In addition to the savings to the general fund and the reduction in local property taxes, the maximum effort school loan fund will see reduced payments from those districts of $793,000, which will ultimately increase general fund costs by that amount to replace those lost payments.

## Libraries

- $1.3 million for the Electronic Library of Minnesota statewide database licensing program to replace federal funds which it has been determined do not qualify to be expended for this purpose.

## Early Childhood and Family Support

- $369,000 in savings from a reduction in School Readiness program funding. The savings is offset by a $369,000 increase in the Department of Education budget to add staff to refocus School Readiness toward preparing 4 and 5 year old children for kindergarten and increasing program oversight and accountability.

- $1.3 million in additional funding for Early Childhood Health and Development Screening. The additional funding will be used to increase reimbursement for screenings for three year olds, helping to ensure early screening.

## Self-Sufficiency and Lifelong Learning

- $252,000 in additional funding for Adult Basic Education due to the reallocation of capped funding. Currently, eight districts have their funding capped under the Adult Basic formula. Capped funds are cancelled back to the general fund. Instead of allowing the funding to cancel, the Governor recommends that the funding be reallocated to other programs, some of which have waiting lists for services.

- $2.0 million for intensive English Instruction for new adult refugees. This appropriation, available for the current biennium only, would allow Adult Basic Education providers to add English a second language instruction to accommodate the large number of refugees entering Minnesota.

## Minnesota Department of Education

- $2.4 million in savings from a cut to the agency's operating budget. This reduction amounts to 5.3 percent of the agency's base budget of $46 million.

- $150,000 in savings though elimination of funding in the agency's operating budget which currently subsidizes all state agency access to the Minnesota State Colleges and Universities Project for Automated Libraries System.

- $2.4 million in one-time funding to develop an interactive computer-based science test for students in grades 5 and 8, and students in high school after completion of biology class.

- $1.9 million to develop and implement a value-added index assessment model for public schools. $300,000 in FY 2006 is for the Department of Education to develop the model, $1.6 million is for implementation of the model in FY 2007.

- $500,000 per year starting in FY 2007 to develop alternative teacher preparation programs leading to increasing the number of licensed teachers in high need areas.

- $500,000 to administer a new corporate income tax credit for businesses which make donations to federal tax-exempt charitable organizations that provide scholarships to students attending K-12 private schools in Minnesota.

- $369,000 for staff costs related to the School Readiness change discussed in the Early Childhood and Family Support section above.

- $20,000 for rulemaking for the Board of School Administrators.

- $125,000 for methamphetamine education materials.

- $25,000 to administer newly created single purpose charter school sponsors.

## Minnesota State Academies for the Deaf and Blind

- As discussed in the Special Education section, preliminary indications from fiscal monitoring of the relationship between the State Academies and the Faribault public schools may result in reduction of special education funding for the Faribault public schools. The Governor is recommending $899,000 in additional funding for the State Academies in order to preserve the current level of special education services provided to their students.

## Perpich Center for Arts Education

- $336,000 in savings due to a 2.6 percent reduction in the agencies operating budget. The Governor recommends that the entire reduction be taken from the Center's Professional Development and Research Group.

## Implications

As is shown in the table below, total revenue increases with the Governor's proposals will be 2.4 percent for FY 2006 and 6.4 percent for 2007. The increase in 2007 is driven in part by a significant (20.7 percent) increase in the expected amount of operating referendum passed by district with the increase in the referendum cap amount.

**Total School District General Fund Revenue (State Aid & Local Levy)**
Revenue per average daily membership

| | Operating Ref. Rev. | Percent Change | Other Revenue | Percent Change | Total Revenue | Percent Change |
|---|---|---|---|---|---|---|
| 2004 | 535 | 47.0% | 7,678 | 0.0% | 8,217 | 2.2% |
| 2005 | 636 | 18.9% | 7,687 | 0.1% | 8,323 | 1.3% |
| 2006 | 671 | 5.5% | 7,915 | 3.0% | 8,586 | 3.2% |
| 2007 | 799 | 19.1% | 8,392 | 6.0% | 9,191 | 7.1% |
| 2008 | 865 | 8.2% | 8,422 | 0.4% | 9,287 | 1.0% |
| 2009 | 960 | 11.0% | 8,438 | 0.2% | 9,397 | 1.2% |

*source: Minnesota Department of Finance*

The Governor's proposal includes a number of changes that are revenue neutral from a state perspective, both in formulas (Equity Revenue and Transportation Sparsity Revenue, for example) and in the way that pupils are counted. When these types of changes are made, even if they are made in a way that is revenue neutral for all districts, because no district is like another, or the average district, these types of changes will always result in shifts in revenue between districts. Two examples are:

- Equity revenue: the Governor recommends recalculating the Equity Revenue formula, which results in reallocation of $5.3 million or 13 percent of Equity revenue to Minneapolis, St. Paul and Duluth school districts, which had not previously qualified for the revenue. Districts without a referendum (42 non-metropolitan districts) see increases over 500 percent in equity revenue, while some metropolitan districts lose half or all of their equity revenue.

- Pupil counting: the Governor recommends changing how pupils will be counted and then adjusting all formulas and equalizing factors by the average change in pupils statewide. The statewide pupil change was a reduction of 16.7 percent. However, the actual change in individual school districts ranges from 20.9 percent reduction to 11.5 percent reduction, with an even broader range of pupil count changes if charter schools are included. As a result, all formulas and equalizing factors are adjusted by 16.7 percent, but the effect to districts varies from 20.9 percent to 11.5 percent.
- Transportation sparsity revenue: the Governor recommends recalculating the factors used in the transportation sparsity formulas. The overall change is a reduction in revenue of 1.0 percent statewide. However, on an individual school district basis, the change in revenue ranges from reductions of 50 percent for some metropolitan schools and 5 to 7 percent for some rural schools to increases of 20 to over 100 percent for some metropolitan area schools.

In addition, in the past when these types of changes have been made, there have also been unforeseen consequences that can have significant negative revenue implications for individual school districts. Ultimately, even though the average increase in general fund revenue over current law for FY 2007 is 6.1 percent, and even with the inclusion of new transition revenue to mitigate the impact of these changes, revenue changes relative to current law vary significantly, from a low of 4.1 percent to a high of 13.0 percent.

In total, the Governor's recommended school district property tax amount increases in FY 2007 by 9.6 percent. Using just the general fund, the Governor's property tax levy amount is 7.0 percent over current law. However, in individual districts, the change varies greatly, from a high of 127.9 percent increase to a low of 48.4 percent decrease. 11 districts have reduced property tax amounts, 155 districts have increases over 10 percent. 83 of those 155 districts will see increases over 15 percent.

*For further information on Education Finance related issues contact Greg Crowe at 296-7165 or [greg.crowe@house.mn](mailto:greg.crowe@house.mn)*

# Health Policy and Finance

The Governor's FY 2006-07 budget recommends a total of $7.0 billion in general fund appropriations for programs administered by agencies in the Health Committee. This amount reflects an increase of $589.7 million, or 9.2 percent, above FY 2004-05 appropriations of $6.4 billion. It also represents a decrease of $634 million, or 8.3 percent below base budget projected spending of $7.623 billion for FY 2006-07. (*Note – part of the Department of Human Services budget dealing with children's programs and economic assistance grants is in the Jobs and Economic Opportunity Committee.*)

While the Governor's budget seeks modest funding increases for agency office space consolidation costs (+$8.4 million) and sex offender referrals and civil commitment services in state operated services (+$10.4 million), the bulk of the Governor's budget proposal creates cost savings. Funding reductions in activities overseen by the Health Committee include 1) major changes in program eligibility (-$76.1 million) for Minnesota's public health care programs, 2) a five percent reduction in hospital payment rates (-$55.5 million), 3) capping caseload growth in certain home and community based waivers (-$52.7 million), and 4) changes in prescription drug purchasing and funding (-$14.2 million).

For the FY 2008-09 biennium (the tails), general fund spending is projected to reach $8.9 billion, reflecting a $965 million (or 13.8 percent) increase above Governor-recommended FY 2006-07 spending levels of $7.0 billion.

**Health**
**Governor's FY 2006-07 General Fund Recommendations**
*(all dollars in thousands)*

| | **November Forecast FY 2004-05** | **Current Law FY 2006-07** | **Governor's Recs FY 2006-07** | **Percentage Change Gov. FY 2006-07 vs. November FY 2004-05** | **Percentage Change Gov. vs. Current Law FY 2006-07** |
|---|---|---|---|---|---|
| Department of Human Services (Health Committee) | $6,205,446 | $7,422,644 | $6,785,312 | 9.4% | -8.6% |
| Department of Health | $122,943 | $129,376 | $132,899 | 8.0% | 2.7% |
| Veterans Homes Board | $59,841 | $60,060 | $60,060 | 0.0% | 0.0% |
| Emergency Medical Services Board | $7,044 | $6,762 | $6,762 | -4.0% | 0.0% |
| Disability Council | $1,112 | $1,000 | $1,000 | -10.1% | 0.0% |
| Ombudsman for Mental Health & Mental Retardation | $2,901 | $2,924 | $2,924 | 0.8% | 0.0% |
| Ombudsman for Families | $491 | $490 | $490 | -0.2% | 0.0% |
| **HEALTH & HUMAN SERVICES TOTAL** | **$6,399,178** | **$7,623,256** | **$6,989,447** | **9.2%** | **-8.3%** |

From the health care access fund, the Governor recommends spending of $1.039 billion, an increase of $438 million or 73.0 percent above FY 2004-05 spending levels of $600.7 million. This change is mostly attributable to two significant proposals: 1) major reductions in eligibility for MinnesotaCare (-$194.5 million), and 2) the shift of funding source for general assistance medical care (GAMC) from the general fund to the health care access fund (+$656.5 million). To fund the higher spending level, the Governor also recommends a transfer of health maintenance organization (HMO) and hospital surcharge revenue ($112.9 million) from the general fund to the health care access fund and a reduction of $158.6 million in the current-law level of transfers from the general fund to the health care access fund.

From the federal Temporary Assistance for Needy Families (TANF) block grant, the Governor proposes spending of $553.6 million, an increase of $125.1 million or 29.2 percent above FY 2004-05 spending levels.

All funds spending for Health and Human Services (including the portion of the Department of Human Services that is in the Jobs and Economic Opportunity Committee), including direct and statutory appropriations, totals $20.1 billion for the FY 2006-07 biennium in the Governor's recommendations. The table below shows the total recommended spending for all funds.

**Health and Human Services**
**Governor's FY 2006-07 All Funds Recommendations**
**(This chart includes the parts of DHS funded in the Jobs & Economic Opportunity Committee)**
*(all dollars in thousands)*

| | November Forecast FY 2004-05 | Current Law FY 2006-07 | Governor's Recs FY 2006-07 | Percentage Change Gov. FY 2006-07 vs. November FY 2004-05 | Percentage Change Gov. vs. Current Law FY 2006-07 |
|---|---|---|---|---|---|
| General Fund | $7,149,878 | $8,781,346 | $8,019,175 | 12.2% | -8.7% |
| State Government Special Revenue | $63,211 | $65,558 | $65,558 | 3.7% | 0.0% |
| Health Care Access Fund | $600,745 | $620,491 | $1,039,369 | 73.0% | 67.5% |
| Special Revenue Fund | $748,107 | $450,774 | $444,308 | -40.6% | -1.4% |
| Federal Funds | $7,850,274 | $8,526,941 | $8,356,518 | 6.4% | -2.0% |
| TANF | $428,505 | $520,584 | $553,556 | 29.2% | 6.3% |
| MERC | $158,038 | $173,210 | $173,210 | 9.6% | 0.0% |
| Child Support Enforcement | $1,419,282 | $1,229,924 | $1,229,924 | -13.3% | 0.0% |
| All Other | $211,889 | $214,476 | $214,476 | 1.2% | 0.0% |
| **HEALTH & HUMAN SERVICES TOTAL** | **$18,629,929** | **$20,583,304** | **$20,096,094** | **7.9%** | **-2.4%** |

## Significant Initiatives

The Governor's FY 2006-07 budget in the Health area contains a total of 16 change items with fiscal impacts for the Department of Human Services and 14 change items with fiscal impacts for the Department of Health. Most of these policy changes are complex in nature, involving multiple actions linked to several budget activities, and sometimes multiple funding sources. The following summary outlines the net fiscal impact of each policy change. Further detail is available in spreadsheet form on the House Fiscal Analysis Department website.

## Department of Human Services

### *Agency Management*

**1. Facilities Consolidation Lease Costs**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Fund Spending | $4.5 million | $4.8 million |
| General Fund Revenue | $1.2 million | $1.3 million |
| HCAF Spending | $1.4 million | $1.4 million |
| HCAF Revenue | $0.6 million | $0.6 million |

These changes would pay the increased rent costs as the DHS consolidates its operations into two buildings, one of them a new facility with lease-purchase costs.

**2. Licensing Requirements**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Fund Spending | $1.2 million | $1.0 million |
| General Fund Revenue | $0.9 million | $0.8 million |
| Special Revenue Fund Spending | $0.2 million | $0.2 million |
| Special Revenue Fund Revenue | $0.2 million | $0.2 million |

This proposal adds staffing for licensing oversight of residential services for children as well as restructuring and adjusting a number of licensing fees.

**3. Fair Hearing Requirements**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Fund Spending | $1.0 million | $0.8 million |
| General Fund Revenue | $0.4 million | $0.3 million |

This proposal would add eight referees and three clerical staff to enable the human services appeals function to meet federal and state requirements for fair hearings for applicants for recipients for human service benefits.

## *Health Care*

**4. Medicare Modernization Act Changes**

| | | |
|---|---|---|
| o General Fund Spending | ($3.0 million) | ($9.9 million) |
| o General Fund Revenue | $0.4 million | $0.7 million |

This proposal includes several program and administrative changes in the medical assistance and prescription drug program associated with the new prescription drug benefit under Medicare Part D.

**5. GAMC Pharmacy Rebates to the Pharmacy Assistance Program**

| | | |
|---|---|---|
| o General Fund Spending (Statutory) | $0.3 million | $2.2 million |
| o General Fund Revenue (Statutory) | $0.3 million | $2.2 million |

The DHS would collect rebates from pharmaceutical manufacturers for prescription drugs distributed in the general assistance medical care program and then use that revenue for a program to help persons without drug coverage to access free or discounted prescription drugs under this proposal.

**6. Pharmaceutical Purchasing**

| | | |
|---|---|---|
| o General Fund Spending | ($8.0 million) | ($ 6.2 million) |

This recommendation includes contracting for specialty pharmaceuticals at lower rates, requiring persons with hemophilia to obtain blood-factor products though certain federally qualified hemophilia treatment centers, aligning payment rates for administering drugs with Medicare rates, reducing pharmacy payment rates for certain prescription medications to average wholesale price minus 14 percent instead of 11.5 percent, and requiring prior authorization for new drugs.

**7. Hospital Rate Reduction of Five Percent**

| | | |
|---|---|---|
| o General Fund Spending | ($16.0 million) | ($35.5 million) |
| o HCAF Spending | ($ 1.3 million) | ($ 2.7 million) |

The Governor recommends a five percent reduction in medical assistance and general assistance medical care fee for service payment rates for inpatient and outpatient hospital services.

**8. Restructure Health Care Eligibility**

| | | |
|---|---|---|
| o General Fund Spending | $49.3 million | $48.7 million |
| o HCAF Spending | ($84.5 million) | ($89.4 million) |
| o HCAF Revenue | $174,000 | $0.0 |

This proposal would reduce MinnesotaCare eligibility for adult parents and caretakers to those with gross income no greater than 190 percent of the federal poverty guidelines, discontinue MinnesotaCare eligibility for adults without children, discontinue GAMC hospital only coverage, and restore the spend-down in GAMC.

**9. Better Manage Health Care Costs**

| | | |
|---|---|---|
| o General Fund Spending | $ 2.3 million | ($0.4 million) |
| o General Fund Revenue | $1.6 million | $1.7 million |
| o HCAF Spending | $3.0 million | $2.0 million |
| o HCAF Revenue | $1.2 million | $0.8 million |

This proposal has a number of components including: better addressing fraud and abuse, increased used of web-based payments, improving the health care enrollment process, complying with federal program integrity requirements, recovering uncompensated transfers of income and assets, recovering from estates assets that are held in irrevocable trusts and annuities, implementing intensive medical care management, and improving cost-effectiveness of coverage.

**10. Refinance Health Care Programs**

| | | |
|---|---|---|
| o General Fund Spending | ($239.0 million) | ($403.4 million) |
| o General Fund Revenue | ($76.0 million) | ($195.3 million) |
| o HCAF Spending | $239.0 million | $403.4 million |
| o HCAF Revenue | $ 74.8 million | $189.7 million |

The Governor recommends moving the general assistance medical care (GAMC) program into the health care access fund from the general fund. Also, revenue from medical assistance surcharges on hospitals and health maintenance organizations would be deposited in the health care access fund rather than the general fund. The proposal would also decrease the amount of transfers from the health care access fund to the general fund currently in law for FY 2006 and FY 2007.

## *Continuing Care*

**11. Nursing Facility Rate Reform**

| | | |
|---|---|---|
| o General Fund | ($ 0.8 million) | ($2.5 million) |

This proposal would revise medical assistance nursing facility rates in FY 2006 so that all facilities would receive a two percent increase over rates in effect on June 30, 2005.

**12. Cap Growth in HCB Waivers**

| | | |
|---|---|---|
| o General Fund Spending | ($13.8 million) | ($38.9 million) |

This funding reduction would be achieved by limiting growth in three home and community based waiver programs: community alternatives for disabled individuals (CADI), traumatic brain injury (TBI), and mental retardation and related conditions (MR/RC).

### Chemical and Mental Health Services

**13. MSOP/Forensic Services**

| | | |
|---|---|---|
| o General Fund Spending | $5.1 million | $6.5 million |
| o General Fund Revenue | $0.5 million | $0.7 million |

This appropriation would address the increased number of referrals and commitments to the Minnesota Sex Offender Program (MSOP) and the Minnesota Security Hospital. This change is in addition to the $13.4 million included in the Deficiency Bill enacted in February 2005.

**14. SOS Adult Mental Health Program Transition**

| | | |
|---|---|---|
| o General Fund Spending | $17.3 million | $0.0 million |

This appropriation is to cover the one-time costs of mental health restructuring and regional treatment center downsizing in state operated services (SOS). An appropriation was previously made for this purpose in FY 2004 but not all used in the FY 2004-05 biennium due to slower than anticipated implementation of the changes. This amount is projected to cancel in June 30, 2005 and the Governor is recommending that it be re-appropriated in FY 2006.

**15. Improve Mental Health Coverage**

| | | |
|---|---|---|
| o General Fund Spending | $0.2 million | $3.2 million |
| o General Fund Revenue | $34,000 | $34,000 |

This increased funding is intended to improve mental health services for people enrolled in Medical Assistance (MA), MinnesotaCare (MNCare) and General Assistance Medical Care (GAMC) by providing more access to appropriate and effective care.

**16. Methamphetamine Treatment**

| | | |
|---|---|---|
| o General Fund Spending | $0.3 million | $0.3 million |

The appropriation is to address increased chemical dependency treatment needs of women with children and adolescents who are or may be abusing methamphetamine, including supports for successful treatment.

## Department of Health FY 2006 FY 2007

### *Administrative Support Service*

**1. Adverse Health Event Reporting**

| | FY 2006 | FY 2007 |
|---|---|---|
| State Gov't Special Rev Fund Spending | $0.3 million | $0.3 million |
| State Gov't Special Rev Fund Revenue | $0.3 million | $0.3 million |

The adverse health event reporting requirement was enacted in 2003 requiring hospitals and surgical centers to report on 27 different types of incidents. Funding was from non-state sources. This proposal establishes ongoing funding and an increase in hospital and surgical center fees to fund the program.

**2. Operations Support (Facilities Leasing Costs)**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Revenue Spending | $0.7 million | $2.6 million |

This funding is to cover the increased costs of agency rent in its new facilities

### *Community & Family Health Promotions*

**3. Grant Reductions**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Fund Spending | ($1.5 million) | ($1.5 million) |

This reduction would come from the dental loan repayment program of $560,000 and the suicide prevention program of $983,000 eliminating the funding base for both programs.

**4. Positive Alternatives Program**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Fund Spending | -0- | $2.5 million |

This program would provide grants to organizations that provide direct care to pregnant women and their unborn children through counseling and support services.

**5. State Trauma System**

| | FY 2006 | FY 2007 |
|---|---|---|
| General Fund Spending | $0.4 million | $0.4 million |

This new activity will establish a statewide trauma system to assure that injured persons are promptly transported and treated at facilities appropriate to the severity of their injury.

## *Health Protection*

**6. Drinking Water Protection Fee**

- State Gov't Special Rev Fund Spending $0.4 million $0.6 million
- State Gov't Special Rev Fund Revenue $0.0 million $1.4 million

The increased appropriation would increase funding for the drinking water protection program. This will be funded by an increase in the drinking water service connection fee.

**7. Food Manager's Certification Program**

- State Gov't Special Rev Fund Spending $62,000 $62,000
- State Gov't Special Rev Fund Revenue $91,000 $91,000

This appropriation will allow the program to operate at a full service level. The fee increase covers the cost of the increased appropriation.

**8. Food, Beverage and Lodging Program**

- State Gov't Special Rev Fund Spending $1.6 million $1.6 million
- State Gov't Special Rev Fund Revenue $1.3 million $1.3 million

The additional spending is to reform and modernize the food, beverage and lodging inspection program for approximately 7,800 restaurants, bars, hotels, motels, resorts and lodging establishments. The fee increase will ensure that program costs are being fully recovered.

**9. Lab Certification Program**

- State Gov't Special Rev Fund Spending $0.2 million $0.2 million
- State Gov't Special Rev Fund Revenue $0.2 million $0.2 million

The additional spending will fully fund the environmental laboratory certification program. The fee increase will ensure that program costs are being fully recovered.

**10. Methamphetamine Lab Remediation**

- General Fund Spending $0.1 million $0.1 million

This appropriation is for the Department of Health to provide technical assistance to local units of government for program to remediate former methamphetamine lab sites.

**11. Plumbing**

- State Gov't Special Rev Fund Spending $0.25 million $0.25 million
- State Gov't Special Rev Fund Revenue ($5,000) ($5,000)

The additional appropriation is to ensure that the plumbing inspection program can meet the demand for plan review service and associated inspections. The fee reduction would be from a modification in the plumbing plan review schedule.

**12. Well Management Program**

| | | |
|---|---|---|
| o State Gov't Special Rev Fund Spending | $0.4 million | $0.6 million |
| o State Gov't Special Rev Fund Revenue | $0.0 million | $0.6 million |

The additional funding meets the increased need in the well management program. The fee increase is to ensure the program is fully funded.

## *Policy, Quality and Compliance*

**13. Complementary and Alternative Practice**

| | | |
|---|---|---|
| o General Fund Spending | ($65,000) | ($65,000) |

This proposal would discontinue the Office of Complementary and Alternative Practice in the Department of Health.

**14. Vital Records Program**

| | | |
|---|---|---|
| o State Gov't Special Rev Fund Spending | $1.1 million | $1.0 million |
| o State Gov't Special Rev Fund Revenue | $1.4 million | $1.4 million |

The increased appropriation is to support the administration of the electronic system of vital statistics and for upgrades to the electronic record system. The fee increase will ensure that the program is fully funded.

*For more information, contact Katherine Schill, Fiscal Analyst, 651-296-5384 or [katherine.schill@house.mn](mailto:katherine.schill@house.mn)*

# Higher Education

The Governor recommends total FY 2006-07 General Fund appropriations for higher education of $2.774 billion. This is an increase of $214.8 million (8.4 percent) from FY 2004-05 appropriations and $21.2 million (.8 percent) from the adjusted base. The following table summarizes the Governor's recommendations for each higher education account:

**Higher Education Finance**
*(all dollars in thousands)*

| | FY 2004-05 | Base FY 2006-07 | Governor's Recs FY 2006-07 | % Change Gov. FY 06-07 vs. FY 04-05 | % Change Gov. vs. Base FY 2006-07 |
|---|---|---|---|---|---|
| **HESO** | 352,953 | 349,904 | 347,614 | -1.5% | -.7% |
| **Mayo** | 2,723 | 2,782 | 2,782 | 2.2% | 0.0% |
| **MnSCU** | 1,106,075 | 1,226,188 | 1,202,888 | 8.8% | -1.9% |
| **U of M** | 1,097,351 | 1,173,884 | 1,220,634 | 11.2% | 4.0% |
| **Total** | **2,559,102** | **2,752,758** | **2,773,918** | **8.4%** | **.8%** |

## Higher Education Services Office (HESO)

The Governor recommends total FY 2006-07 General Fund appropriations for HESO of $347.6 million. This is a decrease of $5.3 million (-1.5 percent) from FY 2004-05 appropriations and $2.3 million (-.7 percent) from the adjusted base. Specific recommendations within these totals include:

- State Grants - Level funding for the State Grant Program of $290.6 million. While the funding remains constant for the FY 2006-07 biennium, a surplus in the base due to changes in federal funding and a variance in demand from the agency's FY 2004-05 projections allow the Governor to recommend that the program eligibility be changed to recognize individual tuition and fees paid by students rather than an average across each campus in the program. The change to average cost was made for the FY 2004-05 biennium to reduce costs in the program. The Governor also recommends increasing the Living and Miscellaneous Expense (LME) portion of the formula to $5,280, restoring part of the reduction to the LME that occurred as part of the FY 2004-05 budget reductions.

- Work Study – Level funding of $24.9 million for the biennium. This is no change from the adjusted base.

- Interstate Tuition Reciprocity – The Governor recommends funding of $2 million for the biennium for this program, a reduction of $5.2 million from the adjusted base. Because the cost of these agreements has dropped dramatically in recent years, the agency projects that the base can be reduced with no impact on the program.

- Learning Network of Minnesota – The Governor recommends funding of $9.3 million for the biennium. This represents a reduction of $1 million (-9.7 percent). The Governor anticipates that users of the system will make up for the difference in usage levels, bandwidth changes or reductions in support levels to campuses.

- State Grant Re-write – The Governor recommends a one-time General Fund appropriation of $310,000 for FY 2006 to convert the State Grant Program computer language from the current COBOL program to a modern computer language.

- Mn College Savings Program – The Governor recommends level funding of $2.24 million for administration and matching grants in the FY 2006-07 biennium. This is no change from adjusted base.

- MINITEX and MnLINK – The Governor recommends level funding of $9.6 million for FY2006-07 for the MINITEX and MnLINK library systems. This is no change from adjusted base.

- Accountability Measurement System – The Governor recommends $400,000 for the development of a statewide higher education accountability measurement system. This system is meant to collect and analyze data on higher education performance and accountability to assist the state and higher education systems in setting performance goals and standards.

- Rochester planning – The Governor recommends $3.2 million to establish an independent, publicly incorporated postsecondary education institution in Rochester. The budget pages note that this is a new entity which does not yet have a base budget.

In addition, the Governor proposes increasing the fee for registration of Private Career Schools and a new fee for schools with multiple locations. This is anticipated to raise $26,000 for the biennium and is part of HESO's attempts to align private school registration fees with the cost of the program as required by statute. The Governor makes one other significant change relative to private colleges by abolishing the Higher Education Facilities Authority (HEFA) and transferring its duties to HESO. HEFA is a state agency which issues revenue bonds on behalf of private colleges for construction projects. HEFA is funded by participating colleges through a fee of .8 percent on the value of bonds issued. The agency has built up a balance of $2.1 million which the Governor recommends be returned to the institutions that paid it.

## Minnesota State Colleges and Universities

The Governor recommends total FY 2006-07 General Fund appropriations for the Minnesota State Colleges and Universities of $1.203 billion. This is an increase of $96.8 million (8.8 percent) from FY 2004-05 appropriations and a decrease of $23.3 million (-1.9 percent) from the adjusted base. The Governor's budget recommendations reflect reductions from the adjusted base in the same amount as the system's statutory enrollment adjustment ($130.8 million). The Governor then goes on to recommend new funds (over FY 2004-05 appropriations) for the following items from the system request:

- $50 million for implementation of a new internal allocation model. When MnSCU was created, it inherited three methods of distributing state appropriations to campuses. Since then, the system has worked to achieve a single allocation system which would address funding inequities between campuses. These funds would be used in the new methodology to achieve that end.
- $20 million is recommended by the Governor to fund Centers of Excellence. This initiative would fund the MnSCU system creating up to eight centers of excellence at selected campuses. Programs would be in the areas of Manufacturing Technology; Science/engineering; Health Care; Information Technology; Business and Teacher Education.
- $5 million for competitive salaries. This initiative would attempt to introduce incentive/performance pay into the MnSCU salary structure.
- $14 million for MN Online. This initiative would significantly expand both the quality and quantity of online programs available through the MN Online.
- $10 million is to increase the capacity and output of MnSCU's nursing programs.
- $5.5 million for the MnSCU innovations fund. These funds will help the system adapt programs more rapidly for changing needs. Funds may be used for a variety of purposes, curriculum development, equipment, technology, etc. but must be matched by funds from "partner organizations".
- $3 million to expand Farm and Small Business Management programs.

## University of Minnesota

The Governor recommends total FY 2006-07 General Fund appropriations for the University of Minnesota of $1.221 billion. This is an increase of $123.3 million (11.2 percent) from FY 2004-05 appropriations and $46.75 million (4 percent) from the adjusted base. The Governor's budget documents reflect changes from a FY 2004-05 base which does not include $17.4 million in Operations and Maintenance (O & M) appropriations which are cycled through the Prepaid Medical Assistance Program (PMAP). However, since these are General Fund appropriations to the University of Minnesota which are included in the Governor's figures for FY 2006-07 they are also included here and in the table above as part of the FY 2004-05 appropriations base. Calculations are made from that starting point. For the Governor's recommendations, as with

MnSCU, the Governor first reflects a reduction from the University's adjusted base in the amount of the statutory enrollment adjustment ($73.75 million) and then applies new funding (above FY 2004-05 appropriations) to the following University request items:

- $36 million for the University's Biosciences for a Health Society initiative. This initiative would address biosciences programs throughout the University.
- $15 million to address Competitive Salaries. This initiative is meant to assist the University in recruitment and retention of top researchers and educators.
- $35 million to address Research Support. This initiative will cover the cost of start-up packages for new faculty, provide seed funds for new research projects, fund major equipment purchases and improve security infrastructure related to research.
- $19.5 million for Preparing Students for the 21st Century Economy. This initiative would improve Honors programs, Fast Track Programs, the Undergraduate Research Opportunities Program and enhances graduate and professional education.
- The Governor also recommends a one-time General Fund appropriation of $15 million for the Minnesota Partnership for Biotechnology and Medical Genomics. This is a research partnership between the University and the Mayo Foundation. The Governor counts $7.5 million of the University's appropriation as going to Mayo reflecting their part in this partnership. This project received $2 million from the General Fund in the FY2004-05 biennium.

The Governor proposes no funding changes to the University Specials, Cigarette Tax revenue or Heath Care Access fund appropriation.

## Mayo Foundation

The Governor recommends FY 2006-07 appropriations of $2.782 million. This is no change from the adjusted base. The Governor also recommends $15 million for the University of Minnesota- Mayo biotechnology research partnership. These funds are appropriated through the U of M. See U of M section for additional details.

*If you have any further questions on higher education related issues, please contact Doug Berg at 296-5346 or doug.berg@house.mn.*

# Jobs & Economic Opportunity Policy & Finance

The Jobs and Economic Opportunity Policy & Finance Committee has budget jurisdiction for 16 state departments, agencies, and boards. The Children & Economic Assistance Grants & Management Divisions within the Department of Human Services are under the jurisdiction of the Committee for the first time in the 2005 Legislative Session.

The Governor recommends General Fund appropriations totaling just over $1.178 billion in the FY 2006-07 biennium for Committee's 16 state departments, agencies, and boards. The recommendation is $150.924 million below base funding level, which is an 11.4 percent reduction. On the revenue side, the Governor recommends eight items that would result in a net $34.505 million gain to the General Fund. Together, the Governor's spending and revenue recommendations would have a net General Fund gain of $185.429 million.

**Governor's FY 2006-07 General Fund Recommendations**
(Dollars in thousands)

| | Forecast FY 04-05 | Current Law Base FY 06-07 | Gov's Recs FY 06-07 | % Change Gov. FY 06-07 vs.Forecast FY 04-05 | % Change Gov. vs. Current Law FY 06-07 |
|---|---|---|---|---|---|
| Employment & Economic Development | 110,934 | 91,972 | 74,856 | -32.5 | -18.6 |
| Explore Minnesota Tourism | 8,909 | 17,252 | 16,252 | 82.4 | -5.8 |
| Housing Finance Agency | 69,954 | 71,540 | 56,540 | -19.2 | -21.0 |
| Commerce | 56,845 | 56,036 | 46,510 | -18.2 | -17.0 |
| Board of Accountancy | 1,211 | 1,154 | 974 | -19.6 | -15.6 |
| Board of Architecture, Eng., et.al. | 1,854 | 1,570 | 1,570 | -15.3 | 0.0 |
| Board of Barbers & Cosmetologists | 825 | 1,398 | 1,398 | 69.5 | 0.0 |
| Labor & Industry | 5,705 | 4,988 | 5,744 | 0.7 | 15.2 |
| Mediation Services | 3,659 | 3,546 | 3,546 | -3.1 | 0.0 |
| Public Utilities Commission | 8,429 | 8,326 | 8,326 | -1.2 | 0.0 |
| Historical Society | 44,687 | 44,687 | 43,573 | -2.5 | -2.5 |
| Region 3 - Occupation Tax | 936 | 936 | 936 | 0.0 | 0.0 |
| Arts Boards | 17,177 | 17,186 | 17,186 | 0.1 | 0.0 |
| DHS: Children & Econ. Assist. | 926,507 | 1,008,496 | 900,752 | -2.8 | -10.7 |
| Board of Electricity | N/A | | | | |
| Iron Range Resources | N/A | | | | |
| Workers Comp Court of Appeals | N/A | | | | |
| **Total** | **1,257,632** | **1,329,087** | **1,178,163** | **-6.3** | **-11.4** |

Notes:
(1) The FY 2004-05 numbers for DEED include one-time funding items and the FY 2004 appropriation for Tourism. These factors overstate the percentage change numbers in Column 4 for DEED and Explore Minnesota Tourism.
(2) Board of Barber & Cosmetologist Examiners' 2006-07 numbers reflect the merger of barber and cosmetologist licensing and regulation.
(3) The Board of Electricity, Iron Range Resources, and Workers Compensation Court of Appeals do not receive GF appropriations.
(4) The DHS FY 04-05 number has been corrected to reflect accounting changes between the 2004-05 and 2006-07 bienniums.

## Department of Employment & Economic Development

The Governor recommends that the Department of Employment and Economic Development receive a General Fund appropriation of $74.856 million in the FY 2006-07 biennium. The recommendation represents a reduction of $17.116 million from the biennium base. The Governor's major recommendations by programs and activities are given in the table below.

| **Department of Employment and Economic Development 2006-07 General Fund Appropriations** (dollars in thousands) | | | |
|---|---|---|---|
| **Program** | **Current** | **Gov's Chg.** | **Gov's Rec.** |
| Business & Community Development | 4,442 | -110 | 4,332 |
| Minnesota Investment Fund | 2,406 | -2,406 | 0 |
| Trade Development | 3,838 | -548 | 3,290 |
| MN Youth Program | 8,380 | -8,380 | 0 |
| Youthbuild | 1,514 | -1,514 | 0 |
| Youth Intervention (Transferred to DPS) | 2,904 | -2,904 | 0 |
| Learn to Earn | 366 | -366 | 0 |
| Mortgage Credit Certificate Aid | 500 | -500 | 0 |
| Administration | 7,442 | -888 | 6,554 |
| Meth Lab Cleanup Revolving Fund (new) | | 500 | 500 |

The Governor also proposes to:

- Eliminate the Displaced Homemakers Program. That recommendation would save the Workforce Development Fund $1.5 million in FY 2006-07. By statute, this $1.5 million would be available to fund the Dislocated Workers Program. The current portion of the marriage license fee ($200,000 per year) that goes to support the Displaced Homemakers Program would be eliminated.
- Change to repayment formula for the Minnesota Investment Fund. The change would be to have 20% payment of repayments, up to $100,000, retained by local units of government and Indian tribal governments. Under current law, the local retention is the first $100,000 of repayments. The impact would be $350,000 per year in addition repayments going to the MIF special revenue account revolving loan fund.
- Create a special revenue revolving fund account capitalized by the proceeds from the Department's sales of promotional and marketing materials.

## Explore Minnesota Tourism

The 2004 Legislature approved the Governor's recommendation that Explore Minnesota Tourism be separated from the Department of Employment and Economic Development and become a stand-alone entity. The Governor recommends that Explore Minnesota Tourism's General Fund appropriation for 2006-07 biennium be $16.252 million. The recommendation is a net $1 million reduction from base, and contains two major components.

- $2 million would be reduced from the Department's base budget under the Governor's proposed budget.
- $1 million in new funding would be for a proposed Public/Private Enhancement Fund. The Fund is designed to build stronger public/private partnership in tourism promotion by

matching contributions from private sector partners. The Governor proposes that the Fund would begin in FY 2007 and the match would be capped at $1 million per year.

## Minnesota Housing Finance Agency

The Governor recommends a $69.47 million General Fund appropriation in FY 2006-07. This is a decrease of $15 million from the MHFA current law base. The table below shows the reductions by housing programs and activities.

| **Minnesota Housing Finance Agency<br>2006-07 General Fund Appropriations**<br>(dollars in thousands) | | | |
|---|---|---|---|
| **Program** | **Current** | **Gov's Chg.** | **Gov's Rec.** |
| Econ. Dev. & Housing Challenge Program | 21,814 | -13,000 | 8,814 |
| Housing Trust Fund | 8,610 | 4,000 | 12,610 |
| Housing Rehabilitation Program | 7,944 | -2,636 | 5,308 |
| Home Ownership Assistance | 1,770 | -1,770 | 0 |
| Affordable Rental Investment Fund | 18,546 | -1,484 | 17,062 |
| Capacity Building Grants | 610 | -110 | 500 |

The funding reductions for the Economic Development and Housing Challenge Program and the Home Ownership Assistance Program would be one-time, with funding to be restored in the 2008-09 biennium. The other programs' reductions would be on going.

The governor is also recommending that the respective Tribal and Urban Indian Housing programs be consolidated into the Economic Development and Housing Challenge Program. The Governor's funding recommendations depicted in the table reflect the consolidated Program's fiscal impacts.

## Department of Commerce

The Governor recommends $46.51 million for the Department's FY 2006-07 General Fund appropriations. The recommendation is $9.526 million less than the current law base.

| **Department of Commerce<br>2006-07 General Fund Appropriations**<br>(dollars in thousands) | | | |
|---|---|---|---|
| **Division/Program** | **Current** | **Gov's Chg.** | **Gov's Rec.** |
| Financial Examinations | 11,988 | | 11,988 |
| Administrative Services | 10,836 | | 10,836 |
| Market Assurance | 9,824 | -200 | 9,624 |
| Energy & Telecommunications | 8,698 | -250 | 8,448 |
| Weights & Measures | 5,014 | | 5,014 |
| Renewable Energy Incentive Payments | 9,676 | -9,076 | 600 |

The recommended funding reductions for the Department of Commerce are:

- $200,000 reduction for the Market Assurance Division. The Division's administrative costs relative to the Contractor Recovery Fund will be paid by that fund, rather than the General Fund.
- $250,000 reduction for the Energy and Telecommunications Division.
- $9.076 million reduction in the appropriation for the Renewable Energy Incentive Payments for small wind generators. The Governor recommends that the incentive payments be made from the Renewable Development Fund rather than the General Fund. The significance is that the program payments will continue, but the funding source for the payments will change.

The Governor is also recommending three initiatives that will yield $31.504 in additional General Fund revenues in the FY 2006-07 biennium.

- $30 million in estimated revenue would be generated under the Governor's recommendation to shorten the current required retention time of holding unclaimed securities before they can be sold. Under current law, the required retention time is three years. The Governor is proposing to shorten the retention time to one year.
- $36,000 would be raised from establishing a one-time $1,500 fee for a certificate of authority to sell insurance in Minnesota. Insurance companies currently doing busy in the state would not be impacted.
- $1.468 million would be raised from adjusting current fees and implementing new fees in several of the Department's insurance-related licensing activities.

### Board of Accountancy

The Governor proposes that the Board receive General Fund appropriations totaling $974,000 in the FY 2006-07 biennium. This represents an $180,000 reduction. The reduction incorporates the Governor's recommendation that the Accountancy Board's administrative functions be combined with the Board of Architecture, Engineering, *et. al.*.

### Board of Architecture, Engineering, Land Surveying, Landscape Architecture, Geoscience and Interior Design

The Board's FY 2006-07 General Fund appropriation would be $1.57 million under the Governor's proposed budget. The Governor's recommendation that the Board would assume the administrative functions of the Board of Accountancy is discussed above.

### Board of Barber & Cosmetologist Examiners

The Governor recommends that the Board's FY 2006-07 General Fund appropriations be $1.398 million. The requested budget amount reflects the 2004 Legislature's action to merge the barbers' and cosmetologists' licensing and regulation functions.

### Bureau of Mediation Services

The Governor recommends General Fund appropriations of $3.546 million in FY 2006-07. The recommendation is at the Bureau's current law base.

### Department of Labor & Industry

The Governor recommends that the Department be appropriated $5.744 million in FY 2006-07 from the General Fund. This represents a $756,000 increase from base. The increase would allow the Department to improve its code enforcement and inspections activities relating to boilers, pressure vessels and high-pressure piping systems.

To finance these activities the Governor recommends increases in license, permit, and penalty and inspection fees amounting to $1.61 million. The recommendation would net the General Fund $864,000 after subtracting the Department's $756,000 increased appropriation. One major fee change the Governor recommends is to make permanent the $5 temporary surcharge on boiler licenses and inspections that was approved by the 2003 Legislature.

### Public Utilities Commission

The Governor is recommending the current law base General Fund funding of $8.326 million for the Commission in the FY 2006-07 biennium. The Commission recovers nearly all of its funding through fees and assessments.

### Historical Society

The Governor's recommended FY 2006-07 General Fund appropriations for the Historical Society totaling $43.573 million, a $1.114 million reduction from the current law base. The table below depicts the Society's program-specific funding under the Governor's proposed budget.

**Minnesota Historical Society**
**2006-07 General Fund Appropriations**
(dollars in thousands)

| Program | Current | Gov's Chg. | Gov's Rec. |
|---|---|---|---|
| Education & Outreach | 24,762 | -1,114 | 23,648 |
| Preservation & Access | 19,544 | | 19,544 |
| FarmAmerica | 213 | | 213 |
| MN International Center | 85 | | 85 |
| MN Military Museum | 67 | | 67 |
| MN Air National Guard | 16 | | 16 |

The Governor recommends that the Society's entire $1.114 million reduction be in its Education & Outreach program. Should the Legislature agree with the Governor's proposed reduction, it might want to consider giving the Society greater discretion over how to allocate the envisioned savings amongst its programs.

### Arts Board

The Governor recommends that the Board receive a General Fund appropriation of $17.186 million for the FY 2006-07 biennium. This is at the Board's current law base. (see table on next page).

| **Minnesota Arts Board<br>2006-07 General Fund Appropriations**<br>(dollars in thousands) | |
|---|---|
| **Program** | **Gov's Rec.** |
| Operation & Services | 808 |
| Grant Programs | 11,534 |
| Regional Arts Councils | 4,844 |

## Workers' Compensation Court of Appeals

This Court receives no General Fund appropriation. The Governor recommends that the Court receive $3.236 million from the Workers Compensation Special Fund in the FY 2006-07 biennium.

## Board of Electricity

The Board receives no General Fund appropriation. The Governor recommends $22.092 million from the Special Revenue Fund for the Board's operations in FY 2006-07. This is a statutory appropriation and includes no reductions from the Board's base funding.

The Governor also recommends a one-time $4 million transfer from the Board of Electricity's special revenue account to the General Fund.

## Iron Range Resources

The Governor recommends that $63.286 million be appropriated for the agency from the Iron Range Resources and Rehabilitation Fund, the Giants Ridge Golf and Ski Resort, and the Northeast Minnesota Economic Protection Fund in FY 2006-07. These are all statutory appropriations.

The Governor also recommends that the Agency receive the current law General Fund open appropriation of $936,000 for pass-through grants to Koochiching and Carlton counties for economic and environmental projects.

## Department of Human Services

The Children & Economic Assistance Grants & Management Divisions within the Department of Human Services are under the jurisdiction of the Jobs & Economic Opportunity Finance Committee for the first time in the 2005 Legislative Session. The Governor recommends that the Divisions be funded at $901.282 million in the 2006-07 biennium. This is a 10.5 percent reduction from the Division's base funding level of $1.01 billion. The dollar reduction is $109.43 million. The details are summarized in the table on the following page.

The reader is advised that only looking at the General Fund impact of the Governor's recommendations has the effect of both understating and overstating the actual dollar effects on some programs. This is especially true of the Governor's recommendations for Minnesota Family Investment Program (*MFIP*) and Basic Sliding Fee (*BSF*) Child Care Assistance Grants.

- The table number for MFIP Child Care Assistance Grants overstates the true dollar effect of the Governor's proposal to continue to freeze reimbursement rates at levels adopted by the 2003 Legislature. The actual fiscal impact is a $52.607 million reduction, and not the $62,491 million shown in the table. The reason for the smaller number is the Governor's additional recommendation is to appropriate $9.884 million in TANF monies for MFIP Child Care Assistance Grants. This has the effect of offsetting a portion of the Governor's recommended General Fund reductions.

- The table number for BSF Child Care Assistance Grants understates the true dollar effect of the Governor's reimbursement rates proposal. The actual impact is a $15.632 million reduction, and not the $10.032 million shown in the table. The reason for the higher number is a recommended accounting change wherein $5.6 million in program receipts would be deposited in the General Fund and be directly appropriated. Under current law, these receipts are deposited in a special revenue account, and are statutorily appropriated. The bottom line is, the $5.6 million in additional General Fund appropriations owing to the proposed accounting change are not new dollars to the program. The actual net impact for all funds going to the program is a $15.632 million reduction under the Governor's proposed budget.

The table's MFIP and BSF Child Care Assistance Grants numbers incorporate the Governor's supplemental budget recommendation to adjust the child care center rates in some counties by establishing a maximum payment rate at the higher of the current rate or the highest rate reported for that county in the 2002 rate survey. This recommendation appropriates an additional $176,000 in MFIP Child Care Assistance and an additional $ 282,000 in BSF Child Care Assistance in the FY 2006-07 biennium.

Beginning with the 2008-09 biennium, the Governor is recommending that FY 2007 child care reimbursement rates be adjusted with the Consumer Price Index. The adjustments would be effective July 1, 2007.

| **Department of Human Services 2006-07 General Fund Appropriations<br>Children & Economic Assistance Grants & Management Division**<br>(dollars in thousands) | | | |
|---|---|---|---|
| **Program** | **Current** | **Gov's Chg.** | **Gov's Rec.** |
| MFI P- DWP Grants | 67,542 | | 67,542 |
| Supportive Services Grants | 17,412 | | 17,412 |
| MFIP Child Care Assistance Grants | 173,000 | -62,491 | 110,509 |
| BSF Child Care Assistance Grants | 60,524 | -10,032 | 50,492 |
| Child Care Development Grants | 3,080 | | 3,080 |
| Child Support Enforcement Grants | 6,510 | | 6,510 |
| Children's Services Grants | 85,891 | 4,177 | 90,068 |
| Children & Community Services | 186,976 | -50,000 | 136,976 |
| General Assistance Grants | 61,980 | | 61,980 |
| MN Supplemental Aid Grants | 61,116 | | 61,116 |
| Group Residential Housing Grants | 174,698 | | 174,698 |
| Other Child & Econ. Asst. Grants | 25,183 | 10,000 | 35,183 |
| Children & Economic Assistance Admin. | 15,142 | 528 | 15,670 |
| Children & Economic Assistance Operations | 69,442 | 74 | 69,516 |

The other major funding recommendations by the Governor for the programs within Children & Economic Assistance Grants & Management Division (in biennium dollar amounts) are:

- $4.838 million in new funding for the Governor's proposed American Indian Child Welfare Project. The project would be begin in FY 2007, and enable up to two tribes to provide child welfare services to American Indian children on their reservations.
- $975,000 in reduced funding for Adoption Assistance. The reduction is reflection of anticipated reduced caseloads. Funding would increase in FY 2008-09 by $5.565 million.
- $1.856 million in reduced funding Relative Custody Assistance, reflecting expected reduced caseloads. Funding would increase beginning in FY 2009.
- $2.17 million in new funding for the Governor's proposed initiative to "Prevent Homelessness for Young Adults Transitioning from Long-term Foster Care."
- $50 million in reduced funding for the Projects of Regional Significance within the Children and Community Services Act program. This reduction would be one-time, in that the Governor is recommending a two-year delay in implementation to July 1, 2007.
- $10 million in new funding for the Governor's proposed initiative to "Address Homelessness with Supportive Housing Service Grants."

*For additional information on Jobs & Economic Development issues, contact Ron Soderberg at 296-4162 or ron.soderberg@house.mn*

# Public Safety Policy and Finance

The Governor's budget recommends a general fund appropriation of $1.667 billion for the FY 2006-07 biennium. This is a $217 million (15 percent) increase from the previous biennium, and a 5.03 percent increase from current law. The public safety budget makes up 5.6 percent of the Governor's proposed general fund budget for FY 2006-07. The following relate to the general fund unless otherwise noted (dollar amounts are for the biennium).

**Public Safety Policy and Finance**
(all dollars in thousands)

| | February Forecast Spending in FY 2004-05 | Current Law FY 2006-07 | Governor's Recs FY 2006-07 | % Change Gov. FY 2006-07 vs. November FY 2004-05 | % Change Gov. vs. Current Law FY 2006-07 |
|---|---|---|---|---|---|
| Supreme Court | 74,890 | 72,168 | 74,436 | -0.61% | 3.14% |
| Court of Appeals | 15,837 | 15,878 | 16,378 | 3.42% | 3.15% |
| Trial Courts | 371,941 | 440,412 | 465,054 | 25.03% | 5.60% |
| Tax Court | 1,441 | 1,452 | 1,452 | 0.76% | 0.00% |
| Uniform Laws Cmsn. | 79 | 78 | 78 | -1.27% | 0.00% |
| Judicial Standards Bd. | 738 | 504 | 504 | -31.71% | 0.00% |
| Public Defense Board | 107,526 | 107,864 | 122,654 | 14.07% | 13.71% |
| Public Safety Dept. | 141,299 | 141,470 | 156,207 | 10.55% | 10.42% |
| Private Detective Bd. | 270 | 252 | 252 | -6.67% | 0.00% |
| Human Rights Dept. | 6,871 | 6,980 | 6,980 | 1.59% | 0.00% |
| Corrections Dept. | 727,785 | 798,959 | 821,815 | 12.92% | 2.86% |
| Sentencing Guidelines | 993 | 872 | 872 | -12.19% | 0.00% |
| **Total** | **1,449,670** | **1,586,889** | **1,666,682** | **14.97%** | **5.03%** |

### Supreme Court

The Governor is recommending a biennial appropriation of $74.436 million, this is a increase of $2.268 million from the FY 2006-07 base. This increase is for caseload increases and other cost pressures.

- Surcharge Increase. The Governor is also recommending a $10 increase in the criminal and traffic surcharge (this will increase the state surcharge from $60 to $70). This will result in a revenue increase to the general fund of $11.4 million for the FY 2006-07 biennium.

## Court of Appeals

The Governor is recommending a biennial appropriation of $16.378 million, this is a increase of $500,000 for caseload increases and other cost pressures.

## District Courts

The Governor is recommending a biennial appropriation of $465.054 million, this is a increase of $24.642 million from the FY 2006-07 base. The Governor is recommending the increase in the following areas:

- $13.842 million for caseload increases and other cost pressures.
- $10.8 million for methamphetamine and sex offender enhancements.

## Tax Court

The Governor is recommending a biennial appropriation of $1.452 million. There is no change from the FY 2006-07 base.

## Board of Judicial Standards

The Governor is recommending a biennial appropriation of $504,000. There is no change from the FY 2006-07 base.

## Public Safety

The Public Safety Policy and Finance Committee is responsible for six programs (other programs in the agency are the responsibility of the Transportation Finance Committee). The Governor is recommending a biennial appropriation of $156.207 million, this is a increase of $14.737 million from the FY 2006-07 base. The Governor is recommending a $4.618 million reduction. This reduction is for the following:

- Savings of $618,000 for the merger of the emergency management center with the BCA communications center.
- $3 million reduction from the CriMNet technical base adjustment.
- $1 million reduction from suspense file funding.

*Bureau of Criminal Apprehension (BCA)*

- $3.851 million increase to replace the Automated Fingerprint System (AFIS). The Department is anticipating an additional $5 million in federal funds for this.
- $1.726 million increase for collection and processing of DNA samples. This also provides funding to expand DNA testing for predatory felony arrestees.
- $577,000 increase for the criminal justice information audit trail.
- $135,000 increase for the ongoing costs of Livescan. The agency also plans on replacing 119 livescans in FY 2007 with federal funds.

- $2.04 million increase for methamphetamine enforcement and awareness. This will add ten BCA agents and provide $40,000 of funding for a methamphetamine awareness program.
- $1.71 million increase for changes to the predatory offender law. This additional funding will be used to upgrade the Predatory Offender system and to increase the monitoring and tracking of registered sex offenders who become noncompliant with the law.
- $150,000 in revenue for continuing the $5 fee to access public criminal history data over the internet.

*Fire Marshal*

$480,000 in revenue by adding the fire inspection fee to hotels and lodging facilities with fewer than 35 rooms, inspections of bed and breakfasts, youth/family camps, juvenile group homes, and migrant worker camps. This fee would go into a dedicated account to be used for the inspection of these facilities.

*Office of Justice Programs*

- $5.3 million increase for the gang and drug task force. During the 2003 session the gang strike force was reduced by $1.5 million, and the Governor now recommends restoring the reduction and combining the gang task force with the drug task force.
- $2.904 million is for the transfer of the Youth Intervention Program grants from the Department of Employment and Economic Development to the Department of Public Safety. This program provides prevention and early intervention services for at-risk youth.
- $1.064 million increase in the crime victim assistance grants.
- $600,000 is for financial crimes task force grants.

*911 Emergency Services/ARMER*

- Increasing the 911 fee by 25 cents per month for the first year and then 10 cents each year after that. This is the fee charged to each customer for their phone lines. The revenue increases will go to pay off prior year obligations to telephone utility companies and to pay for the state's cost in building the statewide trunked public safety radio system. This will result in a $24.296 million increase. The current monthly charge is 40 cents.

## Private Detectives Board

The Governor is recommending a biennial appropriation of $252,000. There is no change from the FY 2006-07 base.

## POST Board

The Governor is recommending a biennial appropriation of $7.886 million. The Governor is also recommending two new additions to the non DWI reinstatement fee. This is estimated to generate $1.595 million which will be dedicated to a special account to increase training reimbursement funding for law enforcement officers in local governments.

## Public Defense Board

The Governor is recommending a biennial appropriation of $122.654 million, this is a increase of $15.128 million for caseload increases and other cost pressures. The Governor is recommending the increase in the following areas:

- $3.39 million for caseload increases and other cost pressures.
- $11.4 million for methamphetamine and sex offender enhancements.

## Department of Corrections

The Governor is recommending a biennial appropriation of $821.815 million, this is a increase of $31.856 million from the FY 2006-07 base. The Governor is recommending the following:

- $7.44 million for the increased costs of health services.
- $6.21 million for sex offender treatment.
- $6.992 million for sex offender enforcement for those offenders under correctional jurisdiction. This will include money for global positioning satellite (GPS), more intensive supervised release agents, housing, civil commitment review, revocation hearings and more aggressive tracking.
- $2.214 million for methamphetamine and sex offender sentencing changes. This is based on proposed sentencing changes.

The Governor has also included forecast adjustments for the Department totaling $71.2 million.

## Sentencing Guidelines

The Governor is recommending a biennial appropriation of $872,000. There is no change from the FY 2006-07 base.

## Human Rights Department

The Governor is recommending a biennial appropriation of $6.98 million. There is no change from the FY 2006-07 base.

## Uniform Laws Commission

The Governor is recommending a biennial appropriation of $78,000. There is no change from the FY 2006-07 base.

**Implications:**

As one can determine from a review of the Governor's Public Safety budget the criminal justice system is growing and a high priority in the Governor's budget. The Governor is funding anticipated increases in sentencing for both methamphetamine and sex offender offenses. However, the cost estimates for the meth and sex offender enhancements in the Governor's budget are only preliminary and are subject to change based on future details of the Governor's plan.

*For additional information on judiciary finance issues, contact Gary Karger at 296-4181 or gary.karger@house.mn.*

# State Government Finance

The Governor recommends total General Fund appropriations of $556 million for the state agencies and programs under the jurisdiction of the State Government Finance committee. This recommended amount is a reduction of $5.4 million, or .96 percent, from the forecasted base for FY 2006-07. The Governor's recommendation also includes $71.1 million in new general fund revenues, bringing the net recommended spending to $484.96 million.

**State Government Finance**
**Total General Fund Spending**
(all dollars in thousands)

| Agency / Program | Forecast FY 2004-05 | FY 2006-07 Base | FY 2006-07 Gov's Recs | % Change Gov. 06-07 vs. FY 04-05 | % Change Gov. vs. Base FY 06-07 |
|---|---|---|---|---|---|
| Legislature | 117,088 | 116,096 | 113,194 | -3.3% | -2.5% |
| Legislative Carryforward | 13,503 | 0 | (8,656) | | |
| Governor's Office | 7,269 | 7,172 | 6,993 | -3.8% | -2.5% |
| State Auditor | 16,727 | 16,612 | 16,512 | -1.3% | -0.6% |
| Attorney General | 53,311 | 45,693 | 44,565 | -16.4% | -2.5% |
| Secretary of State | 12,193 | 11,980 | 11,905 | -2.4% | -0.6% |
| Campaign Finance Bd* | 1,461 | 1,424 | 1,388 | -5.0% | -2.5% |
| Public Subsidy Financing | 4,272 | 3,860 | 0 | -100.0% | -100.0% |
| Investment Board* | 4,402 | 4,334 | 434 | -90.1% | -90.0% |
| Administrative Hearings | 0 | 0 | 524 | | |
| Dept. of Administration | 49,918 | 44,566 | 39,852 | -20.2% | -10.6% |
| Public Broadcasting | 3,806 | 3,806 | 3,806 | 0.0% | 0.0% |
| CAAP Board | 595 | 602 | 602 | 1.2% | 0.0% |
| Dept. of Finance | 30,816 | 30,432 | 29,616 | -3.9% | -2.7% |
| Dept. of Employee Relations | 12,095 | 12,376 | 11,223 | -7.2% | -9.3% |
| Dept. of Revenue | 182,872 | 187,166 | 194,462 | 6.3% | 3.9% |
| Dept. of Military Affairs | 26,934 | 25,261 | 35,961 | 33.5% | 42.4% |
| Dept. of Veterans Affairs | 8,718 | 8,074 | 8,084 | -7.3% | 0.1% |
| Veterans Service Orgs. | 176 | 176 | 326 | 85.2% | 85.2% |
| MN Amateur Sports Cmsn. | 674 | 1,050 | 600 | -11.0% | -42.9% |
| Target Center Appropriation | 1,500 | 1,500 | 1,500 | 0.0% | 0.0% |
| Council on Black Minnesotans | 586 | 564 | 564 | -3.8% | 0.0% |
| Council on Chicano-Latino Affairs | 612 | 550 | 550 | -10.1% | 0.0% |
| Council on Asian-Pacific Affairs | 492 | 486 | 486 | -1.2% | 0.0% |
| Council on Indian Affairs | 1,016 | 964 | 964 | -5.1% | 0.0% |
| Contingent Accounts | 1,000 | 1,000 | 1,000 | 0.0% | 0.0% |
| Tort Claims | 322 | 322 | 322 | 0.0% | 0.0% |
| MN State Retirement | 2,116 | 2,381 | 2,381 | 12.5% | 0.0% |
| Local Pension Aids | 51,244 | 53,664 | 53,664 | 4.7% | 0.0% |
| Misc. Open General Fund | (20,916) | (20,685) | (16,785) | -19.8% | -18.9% |
| **Total Expenditures:** | **584,802** | **561,426** | **556,037** | **-4.9%** | **-0.96%** |

# Constitutional Offices

*Because of the separation of branches of government and constitutional offices, the Governor acknowledged the right of these offices to present their budgets directly to the legislature for consideration. The Governor does not comment on any specific initiatives requested by constitutional offices or the Legislature. However, the Governor's Budget does include recommended overall spending levels for each office.*

| **Constitutional Offices: Office Requests vs. Gov's Recommendation** *General Fund only, $ in thousands* | | | |
|---|---|---|---|
| | **February Forecast** | **Governor's Rec.** | **Const. Office Request** |
| Attorney General | 45,693 | 44,565 | 47,313 |
| Governor | 7,172 | 6,993 | 6,993 |
| Secretary of State | 11,980 | 11,905 | 12,463 |
| State Auditor | 16,612 | 16,512 | 19,739 |

### Attorney General's Office (AGO)

The Attorney General's Office (AGO) requests $47.3 million in direct appropriations from the General Fund for the biennium, an increase of $1.6 million, or 3.5 percent, from base level funding. This level of funding includes an increase of $810,000 each year for eight additional attorney positions and one additional investigator position, to handle duties related to :

- Civil commitment of sex offenders
- Prosecution of methamphetamine cases
- Recovery of funds from tobacco companies
- Equity stripping
- Pharmaceutical litigation

The AGO states that the expected recoveries from litigation related to these industries will exceed the office's requested general fund budget increase.

The Governor's recommended direct General Fund spending level for the AGO is $44.6 million, a decrease of $1.1 million, or 2.5 percent, from the projected FY 2006-07 base.

In addition to the direct General Fund appropriation for the AGO, the office also receives funding through partner agreements with state agencies. Total budgeted general fund expenditures for partner agencies are $16.6 million for the biennium. Non-general fund expenditures for partner agreements are planned at $1.65 million.

*Other Funds*

The AGO requests $3.6 million from the State Government Special Revenue Fund for services provided to health related licensing boards. The AGO also requests $290,000 from the Environmental Trust Fund and $968,000 from the Remediation Fund for investigating and prosecuting environmental crime and for responsibilities associated with insurance claims settlements and recovery associated with landfills in the landfill cleanup program. The Governor concurs with the AGO's requested funding levels for its non-general fund activities.

### Governor's Office

The Governor requests $6.99 million for the biennium to fund his own office, a decrease of $179,000 million, or 2.5 percent, from the FY 2006-07 base level funding. The Governor plans to manage this cut through reductions in personnel and administrative costs.

The Governor's Office also plans to collect $522,000 in special revenue funds from 11 executive branch agencies, to fund the Washington DC office. This funding arrangement was established in FY 2003, after the general fund support for the DC office was abolished.

### Secretary of State

The Secretary of State requests $12.5 million for the biennium, an increase of $483,000 or 4 percent from the FY 2006-07 base. The Secretary's request includes two change items:

- $36,000 in FY 2006 and on-going costs of $7,000 from FY 2007 on for fees set by the American Association of Motor Vehicle Administrators (AAMVA) and the Social Security Administration, for data verification required by federal election laws (HAVA).
- $440,000 for the biennium for 4 positions to handle customer support to local governments using the Statewide Voter Registration System.

The Governor's recommended spending for this office is $11.9 million, a reduction of $75,000, or 0.6 percent reduction from the current base level. The reduction was calculated by applying a 2.5 percent reduction to the office's administration, communications and fiscal functions. No reductions were calculated for the elections and revenue generating functions of the office.

### State Auditor

The State Auditor's office requests $18.7 million, an increase of $2.1 million, or 12.4 percent, over FY 2006-07 base funding. The Auditor's request includes one change item:

- $2.1 million for the biennium to restore staffing levels for the Audit Practice Division to 2003 staffing levels. This increase would be completely offset by general fund reimbursements from audit clients.

The Governor's recommended spending for this office is $16.5 million, a decrease of $100,000, or .06 percent, from current law. The reduction was calculated by applying a 2.5 percent reduction to the constitutional office, government information, and special investigations activities. No reductions were calculated for the office's reimbursable activities.

### Legislature

The Legislature does not participate in the executive agency budget process. Legislative budget requests will be available after their approval by House and Senate leadership.

The Governor recommends a total of $113.2 million for the Legislature, a decrease of $2.9 million, or 2.5 percent, from the FY 2006-07 base.

| **Legislature: Governor's Recommended Funding**<br>*General Fund only, $ in thousands* | | | |
|---|---|---|---|
| | **November Forecast** | **Governor's Rec.** | **$ Change** |
| House | 51,986 | 50,686 | (1,300) |
| Senate | 38,638 | 37,672 | (966) |
| Legislative Coordinating Commission | 25,472 | 24,836 | (636) |
| **Totals:** | **116,096** | **113,194** | **(2,902)** |

The Governor is also proposing a proposing a one-time cancellation of $8.66 million, or 100 percent of the bodies' unobligated carry-forward[1] balances as of the release of the February forecast. The Governor also recommends the one-time transfer to the general fund of $1.76 million in unspent funds from the Electronic Real Estate Task Force, which expired on June 30, 2004.

## *State Agencies*

### Department of Administration

The Governor recommends General Fund spending of $39.85 million for the biennium. This is a decrease of 4.7 million, or 10.6 percent, from the 2006-07 base.

***Technology Services***

The general fund portion of the Technology Services program is the Office of Technology, which is responsible for the oversight of technology spending in state government. The Governor is recommending funding of $3.6 million, a reduction of 27 percent from the base funding. This level of funding would require a reduction of 40 percent of the current staff, or 8 FTE. According to the Governor's budget, this ***"represents an initial phase of the dissolution of the Office of Technology. It is anticipated that a new governance structure for the enterprise management of information technology will be proposed under the Drive to Excellence, which will in effect replace the Office of Technology."***

*Non-General Fund activities*

[1] MN Statute 16A.281 permits the legislature to carry-forward balances between bienniums for three specific purposes: Special session and public outreach activities, severance costs, and one-time investments that "enhance efficiency and improve effectiveness." This general carry-forward authority is unique to the legislature; appropriations to state agencies, the courts and constitutional offices cancel at the end of each biennium unless specific authority to carry-forward an appropriation in authorized in law.

The non-general fund portions of Technology Services include the Intertechnologies Group or *InterTech* internal service fund. Intertech's computer services and telecommunications management are funded through state agency reimbursements to internal service funds. Estimated expenditures for the Intertechnologies fund for FY 2006-07 biennium are $73.1 million for computing services, and $80.7 million for telecommunication services.

***State Facilities Services (previously known as Facilities Management)***

The Governor recommends total funding of $21.9 million, a decrease of $100,000, or 1 percent, from base. Specific funding recommendations include:

- $750,000 for Real Estate Management activity, a reduction of $24,000, or 3.1 percent.
- $1.68 million for Plant Management, a decrease of $52,000, or 3.0 percent from base.
- $15.8 million for the In-Lieu-of-Rent activity, which funds space costs for the Legislature, Governor's residence, Veterans Services organizations, and ceremonial spaces in the Capitol , as well as the Capitol mall.
- $3.69 million for the State Architect's Office, a reduction of $114,000, or 3 percent.

*Non-General Fund activities:*
In addition to these General Fund activities, significant non-general fund accounts include:

- The Building Codes and Standards activity, which is funded through an account in the special revenue fund. The estimated budget for this activity is $13.9 million for the biennium.
- The Facilities Repair and Replacement Account is an account in the special revenue fund used for asset preservation projects for buildings funded through bond proceeds. Projected expenditures from this account are $7.5 million for the biennium.
- The Plant Management internal service fund is used for building and grounds operations for buildings under the custodial control of the department. Projected expenditures from this fund are $51.1 million for the biennium.

***State and Community Services***

The Governor recommends total General Fund appropriations of $5.5 million. Specific recommendations include:

- Information Policy Analysis, $850,000 for the biennium, no change from base.
- Communications.Media, $886,000, no change from base.
- State Demographer (transferred from MN Planning), $908,000, a $42,000 or 4.4 percent reduction.
- Land Management Information Center (LMIC): This function was also transferred from the Office of Strategic and Long Range Planning. The Governor recommends a reduction of $1.7 million in the General fund appropriation for this activity, which is a 77 percent reduction. LMIC will continue its fee-for-service activities, with estimated expenditures of

$1.3 million for the biennium.

- Environmental Quality Board, $1.4 million, a reduction of $56,000 or 3.9 percent.
- Local Planning Assistance: The Governor recommends eliminating all general fund support for this activity, for a savings of $626,000 for the biennium.
- State Archaeologist: $392,000, no change from base.

**Supplemental Budget Recommendation**s: The Governor added two new recommendations after the release of the February forecast:

- Recognition of the transfer of the Municipal Boundaries function to the Office of Administrative hearings. This transfer has already occurred under the Governor's reorganization authority.
- $300,000 in new funding for a Minnesota Council of Faith-Based Initiatives. The proposal includes funding for one FTE to direct and coordinate the effort.

*Non-General Fund activities:*
In addition to these General Fund activities and the LMIC service bureau, significant non-general fund accounts include 3 internal service funds:

| Internal Service Fund | Purpose | Biennial Expenditures |
|---|---|---|
| Risk Management | Self-insurance company for the state's property and casualty insurance coverage | $20.9 million |
| Mail Comm | Outgoing and internal mailing services for agencies | $23.7 million |
| Travel Management | Provides long-term rental vehicles and support services | $29.4 million |

*Administrative / Management Services*

The Governor recommends total General Fund spending of $9.1million, a reduction of $436,000, or 4.6 percent, from base. Specific recommendations include:

- $892,000 for Executive Support, a reduction of $28,000 or 3 percent.
- $1.6 million for Financial Management and Reporting, a reduction of $54,000 or 3.2 percent.
- $922,000 for Human Resources, a reduction of $28,000 or 2.9 percent.
- $4.2 million for Materials Management (procurement), a reduction of $284,000 or 6.4 percent.
- $712,000 for the Management Analysis Division (MAD), a reduction of $22,000, or 3 percent. MAD's general fund appropriation is for legislative mandates and work on behalf of the state as a whole, including transitions and contingency planning. The majority of

MAD's consulting activities are provided on a fee-for-service basis, with projected expenditures of $3.1 million for the biennium.

- Office of Strategic Planning and Performance Measurement: $670,000, a cut of $20,000, or 2.9 percent.

*Non-General Fund activities:*
In addition to these General Fund programs and the MAD fee-for-service activity, significant non-general fund accounts include three internal service funds:

| Internal Service Fund | Purpose | Biennial Expenditures |
|---|---|---|
| Cooperative Purchasing | Allows governmental units (state and local) to purchase goods and services under contract terms established by the state. | $11.5 million |
| Surplus Property | Disposition of state surplus property | $2.4 million |
| Office Supply Connection (Central Stores) | Distribution center for office supplies | $13.95 million |

## Office of Administrative Hearings (OAH)

This agency is supported by the Workers' Compensation Special Fund and revolving fund revenues. The Governor recommends direct appropriations of $14.8 million for the biennium from the Workers Compensation Fund. This is a $312,000, or 2.2 percent increase over the base. The increased funding would be used to upgrade the office's information technology. The OAH expects this increase to have a minimal impact on its hourly rates.

The Governor is also recommending an increase in OAH's fees charged to agencies and local governments for rule hearings and contested case proceedings[2]. This fee increase - from $135/hour to $151.5/hour for administrative law judges, and from $67.5/hour to $75/hour for staff attorneys - would increase the office's revolving fund revenues by $323,000. The additional revenues would be used to build up the reserves in the office's revolving fund, as a hedge against expected cost increases and to prevent operating losses.

Municipal Boundaries transfer: Through his reorganization authority, the Governor has transferred this activity to OAH from the Department of Administration. This activity's recommended budget is $524,000 for the biennium, a reduction of a decrease of $72,000 or 12 percent.

[2] This is the only requested fee increase in the State Government portion of the Governor's budget. The fees for the OAH were reduced by 10 percent in FY 2004 at the direction of the Legislature.

## Amateur Sports Commission (MASC)

The Governor recommends a total of $600,000 for the MASC's operating budget, a decrease of $450,000, or 42.9 percent, from forecast base.

The 2003 Legislature appropriated a portion of the MASC's budget ($225,000 per year) contingent on the agency generating enough fees to offset this amount. The MASC does not plan to generate fees to offset its operating budget, and has requested a repeal of this provision.

## Capitol Area Architectural Planning Board (CAAPB)

The Governor recommends a direct appropriation of $524,000 for the CAAPB , which is base level funding. The agency is also carrying-forward a balance of $78,000 for a capitol-area memorial to Hubert H. Humphrey (authorized in Laws 1993, Chapter 192, Section 16).

## Campaign Finance and Public Disclosure Board

The Governor recommends a General Fund operating budget of $1.39 million, a decrease of $36,000, or 2.5 percent, over the forecast FY 2006-07 base

*Public Subsidy Program: Proposed Elimination*

In addition, the Governor is recommending eliminating all direct funding for the Public Subsidy program. The program is currently funded by a $1.5 million statutory appropriation, and an open general fund appropriation (equivalent to the amount designated by the income tax check-off). Eliminating this funding would save the general fund $5.6 million for the biennium.

Instead, the Governor proposes to fund the program directly from the taxpayer's tax liability, by either increasing their tax owed, or reducing their refund. The Governor estimates that this will result in usage of the program dropping by 50 percent.

*Note: The Governor is also recommending elimination of the Political Contribution Refund program. This change is discussed in the Tax section of this document.*

## Contingent Accounts

The Governor recommends $1 million for the General Fund portion of the contingent accounts. The contingent accounts are appropriations made to provide supplemental funding to state agencies in emergencies or for unexpected deficiencies. The Governor may approve expenditures from the accounts only after consulting with the Legislative Advisory Commission (LAC). However, the Governor can release funds even if the LAC recommends against the expenditure.

In addition to the General Fund appropriation, the Governor recommends an additional $800,000 from the State Government Special Revenue Fund, and $200,000 from the Workers Compensation Special Fund.

## Councils

The Governor recommends base level funding for the 4 minority councils.

**Council on Black Minnesotans -** $564,000 appropriation

**Chicano Latino Affairs Council -** $550,000 for the biennium.

**Council on Asian-Pacific Minnesotans -** $486,000 for the biennium.

**Minnesota Indian Affairs Council -** $964,000 for the biennium.

## Department of Employee Relations (DOER)

The Governor recommends $11.2 million, a decrease of $1.2 million, or 9.3 percent, from base. Change items include:

- Reduction of $126,000 to the Health & Safety Access program. This will eliminate funding for the single statewide contract to assist agencies in providing information regarding exposure in the workplace, as required by the Employee Right to Know act. DOER plans to leverage other state agency resources, including the MN Poison Control center at the Department of Health, to continue to meet the requirements of the law.
- Staff restructuring in the Human Resources Management program, for a savings of $774,000. This is expected to result in the elimination of 3 vacant positions and 2-3 layoffs.
- Moving to online filing of local government pay equity and state agency affirmative action reports, for a savings of $171,000
- Reallocation of shared technology costs to non-general fund activities that are using a larger portion of these resources, for a savings of $82,000.

## Department of Finance

The Governor recommends a total of $29.6 million for the biennium, a reduction of $816,000, or 2.7 percent, from current law. The agency will achieve this cut through operating reductions:

- $120,000 (5.8 percent) reduction in payable and reimbursement accounting. This reduction will prevent the expansion of payment by electronic fund transfer.
- $280,000 (16 percent) reduction to procurement, contract management and asset management support activities. This will reduce support for MAPS modifications, and will limit system changes to critical fixes only.
- $110,000 (3.3 percent) reduction in Treasury management, which will be achieved through less frequent re-bidding of state depository bank accounts.
- $306,000 (5.7 percent) reduction in payroll preparation activities.

## State Board of Investment

The Governor recommends a change in the funding mechanism for the Board. Currently, the SBI is funded through a direct general fund appropriation. The Board then charges its costs back to the state retirement plans, and the receipts are deposited back in the general fund.

Under the new proposal, the SBI would charge each plan directly for its share of the Board's operations, and the receipts would be deposited in a special revenue fund for the Board's use. The expected revenues and expenditures for this activity are $3.9 million for the biennium. A small general fund appropriation ($434,000) would remain to be used to fund the Board's investment activities directly related to the General Fund itself.

### Lawful Gambling Control Board

The 2003 Legislature changed the funding for the Lawful Gambling Control Board from the General Fund to the Special Revenue fund. The Board's activities are now funded from a percentage (.1%) of gross receipts on charitable gambling, and license/permit fees for manufacturers and distributors. Base funding for the Board is $5.1 million.

The Governor is recommending a $548,000, or 10 percent increase in the Board's funding. This would bring the Board's total funding to $5.6 million for the biennium. The new funding would be used for increased compliance staffing, and technology investments.

### Minnesota Racing Commission

The Racing Commission was also moved to the Special Revenue fund in the 2003 session. Its activities are now directly funded through racetrack, racing, and occupational license fees, as well as reimbursements from Canterbury for the cost of stewards, veterinarians, and laboratory services.

The Governor is not recommending any changes to the commission's direct appropriation base of $842,000 for the biennium. However, if a new harness racing track in Anoka county is ultimately approved, the commission will face increased costs related to this track (and in fact, is already accruing some staff costs related to the public hearings and legal/regulatory work for this proposed track). It is anticipated that these costs will be covered through a new license fee.

### Lottery

The Governor recommended total operating expenses for the Lottery of $54.2 million for the biennium, with net proceeds estimated at $134.7 million. Total state proceeds are projected to be $216.4 million for the biennium, with $120 million in estimated General Fund revenues. These total revenues include the net proceeds, in-lieu-of-sales tax, and unclaimed prizes.

**Lottery: Governor's Recommended FY 2006-07 Budget**
*(dollars in thousands)*

| | **FY 2006** | **FY 2007** | **Total FY 2006-07** |
|---|---|---|---|
| Gross Revenue | 393,213 | 400,791 | **794,004** |
| Direct Costs | 296,768 | 302,168 | **598,936** |
| Operating Expense | 26,700 | 27,350 | **54,050** |
| **Net Proceeds** | **69,745** | **71,273** | **141,018** |

The Governor is also recommending transfer of the $2.2 million of the remaining balances in the Unclaimed Lottery prize account. Sixty percent, or $1.3 million, of the balance would be transferred to the General Fund. The remaining $875,000 would be directed to the Environmental Trust Fund. This recommendation is an outcome of the February 2004 Legislative Auditor's report on state lottery operations. That report recommended that the Legislature prohibit the Lottery from spending unclaimed prize money on any additional lottery games. The auditor found that Lottery's use of unclaimed prize money has not been productive in increasing lottery profits.

### The Department of Military Affairs

The Governor recommends $35.1 million for the biennium, an increase of $10.6 million, or 43 percent over the base. The new spending comes in two initiatives:

- $7.7 million to fully fund the tuition reimbursement program. The Department currently has the authority to reimburse tuition for National Guard members up to 100 percent of the amount of undergraduate tuition at the University of Minnesota. However, current funding for this program provides only enough resources for the Department to reimburse at the 80 percent level.
- $3 million for a new mid-career re-enlistment program. This program would provide reenlistment bonuses of $1,000 per year, for up to 5 years, or $5,000 per individual.
- $2.4 million from the Gift fund for grants to assist members of the National Guard Reserves, and their dependents experiencing financial difficulties. Revenues to support the grants would come from a new "Support Our Troops" license plate. This initiative is also discussed in the Transportation section.

*Note: The Governor is also recommending an income tax exemption for National Guard members for their state active duty pay. This initiative is discussed in the Tax section.*

### Public Broadcasting

The Governor recommends base level funding ($3.8 million) for Public Radio and Public Television.

*Public Radio*: The total funding level of $1.02 million is allocated to the Association of Minnesota Public Educational Radio Stations (AMPERS) and Minnesota Public Radio (MPR). Specific funding levels are:

- $626,000 for AMPERS community service grants
- $390,000 for MPR equipment grants.

*Public Television*: $806,000 for equipment grants, and $1.9 million for matching grants, for a total of $2.8 million.

*Twin Cities Regional Cable*: $34,000 is recommended for a grant to Metro Cable Channel 6.

## Public-Local Employees Retirement

Three public retirement programs under the State Government Finance committee's jurisdiction receive either direct or open General Fund appropriations. The funds include:

- MN State Retirement System - $2.4 million for benefits paid to former legislators and elected officials.
- First Class City Teachers State Aid - a $37.5 million open appropriation to reduce the unfunded liabilities of the Minneapolis and St. Paul teachers retirement funds.
- The Minneapolis Employees Retirement Fund (MERF) - $16.1 million to reduce the plan's unfunded liability.

## Department of Revenue

The Governor recommends $185.8 million for the biennium, an increase of $7.3 million over current spending. Changes include:

*New compliance initiative:* The Governor recommends $13.3 million in new funding for the Non-Filer initiative, to fund 105 additional FTE to identify and collect taxes from both individuals and corporations that owe the state taxes but do not file returns, or underreport their state tax liability. This compliance initiative will include a special emphasis on businesses using Foreign Operating Corporation status inappropriately[3].

The department estimates that focusing additional staff resources on this activity would bring in new General Fund revenues of $68 million in FY 2006-07, and $83.6 million in FY 2008-09.

*Operating reductions:* The Governor also recommends operating reductions of $6 million to the department's activities that do not have a direct impact on state revenue collections:

- $ 2 million savings in rents and leases. This includes a one-time rent reduction due to a surplus of funds in the Plant Management account for the Stassen building, and ongoing savings from the reduction of space needed for records storage.
- $4 million savings in computer hardware and systems. This will be achieved by delaying the planned purchases of both hardware and software systems.

## Tort Claims

The Governor recommends $322,000 from the General Fund.

[3] The 2001, 2002 and 2003 Legislatures all funded new or expanded tax compliance initiatives within the Department of Revenue.. A report on the expanded tax compliance initiatives authorized by the 2003 Legislature can be found at: www.taxes.state.mn.us/legal_policy/other_supporting_content/mndor_etcreport_jan2005.pdf

### The Department of Veterans Affairs

The Governor recommends $8.1 million for the biennium, an increase of $10,000, or .1 percent, from current law. The increased funding is related to one item:

- $10,000 increase to the Vietnam Veterans service organization to help with veterans claims processing.

Note: The Governor's original budget recommendations included an additional $90,000 for increased rent costs. This change item has been withdrawn because the rent costs were funded in the deficiency bill passed earlier in the session (Laws 2005, Chapter 2).

### Veterans Service Organizations

The Governor recommends increased funding for three veterans service organizations. The increase, totaling $150,000, is intended to help these organizations provide help with veterans claims processing. The Disabled American Veterans would also receive funding to provide transportation to veterans hospitals and other service facilities.

| | FY 2006-07 Base | Governor's Recommended Funding | $ Change | % Change |
|---|---|---|---|---|
| Veterans of Foreign Wars | 110,000 | 170,000 | 60,000 | 54.55% |
| Military Order of the Purple Heart | 40,000 | 50,000 | 10,000 | 25.00% |
| Disabled American Veterans | 26,000 | 106,000 | 80,000 | 307.69% |
| **Total:** | **176,000** | **326,000** | **150,000** | **85.23%** |

*For more information on State Government Finance issues, contact Helen Roberts, 651-296-4117 or Helen.Roberts@house.mn.*

# Transportation

The Governor's recommended 2006-2007 budget for transportation reduces general fund spending by $2 million for the biennium. From all funds, the budget for transportation totals $3.75 billion for FY's 2006-07, roughly $50 million less in total direct appropriations from the previous biennium. The table below details changes in general fund spending for transportation related purposes.

**Transportation Finance**
(all dollars in thousands, general fund only)

| | Forecast FY 2004-05 | Base FY 2006-07 | Governor's Recs FY 06-07 | % Change Gov. FY 06-07 vs. Forecast FY 04-05 | % Change Gov. vs. Base FY 2006-07 |
|---|---|---|---|---|---|
| Department of Transportation | 32,441 | 32,441 | 32,441 | 0% | 0% |
| Department of Public Safety | 14,017 | 14,022 | 10,489 | -25% | -25% |
| Metropolitan Council Transit | 114,720 | 115,820 | 116,256 | 1% | 0% |
| **Total** | **161,178** | **162,283** | **159,186** | **-1%** | **-2%** |

Highlights from the Governor's budget include:

### Department of Transportation

- A reduction of $163 million from the trunk highway fund for road construction spending. This is due primarily to the lack of federal re-authorization of the transportation funding bill. The lack of federal funds flowing to the state has caused the department to push out to future years some projects scheduled for "advance construction". These advance construction projects were funded in the Governor's transportation package passed in 2003.
- $8 million for small building projects like truck stations and salt sheds throughout the state.
- $8.6 million annual addition to maintenance and operations
- $875,000 per year for electronic communications needs. The dollars are to be used in conjunction with the state's 800mhz public safety radio network.

- The cancellation of $1.9 million in airport construction grants in fiscal year 2005. The cancellation will fill a shortfall in the fund and push the Alexandria long range radar project into next biennium.

## Department of Public Safety

- Elimination of the bicycle registration program. Collections for bicycle registrations had fallen below expenditures for the program in recent years and the recommendation will terminate the activity.
- Fee increases for Motor Vehicle Transfer from $4 to $8 and Driver License Record fee from $2.50 to $5 will result in $6.2 million annually in revenue to the general fund.
- Changing Driver Services from a direct appropriation to an open and standing appropriation through creation of the Driver Services Operating Account. Also contained in the request are a myriad of fee increases that would raise the Driver Services annual budget by $7.5 million annually.

## Metropolitan Council Transit

- No material change is made to the Met Council Transit budget. The Metropolitan Council will receive $436,000 more over the biennium than the agency's base. The increase represents less than one-tenth of one percent increase when measured against the over $300 million annual budget for metro transit from all sources.

## Implications

The reduction in state road construction spending will delay some projects until the re-authorization of a federal transportation funding bill. The impact of the reduction in the program will be greatest in the first year, where the program is reduced by $133 million.

The increase in funding for Operations and Maintenance will address concerns over snow plowing, as well as add dollars for pavement striping, pothole repair and other needs.

Also introduced by Governor Pawlenty, but not described in great detail in the Governor's budget document is his plan to increase funding for transportation. The Governor recommends a constitutional amendment dedicating the remainder of Motor Vehicle Sales Tax collection in the general fund be used for highways and transit. The plan would increase funding for metro transit by 30% when fully implemented, as well as provide large increases for local roads, highways and rural transit. The proposal would shift 46.5% of MVST left in the general fund to transportation uses over several years starting FY 2008. The plan, when fully implemented, would divert over $300 million annually in current general fund revenues to transportation purposes.

The program would also issue bonds totaling $4.5 billion for highway construction over a ten year period. Mn/DOT asserts that paying debt service on these bonds would require a ten cent increase in the gas tax (over the life of the bonds), however the proposal for increased funding from MVST roughly equals a five cent per gallon increase. The remaining dollars needed would come from future growth in fund revenues.

The request by the Department of Public Safety would make allow the agency more flexibility to meet customer demand and serve the driving public. The request does, however, include $7.5 million in annual fee increases to supplement their budget and would result in less legislative oversight in annual operations in Driver Services. The approach has been tried recently with Vehicle Services and has been successful thus far.

The Governor's budget document does not specifically address the slowing growth in transportation revenues, especially motor vehicle sales tax or MVST. Revenue projections have dropped sharply since the February 2004 forecast and that has had an impact not only on the general fund but funding for highways and transit as well.

MVST was used as a source of funds to replace local property tax for funding transit. While the new source of funding has in many years outpaced growth in property tax revenues, it is subject to greater volatility. In FY 2005 MVST is projected to take in slightly less than in FY 2004, and then resume slow growth for the next few years. This has had an impact on Metro Transit which now depends on MVST revenues for over one third of its operating budget. The November 2004 forecast projected a $20 million drop in revenues to the Metropolitan Council for the 2006-2007 biennium from what had been forecast just nine months earlier.

The slow growth in MVST revenue, relatively flat appropriations from the state, and dips in ridership from recent fare increases have provided challenges to the Metropolitan Council to retain services levels. These factors as well as sharply increased fuel costs will have some increased impact on the services delivered in the forthcoming biennium. It is unclear what those impacts will be but it is likely that some level of service restructuring will occur to stay within budget.

*If you have any further questions on transportation related issues, please contact John Walz at 296-8236 or john.walz@house.mn.*

# Taxes & Local Aids and Credits

For the FY 2006-07 biennium, the Governor's recommendations would increase general fund tax revenues by $159 million and reduce general fund expenditures by $73 million. For FY 2008-09, the Governor's proposals would increase general fund tax revenues by $154 million and reduce general fund expenditures by $82 million.

General fund tax revenue increases for FY 2006-07 would come primarily from repealing the December 31, 2005 sunset for two special sales tax rates – the 9% sales tax rate on alcoholic beverages ($84 million) and the 12.7 percent sales tax rate on rental cars ($19 million). Accelerating sales tax payments on leased cars would raise revenues by $39 million. Requiring non-resident partnerships and S-corporation shareholders pay income tax quarterly would raise $14 million, and replacing the sales tax on cigarettes with a per-pack tax at the wholesale level would raise an additional $11 million.

The Governor proposes several tax changes that reduce revenue, including tax credits for dairy farmers ($2.9 million) and for corporations contributing to scholarship funds for private K-12 schools ($3.5 million). The premiums tax rate for life insurance would be phased down from the present two percent to 1.5 percent over four years, reducing revenue by $4.5 million in FY 2006-07 and $13.7 million in FY 2008-09. The proposed phase-in of 100 percent sales apportionment for corporate taxes has little impact in FY 2006-07, but would reduce revenues by $27 million in FY 2008-09. The Governor also proposes tax exemptions for a new international economic development zone ($1.7 million) and for the existing bioscience zone ($1 million).

The major expenditure reduction items include changes to the renter's property tax refund program ($30 million in FY 2006-07 and $82 million in FY 2008-09), extending the temporary reduction to the market value homestead credits to cities ($35 million in FY 2006-07 only), and eliminating the political contribution refund program (about $10 million in each biennium). In addition, the Governor proposes increasing levy authority for school districts which results in an *increase* in expenditures for the homeowner property tax refund program by $3.7 million in the FY 2006-07 biennium and $11.1 million in FY 2008-09.

# Changes in General Fund Tax Revenues

Table 1 summarizes the impact of the proposed changes in general fund revenues.

Table 1
**Changes in General Fund Tax Revenues**
*(Dollars in thousands[1])*

| | Effec. Date | FY 2006 | FY2007 | FY 06-07 Biennium | FY 2008 | FY 2009 | FY 08-09 Biennium |
|---|---|---|---|---|---|---|---|
| **Individual Income Tax** | | | | | | | |
| Require quarterly withholding for nonresident partnerships/S-corps | 1/1/06 | $13,200 | $850 | **$14,050** | $950 | $1,000 | **$1,950** |
| Require 2% withholding on payments to self-employed construction subcontractors | Payments after 8/1/05 | 2,000 | 2,000 | **4,000** | 2,000 | 2,000 | **4,000** |
| Enact 25% investment credit for regional angel investment network funds (for use in JOBZ zones) | FY 2007 | 0 | (10,000) | **(10,000)** | 0 | 0 | **0** |
| Enact 10% investment credit for dairy farms | 1/1/06 (for 6 yrs) | 0 | (2,900) | **(2,900)** | (3,500) | (4,000) | **(7,500)** |
| Simplify calculations for long-term care insurance credit | 1/1/05 | (300) | (330) | **(630)** | (360) | (400) | **(760)** |
| Exempt national guard & reserves active duty pay (in-state) | 1/1/05 | (42) | (42) | **(84)** | (42) | (42) | **(84)** |
| **Total IncomeTax:** | | **$14,858** | **$(422)** | **$14,436** | **$(952)** | **$(1,442)** | **$(2,394)** |
| **Federal Conformity** | various | **$(4,480)** | **$2,285** | **$(2,195)** | **$8,665** | **$5,285** | **$13,950** |
| **Corporate Franchise Tax** | | | | | | | |
| Phase-in 100% sales apportionment over 8 years (2007-2014) | 1/1/07 | $0 | $(2,300) | **$(2,300)** | $(9,800) | $(17,200) | **$(27,000)** |
| Enact credit for contributions to K-12 scholarship funds | 1/1/06 | 0 | (3,500) | **(3,500)** | (3,750) | (3,750) | **(7,500)** |
| Limit applicability of Foreign Operating Corp. (FOC) rules | 1/1/05 | 1,800 | 1,300 | **3,100** | 900 | 500 | **1,400** |
| **Total Corporate Tax:** | | **$1,800** | **$(4,500)** | **$(2,700)** | **$(12,650)** | **$(20,450)** | **$(33,100)** |
| **Sales & Use Taxes** | | | | | | | |
| Up-front payment of tax on car and small truck leases | 10/1/05 | $18,921 | $19,749 | **$38,670** | $5,609 | $744 | **$6,353** |
| Continue special 12.7% tax rate on rental cars beyond expiration date | 1/1/06 | 4,790 | 13,800 | **18,590** | 14,500 | 15,200 | **29,700** |
| Replace sales tax on cigarettes with a per-pack tax at wholesale[2] | 8/1/05 | 8,050 | 2,700 | **10,750** | 2,700 | 2,700 | **5,400** |
| Define industrial production to exclude gas pipelines | 7/1/05 | 1,600 | 3,200 | **4,800** | 3,200 | 3,200 | **6,400** |
| Remote sellers must collect MN sales tax to do business with State of Minnesota | 1/1/06 | 680 | 2,730 | **3,410** | 4,300 | 4,410 | **8,710** |
| **Total Sales & Use Tax:** | | **$34,041** | **$42,179** | **$76,220** | **$30,309** | **$26,254** | **$56,563** |

[1] *Negative numbers represent a cost to the state and positive numbers represent a gain to the state.*
[2] This is the net change in revenue from eliminating a sales tax and adding a new tax. This should probably be shown as a reduction in projected sales tax revenues and a slightly larger increase in revenues from "other taxes."

***Table 1 is continued on following page.***

Table 1 (continued)
**Changes in General Fund Tax Revenues**
*(Dollars in thousands[1])*

| | Effec. Date | FY 2006 | FY2007 | FY 06-07 Biennium | FY 2008 | FY 2009 | FY 08-09 Biennium |
|---|---|---|---|---|---|---|---|
| **Other Tax Provisions** | | | | | | | |
| Enact 2.5% gross receipts tax effective when sales tax on alcohol falls by 2.5% | 1/1/06 | $23,650 | $60,300 | **$83,950** | $62,000 | $63,100 | **$125,100** |
| Reduce life insurance premiums tax to 1.5% | phased in by 2009 | (1,000) | (3,500) | **(4,500)** | (5,800) | (7,900) | **(13,700)** |
| Subject stop-loss policies to insurance premiums tax | 1/1/06 | 1,400 | 3,700 | **5,100** | 4,500 | 5,400 | **9,900** |
| Allow quarterly or annual payment of liquor tax | 1/1/06 | (25) | 0 | **(25)** | 0 | 0 | **0** |
| Base fur tax payments on actual quarterly revenue | 1/1/06 | (25) | 0 | **(25)** | 0 | 0 | **0** |
| Enact assorted tax breaks for International Trade Zone | | 0 | (700) | **(700)** | (1,050) | (1,050) | **(2,100)** |
| Increase Bioscience Zone cap on benefits | 7/1/05 | (1,000) | 0 | **(1,000)** | 0 | 0 | **0** |
| **TOTAL: All Taxes** | | **$69,219** | **$89,342** | **$158,561** | **$85,022** | **$69,197** | **$154,219** |

[1] Negative numbers represent a cost to the state and positive numbers represent a gain to the state.

## Tax Revenues

## Individual Income Tax

**Require quarterly withholding for nonresident partners and S-corporation shareholders:** Under current law, tax payment is delayed until after the calendar year ends, on the following March 15th (S-corporation shareholders) or April 15 (partners). All other taxpayers – including partners and S-corporation shareholders who are Minnesota residents – are required to pay tax as income is earned, either through withholding or quarterly estimated payments. The fiscal impact of primarily one-time money as half a year's tax is shifted forward into FY 2006. Later years see a much smaller gain due to the growth in these tax payments. About 40 percent of the shift is from partnerships.

**Require 2% withholding on certain construction subcontractors**: No withholding is now required if subcontractors are self-employed. This new requirement addresses a serious compliance problem because a substantial amount of this income (particularly the share paid to nonresidents) goes unreported and escapes tax. Although the income is generally reported to the Internal Revenue Service (IRS) on form 1099, state access to that federal data for audit purposes is delayed and incomplete. The rather low (2 percent) withholding rate takes account of the fact that some of these payments are for materials rather than labor. Subcontractors are required to provide the contractor with name, address, and social security number.

The requirement is limited to subcontractor payments that exceed $600 in a calendar year. It applies to all portions of the construction business (construction of buildings, heavy construction, and specialty trades).

**Enact 25 percent investment tax credit for Regional Angel Investment Network funds:** Individual or corporate investors would receive a credit equal to 25 percent of the amount of capital they invest in qualified funds. To qualify, the funds would be required to support businesses in existing Job Opportunity Building Zones (JOBZ).[1] These zones are all located outside the metro area, so the credit is said to target rural Minnesota. The total amount of credits (capped at $10 million) would support $40 million of investment in such funds. No individual taxpayer could receive a credit of more than $250,000.

**Enact 10 percent investment credit for dairy farms**: A total of up to $300,000 in investment in dairy farm buildings, facilities, and equipment would be eligible for the 10 percent credit during the six year life of the credit (tax years 2006-2011), so the maximum benefit is $30,000 per dairy farm. Credits are not refundable, so it can provide a benefit only to the extent if offsets income tax liability. Unused credits can be carried forward for use in the succeeding 15 years, so credits could be received as late as 2026. About 7200 dairy farms are potentially eligible for this credit.

**Simplify calculation of long-term care credit**: Under current law, the long term care credit is available for any premiums not claimed as an itemized deduction for medical costs[2]. Not only does this complicate calculation of the credit; it also treats employees less favorably than the self-employed, who can fully deduct their premiums as self-employed health insurance but can still claim the Minnesota tax credit. The Governor proposes to allow full benefits of the credit for all long-term care premiums, regardless of whether they have already been deducted from income. This provides equal access to the credit and simplifies the calculations, at a cost of $300 to $400 thousand per year.

**Exempt National Guard income for active duty in Minnesota:** The Governor proposes to allow a subtraction for National Guard pay earned when called to active duty in Minnesota. This would include service when called up by either the Governor (after tornadoes and floods) or the President (as was done for airport security). This does not apply to regular training or drill pay.

| |
|---|
| Under current law, Minnesota residents on active duty *outside* Minnesota (National Guard, reserves, or other military personnel) are treated as nonresidents for tax purposes. This effectively exempts their active duty pay from tax. In contrast, active duty pay of Minnesota residents on active duty *inside* Minnesota is now fully taxable. Federal law prohibits Minnesota from taxing *nonresidents* on pay received by U.S. armed forces personnel who are nonresidents and on active duty in Minnesota. |

[1] The meaning of "support businesses" is not defined in the materials available at this time.
[2] Medical costs are deductible only to the extent they exceed 7.5 percent of income.

## **Federal Conformity** (individual income tax and corporate franchise tax)

The Governor proposes Minnesota law to conform to most of the federal changes enacted in 2003 and 2004. Minnesota tax calculations start with federal taxable income. Any change in a federal law that changes the definition of federal taxable income requires that Minnesota either conform to the federal change or add a line on the Minnesota return to add back (or subtract) the difference. Federal conformity is not automatic; failure to do anything (as in the 2004 legislative session) means Minnesota has not conformed. About 75,000 Minnesota taxpayers were required to complete a special new tax form in 2004 (Form M1NC) to add back income deducted federally as a result of tax law changes enacted in 2003 and 2004 that took effect in 2004. This included 25,000 with Health Savings Accounts, 50,000 with teacher expenses, and 1,500 military personnel.

Table 2 shows the major federal law changes to which the Governor proposed to conform (or partially conform). Additional comments on selected items on Table 2:

> *Military Family Relief Act of 2003*: Most of the fiscal impact is from allowing members of the national guard and reserves a deduction for un-reimbursed travel expenses when travel to a guard or reserve meeting exceeds 100 miles and requires an overnight stay (effective retroactive to tax year 2003).
>
> *Health Savings Accounts*: Federal law allows a subtraction for contributions to these tax-preferred accounts by taxpayers who purchase high-deductible medical health care plans. High-deductible plans must have an annual deductible of at least $1,000 ($2000 for family coverage) and maximum out-of-pocket expense of at least $5,000 ($10,000 for family coverage).
>
> Maximum annual deduction is $2,250 for single coverage ($4,500 for family coverage) plus $500 for individuals 55 or older. The 55-and-over differential grows by $100 per year to $1,000 in 2009. Amounts left in accounts at the end of each year can be carried over to the next year. All earnings on amounts contributed are tax-exempt, and distributions are tax-exempt if used for medical expenses. Change would be effective retroactively to the 2004 tax year.
>
> *Increased expensing for small businesses*: The American Jobs Creation Act of 2004 extended the higher limit on expensing under IRS Code section 179 ($100,000 rather than $25,000) for two additional tax years (2006 and 2007), and increases the phase-out threshold. Fully conforming to this federal provision would cost $50.6 million in FY 2006-07. Instead, the Governor proposes to require taxpayers to add back 80 percent of the added expensing amount, but allow a subtraction of one-fifth of that add back in each of the following five years. This "partial conformity" greatly reduces the up-front cost to the state, while eliminating the much greater complexity that would result from not conforming at all. (This is identical to the Minnesota's partial conformity to federal bonus depreciation in 2001 and 2002.[3])

[3] For a more complete explanation and discussion of this method of "partial conformity" and its impact on taxpayers, see the analysis of the 2002 bonus depreciation provision in *Summary of the Fiscal Actions of the 2002 Legislature* (http://www.house.leg.state.mn.us/fiscal/files/02budsum.pdf ), pages 67-70.

Table 2
**Conform to Federal Tax Changes**
*(Dollars in thousands[1])*

| | FY 2006 | FY 2007 | 2006-07 Biennium | FY 2008 | FY 2009 | 2008-09 Biennium |
|---|---|---|---|---|---|---|
| **1. Military Family Relief Act of 2003** | | | | | | |
| All Provisions (Individuals) | $(680)* | $(330) | **$(1,010)** | $(340) | $(350) | **$(690)** |
| **2. Medicare Prescription Drug, Improvement, and Modernization Act of 2003** | | | | | | |
| Health Savings Accounts | $(5,200)* | $(3,000) | **$(8,200)** | $(3,300) | $(3,700) | **$(7,000)** |
| Subtract federal subsidies to employers with retiree prescription drug plans | | | | | | |
| *Individual tax* | *(1,000)* | *(2,000)* | ***(3,000)*** | *(2,200)* | *(2,500)* | ***(4,700)*** |
| *Corporate tax* | *(2,200)* | *(4,500)* | ***(6,700)*** | *(5,000)* | *(5,500)* | ***(10,500)*** |
| **Total** | (3,200) | (6,500) | **(9,700)** | (7,200) | (8,000) | **(15,200)** |
| **3. Working Families Tax Relief Act of 2004** | | | | | | |
| Deduct up to $250 for teacher expenses (indiv.) | $(2,400)* | $0 | $(2,400) | $0 | $0 | $0 |
| Deduction for clean-fuel vehicles | | | | | | |
| *Individual tax* | *(260)** | *50* | *(210)* | *30* | *25* | *55* |
| *Corporate tax* | *(220)** | *40* | *(180)* | *25* | *20* | *45* |
| **Total** | (480)* | 90 | (390) | 55 | 45 | 100 |
| Enhanced deduction for computer donations (corp.) | (830)* | 0 | (830) | 0 | 0 | 0 |
| Other items | (270) | (160) | (350) | (170) | (175) | (345) |
| **4. American Jobs Creation Act of 2004** | | | | | | |
| Increased expensing: Add back 80% in first year, subtract same amount over next 5 years (Partial Conformity) | | | | | | |
| *Individual tax* | *(100)* | *1,300* | *1,200* | *3,400* | *1,750* | *5,150* |
| *Corporate tax* | *(25)* | *300* | *275* | *800* | *425* | *1,225* |
| **Total** | (125) | 1,600 | 1,475 | 4,200 | 2,175 | 6,375 |
| Other provisions | 8,705 | 10,585 | 19,290 | 15,420 | 15,290 | 30,710 |
| Total federal update | (4,480) | 2,285 | (2,195) | 8,665 | 5,285 | 13,950 |

*These items include retroactive provisions affecting tax year 2004 or earlier tax years.
[1] Negative numbers represent a cost to the state and positive numbers represent a gain to the state.

The Governor proposes *NOT* to conform to two federal changes:

- *Increased standard deduction for married couples to twice that for single filers*: This eliminates the marriage penalty created when the standard deduction for married couples is less than twice that for singles. The decision not to conform to this change was driven by costs: Conformity would cost $71 million in FY 2006-07 and $24 million in FY 2008-09.

  By not conforming, Minnesota married filers who do not itemize deductions will be required to add back the difference between the federal and Minnesota standard deduction ($1300 in tax year 2005, declining to zero in tax year 2009 and after).

- *Deduction for U.S. production activities:* This provision relates to reform of international taxation. Conforming would cost $35 million in FY 2006-07 and $51 million in FY 2008-09.

## Corporate Franchise Tax

**Phase-in 100% sales apportionment over eight years:** Multi-state corporations pay tax based on the share of their total income that is apportioned to Minnesota. Under current law, Minnesota's share of that income is calculated as a weighted average of the share of the corporation's total sales that are located in Minnesota (75 percent), the share of its total property that is located in Minnesota (12.5 percent), and the share of its total payroll that is paid in Minnesota (12.5 percent). The proposal would increase the importance of the sales factor from 75 percent to 100 percent, over eight years, as shown below.

| Tax year | Apportionment Factors (percent) | | |
|---|---|---|---|
| | Sales | Property | Payroll |
| 2007 | 78% | 11.0% | 11.0% |
| 2008 | 81% | 9.5% | 9.5% |
| 2009 | 84% | 8.0% | 8.0% |
| 2010 | 87% | 6.5% | 6.5% |
| 2011 | 90% | 5.0% | 5.0% |
| 2012 | 93% | 3.5% | 3.5% |
| 2013 | 96% | 2.0% | 2.0% |
| 2014 | 100% | -- | -- |

The proposed change would reduce a corporation's tax liability if Minnesota's share of its production (property and payroll) exceeds Minnesota's share of its sales. Conversely, the proposal would increase a corporation's tax liability if Minnesota's share of sales exceeds Minnesota's share of its production. Corporations with all their sales, property, and payroll in Minnesota would see no change in their tax liability.

When fully phased in, this proposal would reduce corporate tax revenues by about $50 million per year.

**Winners and Losers from 100% Sales Apportionment:** A detailed analysis in 2004 provided information about who wins and who loses under 100% sales apportionment. At that time, it was estimated that the proposal would reduce taxes for 4500 corporations while increasing taxes for 6,500 corporations. If 100% sales apportionment had been in effect in 2004, those 4,500 corporations would have paid $85 million less tax. This tax reduction would have been partially offset by a tax increase totaling $42 million for 5500 corporations. Some of the tax changes would be large. It was estimated that 130 corporations would see tax cuts exceeding $100 thousand (an average of $500 thousand each), while 80 corporations would see tax increases exceeding $100 thousand (an average of $200 thousand each.)

Those with large tax cuts would include manufacturing firms whose production facilities are concentrated in Minnesota but who sell in national markets. Those with large tax increases would include manufacturing firms with significant sales in Minnesota but negligible production facilities here. Single sales apportionment increases the incentive to locate production facilities in Minnesota.

Every year about 50,000 corporations file tax returns, and the 2004 analysis showed 39,000 of them with no change in tax. These include many who have all their payroll, property and sales in Minnesota, along with others who have zero taxable income.

**Tax credit for contributions to private school (K-12) scholarship funds**: The Governor proposes a tax credit for corporate contributions to scholarship granting organizations that award financial aid to low- and moderate-income families to help cover the cost of tuition at private K-12 schools. No details of this proposal have been released, other than its projected costs. In addition the revenue impact shown on Table 1 above, the Governor proposes an appropriation of $500 thousand each biennium to the Department of Education to administer this program.[4]

**Limit applicability of Foreign Operating Corporation rules:** Minnesota law defines a special category of corporations – foreign operating corporations (FOC) – that qualify for special tax treatment. Generally, these corporations are domestic corporations with less than 20 percent of their property and payroll in the US. The special tax treatment (foreign royalties subtraction and dividends received deduction) can result in 80 percent of their income being exempt from taxation.

These tax rules were enacted in the late 1980s, at the time Minnesota adopted a unitary business combined reporting method for taxing corporate income. It was argued that these provisions were necessary to offset the heavy taxation of foreign operations that would otherwise occur using the combined reporting method.

The Governor's proposals aim to ensure that an FOC's foreign operations have economic substance and are not just a guise to shift profits into a nontaxable shell or form. The proposal would require an FOC to have at least $2 million in foreign property and $1 million in foreign

[4] This appropriation is shown as part of the Governor's proposals for Education Finance.

payroll. This *de minimus* threshold would raise an estimated $2.28 million in the current biennium, but the estimated gain declines in future years.[5]

## Sales and Use Taxes

**Require up-front payment of sales tax on car and small truck leases:** Under current law, a consumer who leases an automobile pays sales tax on each lease payment. The proposal would require that the tax on lease payments all be paid at the time the lease is signed. Although total tax liability would not change, the tax would be paid earlier.[6] The Governor's supplemental recommendations move the effective date forward to October 1, 2005. In addition, it is now recommended that refunds be provided if a lease is terminated early.

Rental vehicles that enter the state after the start of the lease will pay a prorated tax. The up-front tax does not apply to vehicles weighing over 10,000 pounds (heavy trucks) or to short-term rentals of less than 29 days.

This tax shift would raise revenue by $39 million in FY 2006-07 and $6 million in FY 2008-09. There would also be a small revenue increase in future years due to the growth in lease payments.

**Neighboring States:** Iowa, North Dakota, and South Dakota require sales tax on car leases to be paid up front, either by the lessor or the lessee.

**Continue special 12.7 percent tax rate on rental cars beyond expiration date:** Under current law, the sales tax on rental cars will fall from 12.7 percent to the standard sales tax rate of 6.5 percent on January 1, 2006. A sunset data was placed on this special sales tax rate in the 2001 tax omnibus act because the Streamlined Sales Tax Project required that all taxable items be taxed at the same state rate. The Department of Revenue was instructed to determine how the revenue could best be replaced with an alternative form of tax on rental cars. The Streamlined Sales Tax rules have now made it clear that rental car taxes are not covered under the agreement. (All of the revenue from the sales tax on rental cars is deposited in the general fund.)

**Replace sales tax on cigarettes with a per-pack tax levied at wholesale**: Under current law, cigarettes are subject to sales tax at the retail level. The proposal would exempt cigarettes from the sales tax and levy a $0.21 per pack tax on distributors. The rate per pack would be calculated as 6.5 percent of the weighted average retail price, and would be adjusted each year (on July 1st). The new tax would be paid earlier – at the time the wholesaler receives the product rather than at the time of the retail sale. This speedup in the timing of the tax would yield $5.8 million in one-

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[5] The Department of Revenue's *2004 Tax Expenditure Budget* estimates that the FOC provisions benefit about 2000 corporations, reducing taxes by $70 to $75 million per year. The Governor's proposal for *de minimus* thresholds is largely in response to the decision in the *Hutchinson Technology* case. The decline in estimated revenue in the 2006 and 2007 reflects the Revenue Department's belief that corporations will be successful in adapting to the new rules, thus reducing their impact.

[6] The lease price excludes title and registration fees and insurance, which are currently excluded from tax when paid upfront at the beginning of the lease. It also excludes interest paid on the tax if the tax is capitalized into the lease payments.

time revenue in FY 2006.[7] Collecting the tax at the distributor level is also expected to increase compliance, because tax would be collected from about 75 distributors rather than thousands of retail outlets. Increased compliance is estimated to increase tax collections by $2.25 million in FY 2006 and $2.7 million in each later year.[8]

This proposal is similar to replacing the sales tax on cigarettes by raising the excise tax by 21 cents per pack. The tax will be collected following the same rules as the existing 48 cent per pack cigarette excise tax, and the new tax is codified in the same section of law. Unlike the existing excise tax, the new 21 cent per pack tax rate will be adjusted each year for inflation in the price of cigarettes. There are currently two other states that exempt cigarettes from their sales tax and tax them with only an excise tax (Oklahoma and Colorado).

**Define industrial production to exclude natural gas pipelines:** Under current law, certain types of companies are eligible for a refund of taxes paid on purchases of capital equipment.[9] The Minnesota Supreme Court recently ruled (in *Great Lakes Gas Transmission v. Commissioner*, 2002) that certain pipeline companies met that definition. The proposal would overrule that court decision.

**Require remote sellers to collect and remit sales tax in order to do business with the State of Minnesota:** Out-of-state companies who have no physical presence in Minnesota cannot be required to pay sales tax on the sales they make to Minnesotans. This includes some companies who sell to the State of Minnesota. The Governor proposes to require any company making sales to the state to collect and remit Minnesota sales tax on all sales to Minnesotans.[10]

## Other Taxes

**Enact 2.5% gross receipts tax effective when the sales tax rate for alcohol falls by 2.5%:** Under current law, the special 9 percent sales tax on alcoholic beverages will expire at the end of December 2005. A sunset data was placed on this special sales tax rate in the 2001 tax omnibus act because the Streamlined Sales Tax Project (SSTP) required that all taxable items be taxed at the same state rate.[11] At that time, the Department of Revenue was instructed to determine how that revenue could best be replaced with an alternative tax on alcohol. The new 2.5 percent gross

[7] This includes revenue from a one-time tax on cigarette stocks at the retail level on the effective date (August 1, 2005).

[8] The numbers refer to the net change in revenue. Sales tax revenue will fall, and revenue from the new per-pack tax would exceed the loss in sales tax revenue. The revenue from the new tax will not be reported as "sales tax revenue."

[9] M.S. 297A.68 limits eligibility to capital equipment purchased used "primarily for manufacturing, fabricating, mining, or refining tangible personal property."

[10] Technically, these would be use tax payments rather than sales tax. This provision would not apply to state colleges and universities, courts, or any agency in the judicial branch of government. It can be waived in an emergency or if the seller is the single source of the product or service.

[11] SSTP is a multi-state effort to simplify state and local sales taxes. The complexity of the current system means states cannot require sellers to collect tax unless they have a physical presence in the state. As a result, Minnesota will lose an estimated $585 million in sales tax revenue on internet and mail order sales in FY 2006-07. For a more complete discussion of the Sales Tax Simplification Project, see *Summary of the Fiscal Actions of the 2001 Legislature* (http://www.house.leg.state.mn.us/fiscal/files/wrap01/01legact.pdf ), pages 47-48.

receipts tax (at the retail level) will raise the same amount of revenue the expiring extra 2.5 percent sales tax would have raised.

*Violating the spirit (if not the letter) of the STTP agreement:* In 2001, fur clothing was exempted from the sales tax because the agreement allowed no distinction between fur clothing and other clothing (which is exempt.) The sales tax on fur clothing was replaced by a 6.5 percent gross receipts tax (at the wholesale level.) This has been widely criticized as violating the spirit of simplicity. This proposal to replace the higher rate on alcohol with a retail-level gross receipts tax (rather than replacing the revenue with higher excise tax rates) is likely to be criticized as well, and may be ruled as violating that agreement. However, only one other state has had a differential sales tax rate on alcohol (North Dakota) and it has taken this same approach.

**Reduce premiums tax rate on life insurance from two percent to 1.5 percent:** The Governor proposes to phase the tax rate down by 1/8 percent each year (starting in 2006) until it reaches 1.5 percent in 2009. This would make life insurance companies headquartered in Minnesota more competitive in the national market. Because the U.S. Supreme Court has ruled that insurance is not commerce, most states have enacted retaliatory tax provisions (which would otherwise have been ruled unconstitutional under the commerce clause). As a result, a Minnesota company selling life insurance in another state is taxed at the higher of that state's rate or the Minnesota rate. As the insurance market has become more competitive, many states have lowered their tax rates to help their home state companies compete in the national market. For Minnesota companies, a lower Minnesota tax rate will reduce the tax they pay on sales in other states that have tax rates below Minnesota's current two percent rate.

**Subject stop-loss policies to insurance premiums tax**:[12] Stop-loss policies allow employers who self-insure to limit their risk by capping their maximum losses. The Minnesota Supreme Court recently ruled (in *Blue Cross Blue Shield of Minnesota v. Commissioner*, 2003) that these policies were not subject to the insurance premiums tax. This Governor recommends returning to the tax treatment prior to the court ruling. The true self-insurance component of self-insured plans would remain exempt. The proposed change will make the tax treatment of self-insured plans (which federal law exempts from tax under ERISA rules) somewhat more equal to the tax treatment of employee health coverage provided by insurers.

**Allow quarterly or annual liquor tax payments if tax liability is below $500 per month**: This would simplify tax filing for roughly 100 taxpayers. Although tax liability remains unchanged, the delay in payments relative to current law results in a one-time revenue loss.

**Base fur tax liability on actual quarterly sales**: Currently this 6.5 percent gross receipts tax on fur clothing must be paid in equal quarterly payments based on the larger of 90 percent of current year sales or 100% of last year's sales. This change will simplify tax calculation for the 25 furriers who pay the tax. Although total liability will remain unchanged, the delay in payments relative to current law results in a one-time revenue loss.

[12] In addition to the change in general fund revenue shown in Table 1 above, this proposal would raise Health Care Access Fund revenue, as shown in Table 3 below.

**Increase Bioscience Zone cap by $1 million:** The Biotechnology and Health Science Zone was created in 2003. At that time, the tax benefits for qualifying Biotechnology Zone businesses were limited to a total of $1 million, which could be claimed only in the 2004-05 biennium. Businesses apply to the Department of Employment and Economic Development (DEED) for their share of the maximum $1 million in tax certificates.

*Although the zone was authorized for 12 years, no state tax exemptions or credits were authorized beyond the 2004-05 biennium.*[13] The Governor recommends funding $1 million of tax breaks in the zone in the FY 2006-07 biennium.

**International Trade Zone**: The Governor proposes designating a new international economic development zone within 60 miles of the Minneapolis-St. Paul International Airport. The goal is to stimulate development of a regional distribution center, increasing the airport's capacity for international air freight. One contiguous zone of between 500 and 1000 acres would be designated. The new zone would last for 12 years and zone businesses would be granted most of the tax breaks provided within Job Opportunity Building Zones (JOBZ).

The proposed exemptions from state and local taxes are shown in the box below. Over 95 percent of the state fiscal cost through 2009 is due to sales tax exemptions. No appropriation is requested to administer these provisions.

[13] This differs from the JOBZ zones, which were also authorized for 12 years but which have an open appropriation to cover the cost of the tax benefits over the life of the zones.

**International Economic Development Zone**

**Eligible Businesses**: Either (a) an owner or operator of a regional distribution center or (b) a freight forwarder, operating within the zone, and paying each employee salary and benefits equal to at least 110 percent of the federal poverty guideline for a family of four ($18,850 in 2004.)

*Recapture provision*: A business that ceases business operations in the zone must repay any tax reductions received in the 2 years immediately prior to ceasing operations in the zone.

**Businesses** in those zones would generally be exempt from the following taxes for up to twelve years:

- Local property tax on all real property and improvements (though land would still be taxed)
- State property tax on all real property and improvements
- State and local sales and use taxes on goods and services a qualified business uses within the zone
- State and local sales and use taxes on construction materials for business improvements within the zone (whether purchased by the business or a contractor)
- Corporate franchise tax Income tax on business income
- Income tax on rental income from real or tangible personal property located in the zone
- Income tax on capital gains from sale of real or tangible personal property located in the zone (prorated by share of time property was owned while the zone was in effect)

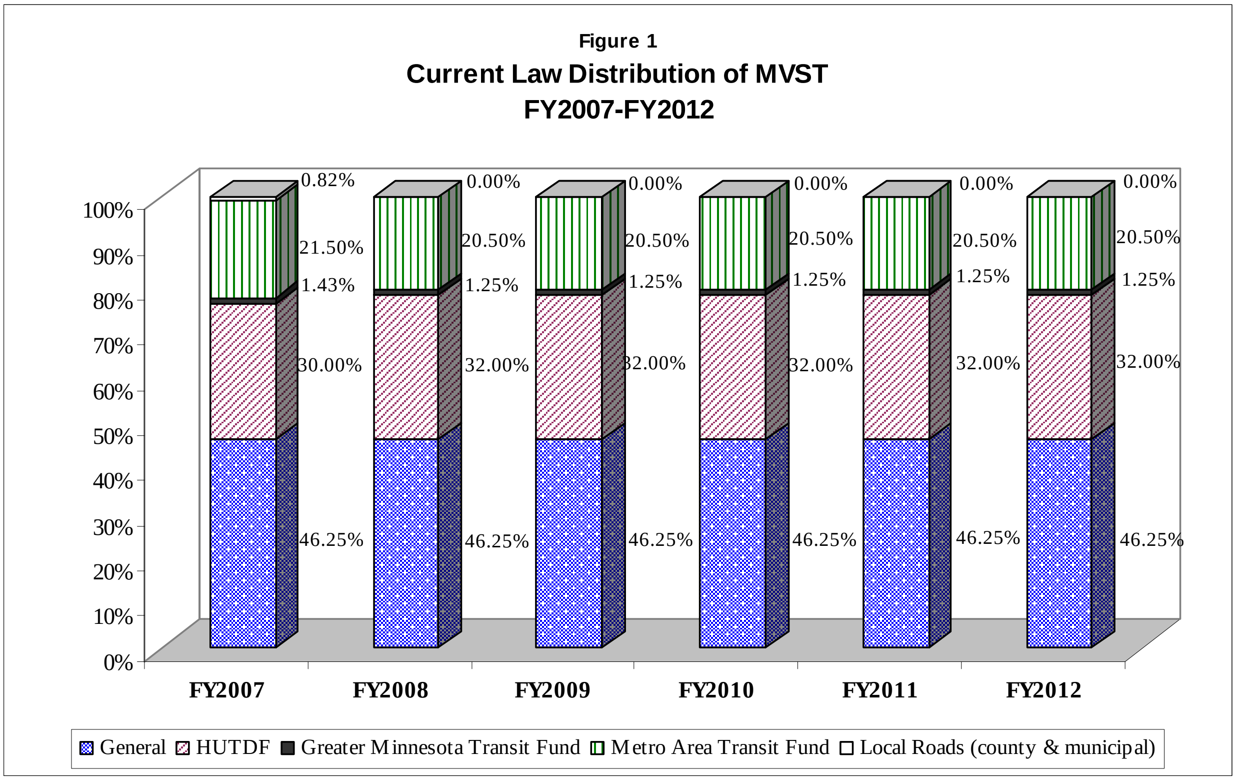
**Payroll Credit:** Businesses would also qualify for a 7 percent tax credit on each dollar of total payroll in excess of $30,000 times the number of full-time equivalent employees. (Pay over $100,000 is subtracted from total payroll for this calculation.) The credit is refundable, and dollar amounts are indexed for inflation.

### Other Revenues

**Casino revenue**: The Governor includes an additional $200 million in new revenue in FY 2006-07 from a single new casino in the Minneapolis-St. Paul metro area. The casino would be operated as a partnership between several tribal governments and the State Lottery, who would share the casino's revenues. The FY 2006-07 revenue would come in the form of an up-front licensing payment. The supplemental budget recommendations documents also show $228 million of general fund revenue in FY 2008-09.

*The fiscal impact of this provision is not included in the totals shown in Table 1 above.*

**Redistribution of Motor Vehicle Sales Tax revenues:** Under current law, revenues from the motor vehicle sales tax (MVST) are allocated to the following funds: general fund (46.25%), highway user tax distribution fund (30%), greater Minnesota transit fund (1.43%), metro area transit fund (21.5%), and local roads (0.82%).[14] Figure 1 shows the current distribution of the motor vehicle sales tax which is scheduled to change slightly beginning in fiscal year 2008. The current *total* estimated revenues for the motor vehicles sales tax is $1.15 billion for FY2006-07 and $1.22 billion for FY2008-09.

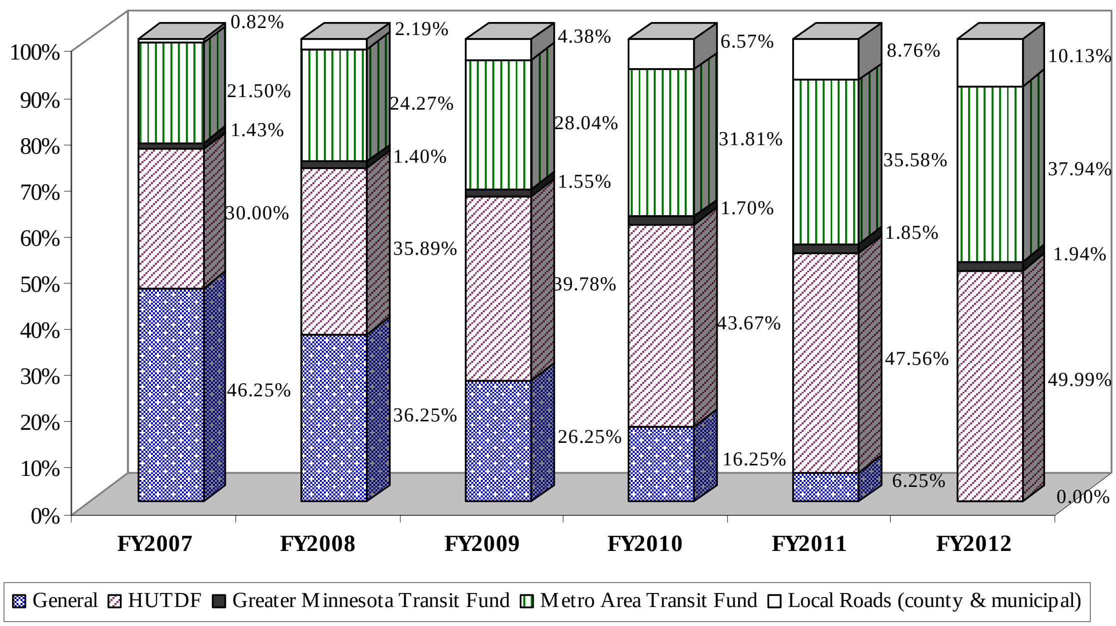



The Governor proposes a constitutional dedication of 100 percent of the motor vehicle sales tax to transportation[15]. This proposal would reallocate the general fund portion of the motor vehicle sales tax revenues to the other funds currently receiving a portion of the revenues. The reallocation of the revenues would phase-in over five years beginning in fiscal year 2008. The general fund portion of the tax would decrease as follows: 36.25% in FY2008, 26.25% in FY2009, 16.25% in FY2010, 6.25% in FY2011, and 0% in FY2012. This will decrease general fund revenues by $62.7 million beginning in FY2008 and $128.8 million in FY2009. Figure 2 shows the five-year phase-in of the redistribution of the motor vehicle sales tax under the Governor's proposal.[16]

| |
|---|
| *The fiscal impact of this provision is not included in the totals shown in Table 1 above.* It is being tracked in the Transportation Finance committee's section of this Money Matters. See www.house.leg.state.mn.us/fiscal/files/Gov05Op/tran.pdf. |

[14] The 0.82% for local roads is the combination of the county state aid highway fund (0.65%) and the municipal state aid street fund (0.17 %.)
[15] This recommendation is shown as part of the Governor's proposal for Transportation.
[16] For the purposes of showing the five years of the motor vehicle sales tax in Figure 1 and 2, it was assumed that the motor vehicle sales tax revenue would increase by 2.7 percent annually in FY2010 through FY2012.

**Figure 2**
**Governor's Recommendation for the Distribution of MVST**
**FY2007-FY2012**




**Replace State-Funded Campaign Fund with Taxpayer Funded Campaign Check-off**. Under current law, a taxpayer can check a box on the income tax or property tax refund return to dedicate $5 to fund campaigns for state office. Checking this box does not increase the taxpayer's tax liability. The Governor proposes to repeal this state-funded check-off, but replace it with a voluntary check-off that would be added to the taxpayer's tax (or subtracted from the taxpayer's refund). The Governor would also eliminate the $1.5 million statutory biennial appropriation that currently supplements the revenue from the current check-off. This change is expected to cut participation by 50 percent. These changes are expected to save the general fund $5.56 million in the FY 2006-07 biennium and $2.56 million in FY 2008-09.

*The fiscal impact of this provision is not included in the totals shown in Table 1 above***.** They are being tracked in the State Government Finance committee's section of this Money Matters. (See www.house.leg.state.mn.us/fiscal/files/Gov05Op/states.pdf)

# *Changes in General Fund Expenditures*

The Governor recommends net general fund expenditure base reductions totaling $73 million, a 2.5% reduction, for FY 2006-2007 and $82 million in FY2008-09 for property tax aids and credits. The major expenditure reduction items include changes to the renter's property tax refund program, extending the temporary reduction to the market value homestead credits to cities and eliminating the political contribution refund program. In addition, the Governor proposes increasing levy authority for school districts which results in an increase in expenditures for the homeowner property tax refund program by $3.7 million in FY2006-07.

Table 3
**Changes in General Fund Aids and Credits Expenditures**
*(Dollars in thousands)* [1]

| | February Forecast FY 2004-05 | Base FY 2006-07 | Governor's Recs FY 2006-07 | Percentage Change Gov. FY 2006-07 vs. February FY 2004-05 | Percentage Change Gov. vs. Base FY 2006-07 |
|---|---|---|---|---|---|
| **Refunds** | | | | | |
| Homeowner Property Tax Refund | $281,299 | $350,000 | $353,695 | 25.74% | 1.06% |
| Renter Property Tax Refund | 290,981 | 302,100 | 271,700 | -6.63% | -10.06% |
| Political Contribution Refund | 10,648 | 11,000 | 500 | -95.30% | -95.45% |
| Other Refunds | 59,383 | 47,933 | 47,933 | -19.28% | 0.00% |
| **Total Refunds** | **642,311** | **711,033** | **673,828** | **4.91%** | **-5.23%** |
| | | **Biennial Change** | **($37,205)** | | |
| **Local Aids** | | | | | |
| Local Government Aid | $902,455 | $873,276 | $873,276 | -3.23% | 0.00% |
| County Program Aid | 272,621 | 411,892 | 411,892 | 51.09% | 0.00% |
| Local Pension Aids | 203,420 | 231,492 | 231,492 | 13.80% | 0.00% |
| Other Local Aids | 127,868 | 64,429 | 64,429 | -49.61% | 0.00% |
| **Total Aids** | **1,506,364** | **1,581,089** | **1,581,089** | **4.96%** | **0.00%** |
| | | **Biennial Change** | **($0)** | | |
| **Property Tax Credits** | | | | | |
| Market Value Homestead Credit | $587,584 | $599,299 | $563,485 | -4.10% | -5.97% |
| Market Value Agricultural Credit | 47,736 | 47,457 | 47,457 | -0.58% | 0.00% |
| Senior Property Tax Deferral | 336 | 533 | 552 | 64.29% | 3.56% |
| Other Credits | 21,529 | 21,418 | 21,418 | -0.52% | 0.00% |
| **Total Credits** | **651,185** | **669,362** | **633,581** | **-2.70%** | **-5.35%** |
| | | **Biennial Change** | **($35,781)** | | |
| | | **Total Biennial Change** | **($72,986)** | | |
| **Total** | **$2,805,860** | **$2,960,815** | **$2,887,829** | **2.92%** | **-2.47%** |

[1]Negative numbers represent expenditure reductions (budget savings) and positive numbers represent expenditure increases

## Local Aids and Credits

**Renter's Property Tax Refund:** The Governor recommends reducing the "percent of rent constituting property taxes" from 19 percent to 16 percent in fiscal year 2007 (refunds based on rent paid in 2005) and to 15 percent in fiscal year 2008 and after (refunds based on rent paid in 2006 and after) for the purposes of calculating the renter's property tax refund also referred to as the "renter's credit." The proposed change results in a reduction in general fund expenditures for the renter property tax refund program of $30.4 million for the FY2006-07 biennium, or a 10 percent reduction from the current forecast base, and $82.2 million reduction for the FY2008-09 biennium.

In 1997 the percent of rent constituting property taxes was changed to a fixed rate of 18 percent and was amended in 1998 to the current law rate of 19 percent. Prior to 1997, rent constituting property taxes was the actual amount of property tax included in the rent. Landlords would calculate the property tax that was attributable to rent for each rental unit.

The Department of Revenue recently surveyed approximately 58,000 landlords in Minnesota to obtain current data on the amount of rent that actually constitutes property taxes. Preliminary analysis of the results by the department of Revenue suggests that rent constituting property taxes varies widely by area and is generally 15 percent or lower.

Below are current estimates for reducing the percent of rent constituting property taxes.

Table 4
**Property Tax Refunds for Renters**
**Options for Computation of Rent Constituting Property Taxes**

| | **($ Millions) Expenditure (Increase) or Decrease** | | |
|---|---|---|---|
| | **F.Y. 2007** | **F.Y.2008** | **F.Y.2009** |
| Change Renter Tax from 19% to 18 % | $10.0 | $10.1 | $10.1 |
| Change Renter Tax from 19% to 17% | $20.2 | $20.3 | $20.4 |
| Change Renter Tax from 19% to 16% | $30.4 | $30.7 | $30.9 |
| Change Renter Tax from 19% to 15% | $40.8 | $41.1 | $41.5 |
| Change Renter Tax from 19% to 14% | $51.1 | $51.6 | $52.0 |
| Change Renter Tax from 19% to 13% | $61.4 | $62.0 | $62.6 |

Source: Department of Revenue

A reduction in rent constituting property taxes will affect all individuals eligible to receive the refund and some renters will become ineligible for a refund. The current maximum refund is $1,310 for claims filed in 2005, based on rent paid in 2004 and 2004 household income. For 2004, program eligibility is restricted to claimants with incomes of $45,970 or less. Under current law, the maximum refund and income is indexed for inflation. The table below (table 5) shows the most recent data for the number of returns filed, the amount of refunds paid and the average return for individuals under 65 years old, senior or disabled individuals, and the breakdown of metro and non-metro filers.

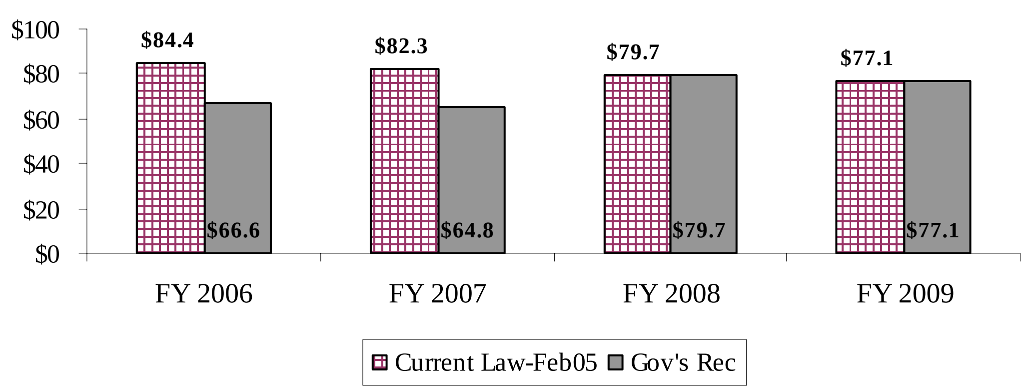
| Table 5<br>**2003 Statewide Renter Property Tax Refunds**<br>**Filed in 2003 (based on 2002 incomes and rent paid in 2002)** | | | | | |
|---|---|---|---|---|---|
| **Filer** | **Number of returns** | | **Total Amount** | | **Average Return** |
| Under 65 | 193,466 | 71.4% | $94.4 mil | 69.3% | $488 |
| Seniors | 77,513 | 28.6% | $41.9 mil | 30.7% | $541 |
| **Total** | **270,979** | **100.0%** | **$136.3 mil** | **100.0%** | **$503** |
| Metro | 160,850 | 59.4% | $89.0 mil | 65.3% | $554 |
| Non-Metro | 100,686 | 37.2% | $43.0 mil | 31.5% | $427 |
| Unknown | 9,443 | 3.5% | $4.3 mil | 3.2% | $458 |

Table Source: House Research Department/Data Source: Department of Revenue

**Extend reductions to Market Value Homestead Credit reimbursements for certain cities**: In aids payable in 2003 and 2004, 103 cities received temporary reductions in the market value homestead credit reimbursement totaling $39 million for the FY2004-05 biennium. Under current law, the market value homestead credit reimbursement to cities is scheduled to return to full funding beginning in fiscal year 2006.

The Governor's budget proposes extending the temporary reductions in the market value credit reimbursement to cities for reimbursements payable in 2005 and 2006 resulting in an expenditure reduction of $35.3 million for the FY2006-07 biennium. The Governor recommends the market value homestead credit reimbursement to these cities return to full funding in fiscal year 2008. Under the previous reductions and in the Governor's current proposal, the homeowner still receives the full amount of the credit on their property tax statement; however, the city's reimbursement for the credit is reduced. The estimated budget savings from extending the reductions under the Governor's proposal is slightly less than the savings achieved in the FY2004-05 biennium because the current law forecast for the cost of the market value homestead credit program is lower for the FY2006-07 biennium. Figure 3 shows the amount of market value homestead credit reimbursement that cities are estimated to receive under current law versus the Governor's proposal.

Figure 3
**Proposed Market Value Credit Reduction to Cities**
**(dollars in millions)**



**Change Market Value Homestead Credit calculation for fractional homesteads:** The Governor recommends amending the calculation of the market value homestead credit for fractional homesteads (i.e., property only partially homesteaded because one or more of the owners does not reside at the property). Prior to the class rate compression in the 2001 property tax reform, the benefit a fractional homestead received was the classification rate of a homestead property for the portion of the property that was homesteaded. Under current law, homestead and non-homestead properties have the same class rate; therefore the current benefit to fractional homesteads is the market value homestead credit.

The phase-out mechanism on the calculation of the market value homestead credit decreases the amount of credit a homestead property can receive as the market value increases above $76,000. The credit is calculated on the full market value of a homestead property, whereas for a fractional homestead, the credit is calculated on the fraction of the property's market value that is homesteaded. This results in fractional homesteads receiving a higher credit amount and therefore a lower net tax than a full homestead due to the phase-out mechanism. The Governor's recommendation amends the calculation of the credit so that a fractional homestead's credit is calculated as if the entire property was homesteaded and then the amount of the credit is multiplied by the fraction of the property that is homesteaded. (See example calculation below in table 6.) This results in an expenditure reduction to the market value homestead credit program of $0.5 million in FY2006-07 and $1 million in FY2008-09.

Table 6
**Example of Homestead vs. Fractional Homestead Current Law and Correction**

| **Property Type:** | **Homestead (Full)** | **Fractional Hmstd (50/50-NonHmstd)** ***Current Law*** | **Fractional Homestead (50/50-NonHmstd)** ***Gov's Rec*** |
|---|---|---|---|
| **A. Market Value** | $200,000 | $200,000 ($100,000 Hmstd/ $100,000 Non-Hmstd) | $200,000 ($100,000 Hmstd/ $100,000 Non-Hmstd) |
| **B. Class Rate** | 1.0 | 1.0/1.0 | 1.0/1.0 |
| **C. Net Tax Capacity** (A x B) | $2,000 | $2,000 | $2,000 |
| **D. Total Local Tax Rate** (sum of all tax rates for each jurisdiction authorized to levy on property) | 115.00 | 115.00 | 115.00 |
| **E. Gross Tax** (C x D) | $2,300 | $2,300 | $2,300 |
| **F. Market Value Credit** (0.40% of MV, max = $304; phase-out rate of 0.09% after $76,000) | **$192.40** (Calculated on homestead MV = $200K) | **$282.40** (Calculated on homestead fraction of MV = $100K) | **$96.20** (Calculated on Homestead MV =$200K, but then multiplied by 50%) |
| **G. Total Net Tax** (E – F) | **$2,107.60** | **$2,017.60** | **$2,203.80** |

In 2004, the House Omnibus Tax Bill (HF 2540) included a variation of this change. The House bill retained the current law calculation of the credit, however it capped the amount of credit a fractional homestead could receive at the amount of credit received by a full homestead property of the same market value. Using the example in table 6, the credit would be $192.40 for a fractional homestead under the proposal in the House Bill, the same as if the property were fully homesteaded.

**Include special assessments for the Senior Property Deferral Program**: Under current law, individuals 65 years or older who have a total household income of $60,000 or less and meet other qualifications can apply for the Senior Property Tax Deferral program. This program allows seniors to defer the amount of their property taxes that exceeds three percent of their household income to a later time. The state then pays the county where the home is located the amount of the deferred tax. The current law estimate for the Senior Property Tax Deferral program is $533,000 for the FY2006-07 biennium. The Governor proposes allowing special assessments and other charges that appear on the property statement to be eligible for the program. The proposed change slightly increases program expenditures by $19,000 for FY2006-07 and by $57,000 in FY2008-09. The proposed change effects 101 seniors currently enrolled in the program.

## Other Expenditures

**Eliminate the Political Contribution Refund Program**: The Governor recommends permanently eliminating the political contribution refund program. The elimination of this program would reduce general fund expenditures by $10.5 million in the FY2006-07 biennium and by $9.9 million in the FY2008-09 biennium.

The political contribution refund program was established in 1990 to provide state paid cash refunds to individuals that contribute to a political party or a candidate for state office who agree to spending limits. The refund is equal to 100 percent of the contribution amount up to $50 for an individual and $100 for a married couple.

**Property Tax Refund Impact of Proposed Increase School Levies**: The Governor recommends increasing the amount schools districts can levy by $148 million in FY2006-07 and $445 million in FY2008-09 relative to current law[17]. The proposed increase in school levies is likely to increase the property tax burden on all taxpayers including homeowners. The increased property tax burden on homeowners would increase state paid homeowner property tax refunds by $3.7 million in FY2006-07 and $11.1 million in FY2008-09.

[17] This recommendation is shown as part of the Governor's proposal for Education Finance.

# *Non-General Fund Changes*

## Health Care Access Fund

Table 7
**Changes in Health Care Access Fund Revenues**
(*Dollars in thousands*[1])

| | Effec. Date | FY 2006 | FY2007 | FY 06-07 Biennium | FY 2008 | FY 2009 | FY 08-09 Biennium |
|---|---|---|---|---|---|---|---|
| Subject stop-loss policies to insurance premiums tax | 1/1/06 | $800 | $2,300 | **$3,100** | $2,700 | $3,300 | **$6,000** |
| Exempt TRICARE payments from provider tax | 1/1/06 | (1,730) | (1,410) | **(3,140)** | (1,500) | (1,580) | **(3,080)** |
| **TOTAL** | | **$(930)** | **$890** | **$(40)** | **$1,200** | **$1,720** | **$2,920** |

[1] Negative numbers represent a cost to the state and positive numbers represent a gain to the state.

**Subject stop-loss policies to insurance premiums tax**: Stop-loss policies allow employers who self-insure to limit their risk by capping their maximum losses. The Minnesota Supreme Court recently ruled (in *Blue Cross Blue Shield of Minnesota v. Commissioner*, 2003) that these policies were not subject to the insurance premiums tax. This Governor recommends returning to the tax treatment prior to the court ruling. The true self-insurance component of self-insurance plans would remain exempt. The proposed change will make the tax treatment of self-insured plans (which federal law exempts from tax under ERISA rules) somewhat more equal to the tax treatment of employee health coverage provided by insurers.

**Exempt TRICARE payments from provider tax**: TRICARE is a federally-funded health plan for military personnel (active, reserve, and retired) and their dependents. The MinnesotaCare taxes generally exempt payments received directly from the federal government. (The proposal would not exempt out-of-pocket payments received from the insured.)

## Environmental Fund

Table 8
**Changes in Environmental Fund Revenues & Expenditures**
(*Dollars in thousands*[1])

| | FY 2006 | FY2007 | FY 06-07 Biennium | FY 2008 | FY 2009 | FY 08-09 Biennium |
|---|---|---|---|---|---|---|
| Appropriation to Department of Environmental Protection | $11,760 | $11,760 | **$23,520** | $11,760 | $11,760 | **$23,520** |
| Increase SWMT proceeds to Environmental Fund to 70% | 12,171 | 12,442 | **24,613** | 12,750 | 13,072 | **25,822** |
| **TOTAL** | **$411** | **$682** | **$1,093** | **$990** | **$1,312** | **$2,302** |

**Increase proceeds of Solid Waste Management Tax to the Environmental Fund**: The Governor recommends establishing a Department of Environmental Protection that essentially merges the current departments of the Minnesota Pollution Control Agency and the Office of Environmental Assistance. To partly fund the new agency, the Governor recommends increasing the percentage of the Solid Waste Management Tax (SWMT) proceeds that are directed to the Environmental Fund. Under current law, the greater of 50 percent or $22 million of the proceeds are directed to the Environmental Fund and 50 percent goes to the general fund. The Governor's proposal increases the percentage to the greater of 70 percent or $33.8 million to the Environmental Fund.

Increasing the percentage of the SWMT proceeds directed to the Environmental Fund results in a loss of revenue to the general fund. The current appropriation to the Office of Environmental Assistance (OEA) from the general fund will move to the Environmental Fund resulting in an expenditure reduction to the general fund (budget savings.) This leaves a relatively small net loss in the general fund because the loss in revenue is slightly greater than the expenditure reduction. The net impact to the general fund is shown below and is part of the proposal for Agriculture, Environment and Natural Resources Finance.

| | FY2006 | FY2007 | FY2008 | FY2009 |
|---|---|---|---|---|
| Expenditure Reduction to OEA | ($11,760) | ($11,760) | ($11,760) | ($11,760) |
| Revenue loss from increasing SWMT proceeds to Env. Fund | ($12,171) | ($12,442) | ($12,750) | ($13,072) |
| **Net Impact to General Fund** | **($411)** | **($682)** | **($990)** | **($1,312)** |

*The fiscal impact of this provision is not included in the totals shown in Table 3 above.* It is being tracked in the Agriculture, Environment and Natural Resource committee's section of this Money Matters. See www.house.leg.state.mn.us/fiscal/files/Gov05Op/env.pdf.

## Airports Fund

**Exempt air ambulances from aviation fuel tax**: Vehicular ambulances are now exempt from the motor fuels tax. This would provide a similar tax exemption for air ambulance services registered the state. There are currently seven such companies.

Table 9
**Changes in Airports Fund Revenues & Expenditures**
(*Dollars in thousands*[1])

| | FY 2006 | FY2007 | FY 06-07 Biennium | FY 2008 | FY 2009 | FY 08-09 Biennium |
|---|---|---|---|---|---|---|
| Exempt air ambulances from aviation fuels tax | $(15) | $(15) | **$(30)** | $(15) | $(15) | **$(15)** |

***For additional information on income, corporate, sales and health care taxes, contact Paul Wilson at 651-297-8405, or paul.wilson@house.mn .***

***For additional information on property aids and credits, motor vehicle taxes and other taxes, contact Marie Zimmerman at 651-296-7171 or marie.zimmerman@house.mn .***