# Short Subjects

## Minnesota House of Representatives, House Research

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**Karen Baker and Steve Hinze** **Updated: January 2007**

# Limited Market Value

***What is limited market value?***

Limited market value (LMV) is a limitation on the amount that a property's market value may grow from one year to the next for purposes of property taxation. It was enacted to help mitigate rising property taxes resulting from rapidly inflating property values.

***What property does LMV apply to?***

The following classes of property qualify for LMV:

- agricultural homestead and nonhomestead
- residential homestead and nonhomestead
- seasonal recreational residential property (i.e., cabins)
- timberland (beginning with the 2001 assessment)

***Is it permanent?***

LMV provisions were in effect from 1973 to 1979, and again from 1993 to the present. The 2001 Legislature phased out LMV over a six-year period—from assessment years 2002-2007. The 2005 Legislature extended the phaseout an additional two years. Beginning in assessment year 2009 (for taxes payable in 2010), all property will be valued at its estimated full market value for property tax purposes. The table at the bottom of the page shows the phase-out schedule.

***Does the assessor continue valuing the property?***

The assessor continues to determine the property's fair market value. This value is called the "estimated market value" (EMV). However, property that qualifies for treatment under LMV may not be taxed at the full value of the property if its growth exceeds the limits.

***How does it work?***

For qualifying property in assessment year 2006 (taxes payable in 2007), the increase in market value cannot exceed the **greater** of:

- 15 percent of the LMV in the preceding assessment year, or
- 25 percent of the difference between the current year's EMV and the previous year's LMV.

***How does the phaseout work?***

For each year, the maximum valuation increase is determined by calculating the increase allowed under columns (1) and (2), and choosing whichever is higher.

| Assessment Year/ Payable Year | (1) Percentage of previous year's LMV | (2) Percentage of difference between previous year's LMV and current year's EMV |
|---|---|---|
| 2002/2003 | 10% | 15% |
| 2003/2004 | 12 | 20 |
| 2004/2005 | 15 | 25 |
| 2005/2006 | 15 | 25 |
| 2006/2007 | 15 | 25 |
| 2007/2008 | 15 | 33 |
| 2008/2009 | 15 | 50 |

***Example calculations***

*Assessment year 2006/payable year 2007*
The LMV of a home is $100,000 for assessment year 2005. For assessment year 2006, the assessor determines that the EMV of the home is $130,000. The maximum market value increase for tax purposes is the greater of:

- 15 percent increase over the previous year, which is $15,000, or
- 25 percent of the $30,000 difference in value, which is $7,500.

Therefore, the home's LMV is $100,000 plus $15,000, or $115,000 for assessment year 2006 (for taxes payable in 2007).

***How much has LMV grown?***

The table below shows the amount of market value that LMV excluded from the tax rolls for tax years 1994-2007.

| **Taxes Payable Year** | **EMV*** | **LMV*** | **Excluded Value*** | |
|---|---|---|---|---|
| | | | **Amount** | **Percentage** |
| 1994 | $124.1 | $123.5 | $0.7 | 0.5% |
| 1995 | 132.0 | 131.0 | 1.0 | 0.8 |
| 1996 | 142.1 | 140.4 | 1.6 | 1.1 |
| 1997 | 152.1 | 150.0 | 2.0 | 1.3 |
| 1998 | 163.6 | 161.1 | 2.5 | 1.5 |
| 1999 | 176.6 | 173.3 | 3.4 | 1.9 |
| 2000 | 202.6 | 197.0 | 5.6 | 2.8 |
| 2001 | 226.4 | 215.8 | 10.6 | 4.7 |
| 2002 | 260.4 | 239.4 | 21.0 | 8.1 |
| 2003 | 284.8 | 253.9 | 30.9 | 10.8 |
| 2004 | 322.9 | 288.0 | 34.9 | 10.8 |
| 2005 | 364.6 | 331.5 | 33.1 | 9.1 |
| 2006 | 412.0 | 379.5 | 32.5 | 7.9 |
| 2007 | 458.2 | 425.2 | 33.0 | 7.2 |

* Affected property classes only. All amounts in billions.

***How much are the classes of property affected by LMV?***

| **Excluded Value by Property Class for Taxes Payable in 2007** | | | |
|---|---|---|---|
| | Excluded Value under LMV (Billions) | Percentage of Total LMV Exclusion | Percentage Reduction Relative to Property Class |
| Residential Homestead | $9.86 | 29.9% | 3.1% |
| Residential Nonhomestead | 3.74 | 11.3 | 10.2 |
| Agricultural | 13.95 | 42.2 | 18.0 |
| Seasonal Rec. Residential | 5.47 | 16.6 | 21.1 |
| **Total** | **$33.03** | **100.0%** | **7.2%** |

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959 or Steve Hinze at 651-296-8956.

**Colbey Sullivan**

**January 2007**

# Corporate Farm Law

***What is Minnesota's corporate farm law?***

In general, the law bars corporations, limited liability companies, pension or investment funds, trusts, and limited partnerships from farming, owning, or leasing farmland in Minnesota. Minn. Stat. § 500.24, Farming by Business Organizations.

***What is the history of the law?***

The current law was passed in 1973 and has been amended roughly 30 times since. However, restrictions on corporate ownership of land in Minnesota predate the codification of Minnesota Statutes in 1939.

***What is the purpose of the law?***

To "encourage and protect the family farm as a basic economic unit, to insure it as the most socially desirable mode of agricultural production, and to enhance and promote the stability and well-being of rural society in Minnesota and the nuclear family." Minn. Stat. § 500.24, subd. 1.

***What constitutes "farming" under the law?***

Farming includes the production of agricultural products, livestock or livestock products, milk or milk products, and fruit or other horticultural products. The law does not apply to food processing, refining or packaging operations, the provision of spraying or harvesting services by a processor or distributor of farm products, the production of timber or forest products, poultry or poultry products, or the feeding and caring for livestock delivered to a corporation for slaughter or processing.

***What are some allowable farm business structures?***

In addition to family farms and multiple family-based business structures (e.g., family farm trust), the law either implicitly or explicitly allows farming and/or farmland ownership/leasing by:

- sole proprietorships;
- general and limited liability partnerships;
- authorized versions of otherwise-prohibited business structures (e.g., authorized farm corporations);
- nonprofits; and
- utility corporations and electric generation or transmission co-ops.

***Are there any additional exceptions to the law?***

Restricted business entities may own and/or operate farmland under the following exemptions:

- land purchased and converted for nonfarm development
- "grandfathered" land owned or leased before certain dates
- land used for growing seed, wild rice, nursery plants, or sod
- certain small parcels of land
- land used for aquatic, religious, breeding stock, and research farms
- gifted or repossessed land if disposed of within a specified period of time

In addition, entities that do not meet any of the above criteria may apply to the commissioner of agriculture for a special exemption.

***Do other states have similar laws?***

Iowa, Kansas, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, and Wisconsin also have corporate farm laws.

***Are these laws constitutional?***

A common requirement of corporate farm laws is that the owner or at least one family member reside on or actively farm the land. In December of 2006, a federal appeals court struck down Nebraska's corporate farm law, ruling that it violated the dormant commerce clause of the United States Constitution. The laws in Iowa and South Dakota were similarly ruled unconstitutional in 2003. All three were found to be discriminatory, benefiting in-state economic interests at the expense of those residing out-of-state.

Minnesota's corporate farm law has never been challenged, due in part to the exemptions added since its original passage in 1973.

**For more information:** Contact legislative analyst Colbey Sullivan at 651-296-5047. Also see the House Research publications *Corporate Farm Law 1851-1991* (November 1991) and *Alien Farmers in Minnesota 1851-2004* (December 2004) for more on the history of laws restricting who may farm and own farmland in Minnesota.

**HOUSE RESEARCH** | **Short Subjects**

**Joel Michael**

**Updated: January 2007**

# Cigarette and Tobacco Excise Taxes and Fees

***Minnesota imposes several taxes and fees on cigarettes and tobacco products***

Minnesota imposes a series of taxes and fees on the sale or possession of cigarettes and tobacco products. The table lists the taxes and fees and their rates. The cigarette taxes and fees are all imposed on a "per unit" basis—i.e., on the number of cigarettes sold, not as a percentage of the sale price. Because the tax is a per unit tax, it does not increase as the price of cigarettes increases. By contrast, the taxes and fees on tobacco products, such as cigars, pipe tobacco, snuff, and chewing tobacco, are imposed as a percentage of their wholesale prices.

| Tax or fee | Per pack of 20 rate | Percent of price |
|---|---|---|
| Cigarette excise tax | 48 cents | NA |
| Tobacco products excise tax | NA | 35% |
| Health impact fee | 75 cents | 35% |
| Fee on cigarettes manufactured by nonsettling companies | 35 cents | NA |
| Tax in lieu of general sales tax (rate for FY2006) | 25.5 cents | NA |

***The 2005 Legislature converted the sales tax to a per pack tax and imposed the health impact fee***

The 2005 Legislature made two changes in cigarette and tobacco products taxation:

- It converted the 6.5 percent state general sales tax on cigarettes to a flat amount per pack tax collected from wholesalers (rather than as a percentage of the retail sale prices, as other products are taxed under the sales tax). The commissioner of revenue annually sets the amount based on a survey of the average retail price of cigarettes. The 2005 legislation set the amount initially at 25.5 cents per pack.
- The 2005 Legislature also imposed a health impact fee of 75 cents per pack of cigarettes and 35 percent of the wholesale price of tobacco products. Combining the Minnesota's excise tax and fee, the burden equals $1.23 per pack and 70 percent of the wholesale price of tobacco products. This fee is imposed and collected in the same manner as the cigarette excise tax.

***Payments made to settle state lawsuits against the tobacco industry have similar effects as excise taxes***

Settlements of the states' lawsuits against the tobacco companies have about the same economic effect as a cigarette tax, since these settlement payments are passed along to consumers (nationally) through higher cigarette prices. However, they do not affect companies that were not part of the lawsuit. To compensate partially for the lower prices of cigarettes produced by nonsettling companies, the 2003 Legislature imposed a 35-cent per pack fee on those cigarettes. Other states have imposed similar fees: Michigan and Utah impose a 35-cent surcharge, and Alaska a 25-cent surcharge.

***The Minnesota Supreme Court upheld both of the fees***

Industry interests challenged both cigarette fees on various grounds. The Minnesota Supreme Court rejected these challenges, upholding the state's power to impose the fees. *Council of Independent Tobacco Mfr. v. State,* 713 N.W.2d 300 (Minn. 2006) *cert. denied* 75 USLW 3121 (2006) (fee on nonsettling companies); *State v. Philip Morris,* 713 N.W.2d 350 (Minn. 2006) (health impact fee).

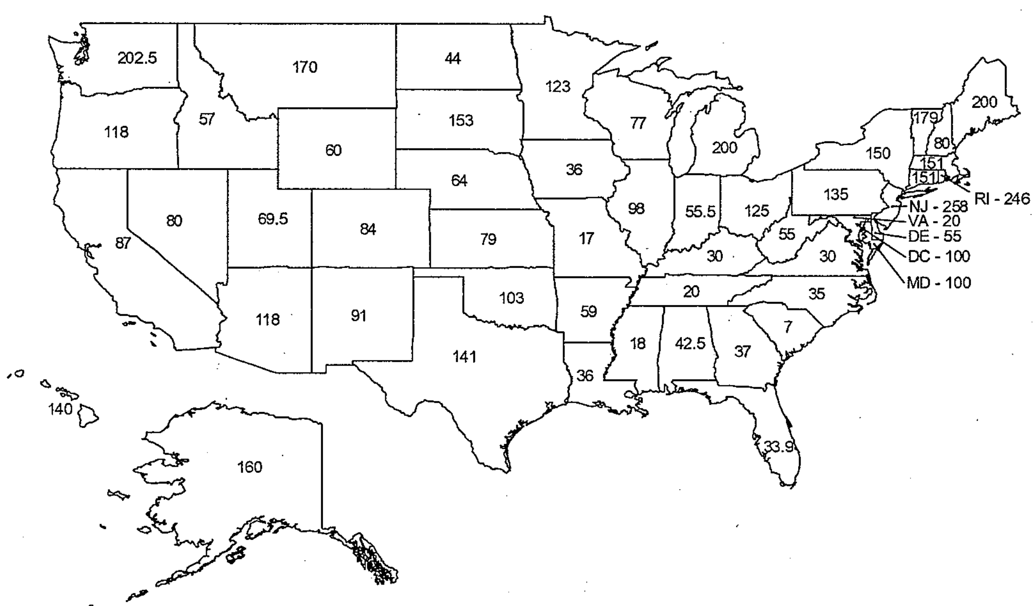
***The taxes and fees are estimated to yield revenues of about $450 million***

For fiscal year 2007, the Finance Department estimates collections from the two excise taxes and the sales tax on cigarettes will be $221.6 million and from the health impact fee, $223.4 million. Revenues from the tobacco products tax are deposited in the general fund. For fiscal year 2007, cigarette tax revenues of $22.25 million go to fund the Academic Health Center, $8.55 million to the medical education and research account, and the rest to the state general fund. The health impact fee revenues are deposited in a health impact fund and are transferred to the general fund after the commissioner of human services certifies that state health programs have incurred tobacco-related costs equal to the fee.

***Neighboring states have significantly lower tax rates***

Because cigarettes can easily be transported, the tax rates in other states (especially border states) are important. Taking into account the combined effects of the tax and fee ($1.23/pack), most of Minnesota's bordering states have lower rates, ranging from 77 cents (Wisconsin) to 36 cents (Iowa). South Dakota ($1.53) has a higher rate. All states' rates are shown on the map. The map does not reflect local cigarette taxes; some of these local taxes are substantial (e.g., $2.00 per pack in Chicago). The map does not reflect the effect of general sales taxes (including Minnesota's per pack tax in lieu of the sales tax). Some states have no sales tax or exempt cigarettes from sales taxation, lowering the overall tax burden. Arizona's rate will rise to $2 on May 1, 2007, and Alaska's and Vermont's rates will increase by 20 cents on July 1, 2007. Hawaii's tax is scheduled to increase by 20 cents each July 1 from 2007 through 2011.

**State Cigarette Tax Rates***
as of 1/1/2007
cents per pack




* These exclude some significant local taxes.
Source: Federation of Tax Administrators and other sources

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057.

**Pat Dalton**

**Updated: January 2007**

# The City LGA Program

***City LGA underwent major changes in 2003***

In 2003 the city local government aid (LGA) program underwent major changes. The revision eliminated most of the city aid base (grandfathered aid) under the old program and distributed more money under new need formulas. The program appropriation was reduced and an automatic inflation adjustment to the appropriation was eliminated.

***The appropriation was reduced, although some of it was restored beginning in 2006***

The reduction in city LGA was done in two stages. City LGA was reduced to $465 million in calendar year (CY) 2003 from the originally certified appropriation of $587 million. The city LGA was further reduced to $429 million in CY 2004 with an additional $8 million paid in transition aid for one year. In 2005, the LGA appropriation was set at $437 million annually. This was increased to $484 million annually beginning with CY 2007 aids.

***Most of the LGA "grandfather" is eliminated***

Under the old law, about $367 million of the total LGA appropriation was "grandfathered" to cities as city aid base—$321 million based on 1993 aid payments and the remainder due to special provisions for specific cities. In CY 2004, the city aid base was reduced to $26.5 million distributed under the special provisions, with most going to large cities in outstate Minnesota based on a provision that was part of the 2001 property tax reform. Beginning with aid in 2006, about $3.9 million of the $48 million additional aid was added to the city aid base to fund an extra $5 per capita to cities with a population under 5,000.

***New measures of city "need" were enacted***

The League of Minnesota Cities (LMC) developed the old measures of city "need" in 1992. The new need formula for large cities, which contains different factors than the old formula, was developed using the same methodology as used in the LMC study. The coefficients for the factors in the small city need measure were updated through regression analysis on current city spending.

***Taconite aid is included in calculating LGA***

The measure of a city's "ability to raise revenue" under the old law was the city's tax base multiplied by an average city tax rate. Under the new law, ability to raise revenue also includes each city's taconite aid payment. The inclusion of taconite aid is phased in over a four-year period beginning with aids payable in 2005. In 2006, the inclusion of taconite aid was removed for seven cities.

***There are limits on increases and decreases to individual cities***

Beginning in CY 2005, increases in LGA payments to any city are limited to an amount equal to 10 percent of the city's levy in the previous year. Decreases for large cities are limited to 10 percent of the city's levy in the previous year, while decreases for smaller cities are limited to 5 percent of the city's *certified* 2003 LGA amount (before 2003 aid reductions).

## City LGA Formula – Old Law vs. Current Law

| Characteristic | Old Law (last in effect in CY 2002) | Current Law as of CY 2007 |
|---|---|---|
| **Funding** | \$587 million in CY 2002<br>Automatic increases between 2.5% and 5.0% annually | \$484.5 million per year with no inflation adjustment |
| **City aid base (grandfathered aid)** | \$360 million; with about \$321 million based on 1993 aid payments | \$30.4 million to certain cities based on specific criteria |
| **City formula aid** | \$227 million distributed based on a percentage of "need" minus "ability to raise revenue" in CY 2002 | \$454.1 million distributed based on a percentage of "need" minus "ability to raise revenue" in CY 2007 |
| **Large city need per capita measure (New formula with some new factors)** | = 152.041<br>+ 3.462312 x pre-1940 housing %<br>+ 2.093826 x comm'l/industrial %<br>+ 6.862552 x pop. decline %<br>+ 0.0026 x population | = 355.0547<br>+ 5.0734908 x pre-1940 housing %<br>+ 19.141678 x pop. decline %<br>+ 2504.06334 x road accident factor<br>- 49.10638 x household size<br>- 35.20915 if in metro area |
| **Small city need per capita measure (Updated coefficients of old formula)** | = 1.795919 x pre-1940 housing %<br>+ 1.562138 x comm'l/industrial %<br>+ 4.177568 x pop. decline %<br>+ 1.04013 x transformed pop.<br>– 107.475 | = 2.387 x pre-1940 housing %<br>+ 2.67591 x comm'l/industrial %<br>+ 3.16042 x pop. decline %<br>+ 1.206 x transformed pop.<br>– 62.772 |
| **Ability to raise revenue measure** | = Average city tax rate x adjusted city tax capacity (tax base) | = Average city tax rate x adjusted city tax capacity (tax base) – 75% of taconite for most taconite cities*<br>(Inclusion of taconite aids will be at 100% for CY 2008 and thereafter) |
| **Limits on increases and decreases** | No city's aid can increase by more than 10% of its levy from the previous year<br><br>No city can receive less aid than its city aid base (grandfathered aid) amount | No city's aid can increase by more than 10% of its levy from the previous year<br><br>No large city's aid loss can exceed 10% of its levy in the previous year and no small city's loss in any year can exceed 5% of its certified 2003 LGA |

* The taconite aid paid to the cities of Babbitt, Eveleth, Hibbing, Keewatin, Mountain Iron, Silver Bay, and Virginia are not included in calculating their ability to raise revenue measure.

**For more information:** Contact legislative analyst Pat Dalton at 651-296-7434. Also see the House Research publication *Aid Cuts to Local Governments in CY 2003 and 2004*, February 2004.

Pat Dalton

Updated: February 2007

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Kathy Novak January 2007

# Election of University of Minnesota Regents

Regents are elected by the legislature to govern the University of Minnesota. The 2005 Legislature changed the process for nominating regent candidates to include a role for the governor and a joint committee of the legislature, established in law. This short subject describes the legal requirements for recruiting, reviewing, recommending, nominating, and electing regents.

***The Minnesota Constitution provides for regent elections***

The Minnesota Constitution requires that 12 regents be elected by a joint convention of the Minnesota Legislature to staggered six-year terms to govern the University of Minnesota. One-third of the board of regents is elected each odd-numbered year at a joint convention of the legislature. Minn. Const., art. XIII, § 3, and University of Minnesota Charter §§ 4 and 5.

***The board of regents must represent specific areas and include one student***

Of the 12 regents, eight must reside in Minnesota's congressional districts, one in each district. Minn. Stat. § 137.024.

The four remaining regents are elected from the state at-large. Minnesota law also requires one of the four at-large regents to be a University of Minnesota student at the time of the election. Minn. Stat. § 137.024.

***Minnesota law requires an advisory council to recruit and screen regent candidates***

The regent candidate advisory council is established in law to identify, recruit, and recommend qualified candidates. The council has 24 members, including student members, appointed by the House and the Senate to staggered terms. Student members serve two-year terms. All others serve six-year terms. The council now makes its recommendations to the governor, instead of directly to a joint committee of the legislature.

The council must develop selection criteria for recruiting regent candidates. The law now requires the criteria to include representational diversity, including geography, gender, race, occupation, and experience. An additional requirement was added for the council to identify the membership needs of the board, including the skills and characteristics necessary to govern the university. The council's selection criteria cannot include a limit on the number of terms served by an individual regent. Minn. Stat. § 137.0245.

***The advisory council recommends regent candidates to the governor***

Under the 2005 changes, the regent candidate advisory council must make its recommendations to the governor by January 15 of each odd-numbered year. The council must recommend two to four candidates for each regent to be elected.

The council must identify membership needs for the board of regents and include them in a report to the governor.

***The governor submits a slate of candidates to a joint legislative committee***

Under the 2005 law, the governor now receives the recommendations of the advisory council and makes recommendations to a joint committee. After receiving the council's recommendations, the governor has until February 15 of the odd-numbered year to nominate regent candidates. The governor must submit a single nominee for each vacancy to a joint committee of the House and Senate; the joint committee is established in law.

In making nominations, the governor must consider the university's needs and what is required to bring gender, racial, and ethnic balance to the board of regents. The governor must inform the joint committee how individual nominees and the slate of nominees meets the needs identified in the advisory council report. Minn. Stat. § 137.0246.

***The joint legislative committee may forward or reject the governor's nominees***

The 2005 Legislature established a joint committee to consider and possibly present the governor's regent nominees to the joint convention. The committee consists of 20 appointed members, half from the Senate, half from the House. In addition:

- five of the appointments of each body must be members of the minority party recommended by the minority leader; and
- the chairs and ranking minority members of the education policy committees and the higher education budget divisions must be appointed.

A committee quorum exists when a majority of the House members and majority of the Senate members are present at the joint committee meeting.

The joint committee must meet by February 28 of each odd-numbered year, or on a date set by concurrent resolution, to consider the governor's slate of regent nominees.

The joint committee may recommend the governor's nominees to a joint convention of the legislature. If the joint committee does not recommend a governor's nominee, the governor must submit a different nominee for the same regent vacancy. Minn. Stat. § 137.0246.

***A joint convention of the Senate and the House elects regents***

The joint rules of the Senate and House provide for the election of the regents at a joint convention of the legislative bodies. The rules require the joint committee to report the names of a person recommended for each seat. The person is considered to be nominated for a regent position. Members of the legislature are authorized to submit additional nominations. The candidate for a regent vacancy who receives a majority of the votes cast is declared the winner. Temporary Joint Rules of the 83rd session, 4.02.

**For more information:** Contact legislative analyst Kathy Novak at 651-296-9253.

Steve Hinze and Karen Baker

Updated: January 2007

# Property Tax 101: Property Tax Variation by Property Type

*What causes property taxes to vary by type of property?*

The primary cause of variation in property tax burdens is Minnesota's classified property tax system. In a classified system, each class of property is assigned one or more *class rates*. The property's taxable market value is multiplied by the class rate(s) to determine the property's tax base, technically called its *net tax capacity*.

Besides the class rates, variations in tax by type of property also occur because the state general tax and school district operating referendum levies apply to some types of property but not to others. (All voter-approved levies, except school district levies for bonded debt, are levied on referendum market value. School district levies for bonded debt are levied on the net tax capacity of all types of property.) The table below shows class rates and the applicability of taxes by type of property.

**Class Rate Schedule for Taxes Payable in 2007**

| Class | Property Type (major property types only) | Class Rate | Subject to State Tax? | Subject to Referendum Levies? |
|---|---|---|---|---|
| **1** | **Homestead** | | | |
| 1a | Residential homestead: | | | |
| | Up to $500,000 | 1.00% | No | Yes |
| | Over $500,000 | 1.25 | No | Yes |
| **2** | **Agricultural** | | | |
| 2a | Agricultural homestead: | | | |
| | House, garage & 1 acre – same as residential homestead | | | |
| | Agricultural land & buildings: | | | |
| | Up to $690,000 | 0.55 | No | No |
| | Over $690,000 | 1.00 | No | No |
| 2b | Agricultural nonhomestead | 1.00 | No | No |
| **3** | **Commercial/Industrial/Public Utility** | | | |
| 3a | Commercial/Industrial/Public Utility: | | | |
| | Up to $150,000 | 1.50 | Yes* | Yes |
| | Over $150,000 | 2.00 | Yes* | Yes |
| | Electric generation attached machinery | 2.00 | No | Yes |
| **4** | **Other residential** | | | |
| 4a | Market-rate apartments (4 or more units) | 1.25 | No | Yes |
| 4bb | Residential nonhomestead single unit: | | | |
| | Up to $500,000 | 1.00 | No | Yes |
| | Over $500,000 | 1.25 | No | Yes |
| 4b | Residential nonhomestead 2-3 unit and undeveloped land | 1.25 | No | Yes |
| 4c | Seasonal recreational residential (noncommercial): | | | |
| | Up to $500,000 | 1.00 | Yes** | No |
| | Over $500,000 | 1.25 | Yes** | No |

* Subject to state general tax at commercial-industrial rate.
** Subject to state general tax at seasonal recreational rate.

***What other factors cause property taxes to vary by type of property?***

Variations also occur because certain types of property qualify for property tax credits that reduce the amount of tax that would otherwise be due. The two largest credit programs are the homestead market value credit and the agricultural market value credit, which apply to all residential homesteads and all agricultural homesteads. Other credits apply to property in some areas of the state but not to others.

Local variation also occurs because tax rates are determined separately for each taxing jurisdiction in the state, based on each jurisdiction's levy and tax base.

***What is effective tax rate?***

Effective tax rate is a measure of tax burden useful in making property tax comparisons. It is defined as net tax divided by market value (i.e., tax as a percent of market value). It allows comparison of tax burdens between properties of different values, different types, and different locations.

**Comparison of Property Taxes on Various Types of Property, within the same taxing jurisdiction, each with a market value of $200,000 (Property taxes payable in 2007)**

| Property Type | Class Rate(s) | Net Tax Capacity | Property Tax* | | Effective Tax Rate |
|---|---|---|---|---|---|
| | | | Gross | Net | |
| Agricultural homestead** | 0.55/1.0% | $1,325 | $1,400 | $873 | 0.44% |
| Agricultural nonhomestead | 1.0 | 2,000 | 2,000 | 2,000 | 1.00 |
| Residential homestead | 1.0 | 2,000 | 2,300 | 2,108 | 1.05 |
| Seasonal recreational residential (i.e., cabin) | 1.0 | 2,000 | 2,386 | 2,386 | 1.19 |
| Residential nonhomestead (1 unit) | 1.0 | 2,000 | 2,300 | 2,300 | 1.15 |
| Residential nonhomestead (2-3 units) | 1.25 | 2,500 | 2,800 | 2,800 | 1.40 |
| Apartment | 1.25 | 2,500 | 2,800 | 2,800 | 1.40 |
| Commercial/Industrial | 1.5/2.0 | 3,250 | 5,143 | 5,143 | 2.57 |
| Commercial/Industrial @ $2,000,000*** | 1.5/2.0 | 39,250 | 61,483 | 61,483 | 3.07 |

* These examples assume a total local net tax capacity tax rate of 100 percent, a state commercial-industrial tax rate of 49 percent, and a state seasonal recreational tax rate of 25 percent, a total market value tax rate of 0.15 percent.

** The agricultural homestead is assumed to consist of a house valued at $50,000 and agricultural land and buildings valued at $150,000.

*** This property has a market value of $2,000,000 to show a typical effective tax rate on a larger commercial/industrial property.

**For more information:** Contact legislative analyst Steve Hinze at 651-296-8956 or Karen Baker at 651-296-8959.

# HOUSE RESEARCH | Short Subjects

Steve Hinze and Karen Baker

Updated: February 2007

## Property Tax 101: Property Tax Variation by Property Type

*What causes property taxes to vary by type of property?*

The primary cause of variation in property tax burdens is Minnesota's classified property tax system. In a classified system, each class of property is assigned one or more *class rates*. The property's taxable market value is multiplied by the class rate(s) to determine the property's tax base, technically called its *net tax capacity*.

Besides the class rates, variations in tax by type of property also occur because the state general tax and school district operating referendum levies apply to some types of property but not to others. (All voter-approved levies, except school district levies for bonded debt, are levied on referendum market value. School district levies for bonded debt are levied on the net tax capacity of all types of property.) The table below shows class rates and the applicability of taxes by type of property.

**Class Rate Schedule for Taxes Payable in 2007**

| Class | Property Type (major property types only) | Class Rate | Subject to State Tax? | Subject to Referendum Levies? |
|---|---|---|---|---|
| **1** | **Homestead** | | | |
| 1a | Residential homestead: | | | |
| | Up to $500,000 | 1.00% | No | Yes |
| | Over $500,000 | 1.25 | No | Yes |
| **2** | **Agricultural** | | | |
| 2a | Agricultural homestead: | | | |
| | House, garage & 1 acre – same as residential homestead | | | |
| | Agricultural land & buildings: | | | |
| | Up to $690,000 | 0.55 | No | No |
| | Over $690,000 | 1.00 | No | No |
| 2b | Agricultural nonhomestead | 1.00 | No | No |
| **3** | **Commercial/Industrial/Public Utility** | | | |
| 3a | Commercial/Industrial/Public Utility: | | | |
| | Up to $150,000 | 1.50 | Yes* | Yes |
| | Over $150,000 | 2.00 | Yes* | Yes |
| | Electric generation attached machinery | 2.00 | No | Yes |
| **4** | **Other residential** | | | |
| 4a | Market-rate apartments (4 or more units) | 1.25 | No | Yes |
| 4bb | Residential nonhomestead single unit: | | | |
| | Up to $500,000 | 1.00 | No | Yes |
| | Over $500,000 | 1.25 | No | Yes |
| 4b | Residential nonhomestead 2-3 unit and undeveloped land | 1.25 | No | Yes |
| 4c | Seasonal recreational residential (noncommercial): | | | |
| | Up to $500,000 | 1.00 | Yes** | No |
| | Over $500,000 | 1.25 | Yes** | No |
| 4d | Low-income apartments | 0.75 | No | Yes |

* Subject to state general tax at commercial-industrial rate.
** Subject to state general tax at seasonal recreational rate.

***What other factors cause property taxes to vary by type of property?***

Variations also occur because certain types of property qualify for property tax credits that reduce the amount of tax that would otherwise be due. The two largest credit programs are the homestead market value credit and the agricultural market value credit, which apply to all residential homesteads and all agricultural homesteads. Other credits apply to property in some areas of the state but not to others.

Local variation also occurs because tax rates are determined separately for each taxing jurisdiction in the state, based on each jurisdiction's levy and tax base.

***What is effective tax rate?***

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| Property Type | Class Rate(s) | Net Tax Capacity | Property Tax* | | Effective Tax Rate |
|---|---|---|---|---|---|
| | | | Gross | Net | |
| Agricultural homestead** | 0.55/1.0% | $1,325 | $1,400 | $873 | 0.44% |
| Agricultural nonhomestead | 1.0 | 2,000 | 2,000 | 2,000 | 1.00 |
| Residential homestead | 1.0 | 2,000 | 2,300 | 2,108 | 1.05 |
| Seasonal recreational residential (i.e., cabin) | 1.0 | 2,000 | 2,386 | 2,386 | 1.19 |
| Residential nonhomestead (1 unit) | 1.0 | 2,000 | 2,300 | 2,300 | 1.15 |
| Residential nonhomestead (2-3 units) | 1.25 | 2,500 | 2,800 | 2,800 | 1.40 |
| Apartment | 1.25 | 2,500 | 2,800 | 2,800 | 1.40 |
| Low-income apartment | 0.75 | 1,500 | 1,725 | 1,725 | 0.86 |
| Commercial/Industrial | 1.5/2.0 | 3,250 | 5,143 | 5,143 | 2.57 |
| Commercial/Industrial @ $2,000,000*** | 1.5/2.0 | 39,250 | 61,483 | 61,483 | 3.07 |

* These examples assume a total local net tax capacity tax rate of 100 percent, a state commercial-industrial tax rate of 49 percent, and a state seasonal recreational tax rate of 25 percent, a total market value tax rate of 0.15 percent.

** The agricultural homestead is assumed to consist of a house valued at $50,000 and agricultural land and buildings valued at $150,000.

*** This property has a market value of $2,000,000 to show a typical effective tax rate on a larger commercial/industrial property.

**For more information:** Contact legislative analyst Steve Hinze at 651-296-8956 or Karen Baker at 651-296-8959.

Randall Chun

Revised: January 2007

# Medical Assistance

Medical Assistance (MA), the state's Medicaid program, is a jointly funded, federal-state program that pays for health care services for low-income individuals. The program is administered locally by counties, under the supervision of the state Department of Human Services (DHS). The program is governed by Minnesota Statutes, chapter 256B, and by federal Medicaid law, which allows states considerable flexibility in designing their Medicaid programs.

***Eligibility***

To be eligible for MA, an individual must meet the following criteria:

- Be a member of a group for which MA coverage is mandatory under federal law or a member of an optional group that the state has chosen to cover. Covered groups include families, children, pregnant women, the elderly, and persons with disabilities.

- Meet program income and asset limits. Different limits apply to different categories of individuals. Certain types of income and specified assets are excluded when determining eligibility. Income and asset limits for selected groups are described below.

| Eligibility group | Net income limit, as % of federal poverty guidelines (FPG) | Asset limit* |
|---|---|---|
| Children < age 2 | 280 | None |
| Children 2 through 18 | 150 | None |
| Children 19 through 20 | 100 | None |
| Pregnant women | 275 | None |
| Parents | 100 | $10,000 for one/$20,000 for two or more persons |
| Aged, blind, or disabled | 100 | $3,000 for one/$6,000 for two/$200 each additional |

* The homestead, household goods, a vehicle, a burial plot and certain assets for burial expenses, and other specified items are not counted as assets.

Individuals with incomes over these limits can also qualify for MA through a spenddown. Under a spenddown, an individual must incur medical bills in an amount that is equal to or greater than the amount by which the individual's income exceeds the spenddown limit of 100 percent of FPG for families and children and 75 percent of FPG for individuals who are aged, blind, or disabled.

***Eligibility (cont.)***

- Be a U.S. citizen or a noncitizen who meets specified immigration criteria.
- Be a resident of Minnesota.
- Meet other program eligibility requirements.

***Covered services***

Minnesota provides all federally mandated services and most services designated by the federal Medicaid program as optional. These services include, but are not limited to: physician care, hospitalization, therapy and rehabilitation, dental, medical equipment and supplies, home health care, health clinic services, mental health, prescription drugs, medical transportation, nursing home, and intermediate care facility for persons with mental retardation and related conditions (ICF/MR) services. Adult enrollees who are not pregnant are subject to copayments for certain services.

The state has also received federal approval to provide services not normally covered by Medicaid. These home and community-based "waivered services" are intended to make it possible for individuals to remain in the community, rather than reside in a hospital, nursing home, or ICF/MR.

***Provider reimbursement***

The MA program reimburses providers under both a fee-for-service system and a managed care system (composed of the Prepaid Medical Assistance Program or PMAP and county-based purchasing initiatives). Under the fee-for-service system, health care providers bill DHS and are reimbursed at rates specified by state law. Under managed care, prepaid health plans (or counties in the case of county-based purchasing) receive a monthly capitation payment for each enrollee. The state does not set provider reimbursement rates; these rates are instead the product of negotiation between the health care providers and the prepaid health plan or county.

***Funding and expenditures***

The federal share of MA costs is determined by a formula that is based on state per capita income. In fiscal year 2007, the federal government pays 50 percent of the cost of MA services, and the state is responsible for the remaining 50 percent. In fiscal year 2006, total state and federal MA expenditures for services were $5.435 billion.

***Recipients***

During fiscal year 2006, an average of 498,406 individuals were eligible for MA services each month. As of September 2005, 284,207 MA recipients in 83 counties received services under PMAP or a county-based purchasing initiative.

***Application procedure***

Individuals interested in applying for MA should contact their county human services agency.

**For more information:** Contact legislative analyst Randall Chun at 651-296-8639. Also see the House Research information brief *Medical Assistance*.

**Randall Chun**

**Revised: January 2007**

# General Assistance Medical Care

General Assistance Medical Care (GAMC) is a state-funded program that pays for certain health care services for low-income Minnesota residents who are not eligible for other health care programs. Most GAMC enrollees are low-income adults between the ages of 21 and 64 who do not have dependent children. The program is administered locally by the counties, under the supervision of the Department of Human Services (DHS), and is governed by Minnesota Statutes, section 256D.03.

***Eligibility***

To be eligible for GAMC, an individual must meet the following criteria:

- Receive General Assistance (GA) or Group Residential Housing (GRH), or meet the GAMC income and asset limits and be exempt from enrollment in MinnesotaCare (see table below)
- Not be eligible for Medical Assistance (MA)
- Be a Minnesota resident; GAMC has a 30-day durational residency requirement
- Meet other program eligibility requirements

| Eligibility Group | Income Limit | Asset Limit* | Covered Services | Cost-Sharing |
|---|---|---|---|---|
| 1. GA and GRH recipients | GA limit ($203/ month for one person; $260 for married couple) or GRH assistance standard | GA limit ($1,000 per assistance unit) or GRH limit ($2,000 aged, blind, or disabled; $1,000 all others) | All covered services | Copayments |
| 2. GAMC full coverage | 75 percent of federal poverty guidelines (FPG) | $1,000 per household | All covered services | Copayments |
| 3. GAMC hospital-only coverage | Greater than 75 percent but not exceeding 175 percent of FPG | $10,000 per household of one/$20,000 per household of two or more | Inpatient hospital services and physician services provided during inpatient stay | $1,000 deductible for each hospitalization |

* The homestead, household goods, a vehicle, and other specified items are not counted as assets.

Since September 1, 2006, certain GAMC applicants and recipients have been enrolled in MinnesotaCare as adults without children, immediately following approval of GAMC coverage. GAMC applicants and enrollees who are eligible due to receipt of GA or GRH, are awaiting a determination of disability, who do not meet the MinnesotaCare residency requirement specified, or belong to other groups are exempt from this enrollment requirement.

***Covered services***

GAMC covers a range of medical services for individuals with incomes not exceeding 75 percent of federal poverty guidelines (FPG). These include, but are not limited to, physician care, hospitalization, rehabilitation, dental, medical equipment and supplies, mental health, prescription drugs, and medical transportation.

Services not covered include: home health care services, nursing home services, therapy services provided by independently enrolled providers, pregnancy and related services (GAMC enrollees who are pregnant qualify for coverage of these services under MA and/or Emergency MA), and services in an intermediate care facility for persons with mental retardation and related conditions (ICF/MR).

Covered services for enrollees with incomes greater than 75 percent but not exceeding 175 percent of FPG are limited to inpatient hospital services and physician services provided during an inpatient stay.

***Cost-sharing***

Enrollees with incomes at or below 75 percent of FPG are subject to the following copayments:

- $25 for eyeglasses
- $25 for nonemergency visits to an emergency room
- $3 per brand-name prescription and $1 per generic, subject to a $12-per-month limit. Antipsychotic drugs are exempt from copayments.
- 50 percent coinsurance for basic restorative dental services

Enrollees with incomes greater than 75 percent but not exceeding 175 percent of FPG are subject to a $1,000 deductible for each inpatient hospitalization.

***Provider reimbursement***

The GAMC program reimburses providers under both a fee-for-service system and a managed care system (composed of prepaid GAMC and county-based purchasing initiatives). Under the fee-for-service system, health care providers bill DHS and are reimbursed at rates specified by state law. Under managed care, prepaid health plans (or counties in the case of county-based purchasing) receive a monthly capitation payment for each enrollee. The state does not set provider reimbursement rates; these rates are instead the result of negotiation between the health care providers and the prepaid health plan or county.

***Funding and expenditures***

GAMC is completely state-funded; there is no federal funding. During fiscal year 2006, the state spent $288.8 million in payments to medical providers for GAMC services.

***Recipients***

In fiscal year 2006, an average of 39,201 persons were eligible for GAMC services each month. As of September 2005, 27,402 GAMC recipients were enrolled in prepaid GAMC or a county-based purchasing initiative.

***Application procedure***

Individuals interested in applying for GAMC should contact their county human services agency.

**For more information:** Contact legislative analyst Randall Chun at 651-296-8639. Also see the House Research information brief *General Assistance Medical Care*.

Randall Chun

Revised: January 2007

# MinnesotaCare

MinnesotaCare is a state program that provides subsidized health care coverage to low- and moderate-income families and individuals. The program is administered by the Department of Human Services (DHS); counties have the option of processing applications and determining eligibility. The program is governed by Minnesota Statutes, chapter 256L.

***Eligibility***

To be eligible for MinnesotaCare, an individual must meet the following criteria:

- Have gross income that does not exceed 275 percent of the federal poverty guidelines (FPG) for families and children ($55,032 for a household of four), and 175 percent of FPG for single adults and households without children ($17,160 for a household of one and $23,112 for a household of two). Parents with annual gross incomes over $50,000 are ineligible, whether or not they otherwise meet the 275 percent of FPG standard; this income cap does not apply to pregnant women and minor parents.
- Have assets that do not exceed $10,000 for a household of one and $20,000 for a household of two or more, after certain exclusions. This asset standard does not apply to pregnant women and children.
- Not have access to employer-subsidized health care coverage, and not have had access to this coverage through the current employer for 18 months prior to application or renewal. This requirement does not apply to children with incomes that do not exceed 150 percent of FPG and certain other children.
- Have no health care coverage at the time of application and for four months prior to application or renewal. Children with incomes that do not exceed 150 percent of FPG and certain other children considered to be "underinsured" are exempt from this requirement.
- Be a resident of Minnesota. Pregnant women, families, and children must meet the residency requirements of the Medical Assistance (MA) program; adults without children must satisfy a 180-day residency requirement.
- Since September 1, 2006, certain General Assistance Medical Care applicants and recipients have been enrolled in MinnesotaCare as adults without children and are exempt from premiums and certain eligibility criteria until six-month renewal.

***Covered services***

Pregnant women and children have access to a broader range of covered services than adults who are not pregnant. Pregnant women and children receive coverage for all health care services provided under MA. MA covers physician care, hospitalization, prescription drugs, nursing home care, and a wide range of other health care and long-term care services.

Parents, and single adults and households without children with incomes not exceeding 75 percent of FPG, are covered for most, but not all MA services. Services not covered include personal care attendant services, private duty nursing, nursing home care, ICF/MR (intermediate care facility for persons with mental retardation and related conditions), and special transportation services. Adults who are not pregnant are also subject to certain benefit limitations that do not apply to pregnant women or children.

Single adults and households without children, with incomes greater than 75 percent but not exceeding 175 percent of FPG, are covered under a limited benefit set that includes inpatient hospitalization, physician care, and other specified services.

***Premiums and cost-sharing***

Enrollees must pay premiums based on a sliding scale. Children with incomes that do not exceed 150 percent of FPG pay a reduced annual premium of $48. Adult enrollees who are not pregnant are subject to coinsurance and copayments for specified services.

***Provider reimbursement***

All enrollees receive health care services through prepaid health plans. The MinnesotaCare program pays prepaid health plans a monthly capitation payment for each MinnesotaCare enrollee. MinnesotaCare does not set provider reimbursement rates; these rates are instead the result of negotiation between health care providers and the prepaid health plan.

***Funding and expenditures***

In fiscal year 2006, the MinnesotaCare program paid $438 million for medical services provided to enrollees. Fifty-seven percent of this cost was paid for by the state, 35 percent by the federal government, and 8 percent by enrollees through premium payments (this last category also includes copayments and prescription drug rebates).

State funding for MinnesotaCare and other health care access initiatives is provided by a tax of 2.0 percent on the gross revenues of health care providers and a tax of 1.0 percent on the premiums of nonprofit health plan companies.

The state receives federal funding at the MA match rate for health care services provided to enrollees who are children, parents, or pregnant women. The state receives federal funding at an enhanced match rate (under the State Children's Health Insurance Program) for parents and relative caretakers with incomes between 100 percent and 200 percent of FPG.

***Recipients***

As of November 2006, 121,731 individuals were enrolled in the MinnesotaCare program. Just over 70 percent of these enrollees are parents, children, or pregnant women.

***Application procedure***

MinnesotaCare applications can be obtained by calling 1-800-657-3672. Applications are also available at county human services agencies.

**For more information:** Contact legislative analyst Randall Chun at 651-296-8639. Also see the House Research information brief *MinnesotaCare*.

# HOUSE RESEARCH | Short Subjects

Jim Cleary

January 2007

# Veteran's Preference in State and Local Government Employment

***What is "veteran's preference"?***

The Minnesota Veteran's Preference Act (VPA) grants veterans a limited preference over nonveterans in hiring and promotion for most state and local governmental employment. It also provides local government employees who are veterans some protection against unfair demotions and dismissal.

These preferences and protections are commonly referred to as "veteran's preference" and are codified in Minnesota Statutes sections 43A.11, 197.455, 197.48, and 197.481.

***To which positions does veteran's preference apply?***

Minnesota veteran's preference applies to most positions of employment in state civil service, as well as to most positions within political subdivisions. VPA *does not apply* to employment in the private sector or federal government.

***How does veteran's preference apply to state civil service?***

In state civil service, people who claim veteran's preference and who meet the minimum qualifications for a vacant position are listed before qualified nonveteran applicants in the applicant pool for the position. Disabled veterans must be listed ahead of nondisabled veterans.

The appointing authority can hire anyone in the pool, but if it rejects a person in the finalist pool who has claimed veteran's preference, it must notify the person of the reasons for the rejection. (Minn. Stat. § 43A.11)

***How does veteran's preference apply to political subdivisions?***

For political subdivisions (including counties, cities, towns, school districts, and any other political subdivisions), nondisabled veterans who have a passing score or rating on an exam can elect to receive a credit of five points (on a 100-point scale). Disabled veterans can elect to receive a credit of ten points. A disabled veteran can also use a credit of five points on a promotional exam. (Minn. Stat. § 197.455)

***How does veteran's preference work in firing?***

A veteran holding a position of appointment or employment in any political subdivision can be removed from that position only for incompetence or misconduct established in a hearing, with due notice and stated charges in writing.

Exempted from such protection are veterans working as a secretary, teacher, superintendent of schools, chief deputy of any elected official or head of a department, or any person holding a strictly confidential relation to an appointing officer. (Minn. Stat. § 197.46)

***How are veteran's preference laws enforced?***

A veteran who has been denied veteran's preference rights by the state or any political subdivision of the state may petition the commissioner of veterans affairs for an order directing the agency to grant the relief that the commissioner finds justified. The commissioner is given broad powers of subpoena, as well as access to records, witnesses, and documents. The affected political subdivision must bear all costs incurred by the commissioner for this purpose.

In accordance with various provisions of the Administrative Procedure Act (Minn. Stat. ch. 14), either party may appeal the commissioner's orders to the district court. The commissioner and attorney general may represent the veteran in any appeal following a favorable decision for the veteran. When a party refuses or fails to comply with a final decision of the commissioner, the commissioner may ask the Ramsey County District Court to order the party to comply and award damages. (Minn. Stat. § 197.481)

***Are retired military personnel eligible for veteran's preference?***

Since the post-Vietnam War era, persons who were eligible for a military pension based entirely on years of military service were not eligible for veteran's preference in Minnesota. However, that statutory provision was repealed in 2005. Retired military veterans now have the same preference as other veterans in state and local government hiring.

**For more information:** Contact the Minnesota Department of Veterans Affairs at 651-296-2345. For federal veteran's preference laws, contact the local veterans' representative for the U.S. Department of Labor at 651-297-1186.

Nina Manzi and Joel Michael February 2007

# Capital Gains Taxation: Federal and State

***What is capital gains income?***

Assets owned for personal or investment purposes are called "capital assets." Common capital assets include an individual's home, stock holdings, and longer-lived business assets. When a taxpayer sells a capital asset, the difference between the amount realized on the sale and the taxpayer's basis is either a capital gain or a loss. The taxpayer's "basis" is usually what the taxpayer paid for the asset, less any depreciation deductions claimed for business assets. Special rules apply to assets received as a gift or through inheritance.

***What are short-term and long-term gains and losses?***

The gain or loss on an asset held for more than one year is considered "long-term." If the taxpayer disposes of an asset after holding it for a year or less, the gain or loss is "short-term."

***How does the federal government tax capital gains income?***

For most taxpayers, the maximum federal income tax rate for net capital gains income is 15 percent in tax year 2007. The maximum rate for taxpayers in the 10 or 15 percent bracket for ordinary income is 5 percent—in tax year 2007 the 5-percent rate applies for married joint filers with taxable income under $63,700. The amount of net capital gains income that qualifies for the maximum 15- or 5-percent rate is the long-term capital gain after subtracting both long-term capital losses and net short-term capital losses (i.e., in excess of short-term capital gains). Short-term capital gains do not qualify for the preferential federal rates but are taxed as ordinary income.

***Are there higher rates for certain kinds of income?***

Three exceptions to the maximum 15- and 5-percent federal rates apply:

- The portion of the gain from qualified small business stock is subject to a maximum 28-percent rate (up to 50 percent of the gain on the sale of this stock may be excluded from taxable income entirely)
- The net capital gain from selling collectibles (such as coins or art) is subject to a maximum 28-percent rate
- The part of any net capital gain on property for which the taxpayer claimed "additional depreciation" (Section 1250 real property) is taxed at a maximum 25-percent rate

***Is there special tax treatment for gains realized through the sale of the taxpayer's home?***

Yes. Taxpayers who meet "use" and "ownership" tests may exclude up to $250,000 of gain on the sale of the home (up to $500,000 for married joint taxpayers). Under the "use" test, the taxpayer must have used the home as his or her principal residence for two of the five years preceding the sale. Under the "ownership" test, the taxpayer must have owned the home for at least two years. There is no limit to the number of times a taxpayer may claim this exclusion.

***Can capital losses reduce ordinary income?***

Yes, up to $3,000 per year of capital losses can be deducted from ordinary income. Losses over $3,000 are carried forward to future tax years. Losses on personal use items, such as a home or car, are not deductible.

***How does Minnesota tax capital gains income?***

Minnesota includes the full amount of net capital gains income in taxable income and subjects it to the same tax rates as apply to other kinds of income: 5.35, 7.05, and 7.85 percent. Minnesota does, however, recognize the federal exclusion for up to $250,000 of gain realized on the sale of the taxpayer's home ($500,000 for married joint taxpayers) and the exclusion for a portion of the gain on qualified small business stock.

***How do other states tax capital gains income?***

Of the states that impose an individual income tax:

- 31 states, including Minnesota, do not provide preferential treatment for capital gains income
- One state (Rhode Island) calculates state tax as a percentage of federal tax liability, and thus follows the maximum federal rates on capital gains
- Five states (Arkansas, North Dakota, South Carolina, Vermont, and Wisconsin) exclude a portion of capital gains income from taxable income
- Three states exclude all or part of the gain on property located in the state (Colorado, Idaho, and Iowa); the exclusion does not apply to gains on sale of stocks except in Colorado, where at least 50 percent of the company's payroll and property must be located in-state for the exclusion to apply to sale of stock
- One state (Massachusetts) applies a lower rate to capital gains income, depending on how long the taxpayer has held the asset

***What are the income levels and filing types of people who have capital gains income?***

In tax year 2004, about 24 percent of all returns filed by Minnesota residents reported some capital gains income. Most capital gains income—79 percent—was claimed by married taxpayers filing joint returns. The table shows the distribution of capital gains income by income range in 2004.

| Federal adjusted gross income | $ of capital gains reported (millions) | % of all gains reported | % of income consisting of gains | Average gains per return |
|---|---|---|---|---|
| Less than $50,000 | $407 | 6.2% | 1.3% | $1,649 |
| $50,000 to $99,999 | $591 | 9.1% | 1.4% | $3,552 |
| $100,000 to $500,000 | $2,056 | 31.5% | 5.4% | $15,568 |
| Over $500,000 | $3,467 | 53.2% | 23.0% | $340,084 |
| All incomes | $6,521 | 100% | 5.3% | $11,743 |

***What are the ages of taxpayers who have capital gains income?***

In tax year 2004, almost half of all returns filed by taxpayers aged 65 and older reported some capital gains income. The table shows the distribution of capital gains income by taxpayer age in 2004.

| Taxpayer age | $ of capital gains reported (millions) | % of all gains reported | % of income consisting of gains | Average gains per return |
|---|---|---|---|---|
| Less than 25 | $58 | 0.9% | 1.0% | $1,195 |
| 25 to 39 | $417 | 6.4% | 1.4% | $4,764 |
| 40 to 64 | $3,954 | 60.6% | 5.4% | $14,408 |
| 65 or older | $2,092 | 32.1% | 13.5% | $14,453 |
| All ages | $6,521 | 100% | 5.3% | $11,743 |

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057.

**Karen Baker**

**Updated: February 2007**

# Mortgage and Deed Taxes

***What is the mortgage registry and deed tax?***

The mortgage registry tax (MRT) is a tax based upon the amount of debt secured by a mortgage of real property. The tax is imposed on the privilege of recording the mortgage. The deed tax is a transfer tax; it is imposed on the value of real property transferred. While these taxes are independent of each other, they are often thought of as a pair since many property transactions involve both a mortgage and a deed.

***What are the rates?***

The MRT is calculated at the rate of 0.23 percent of total debt secured. The deed tax is calculated at the rate of 0.33 percent of net consideration (i.e., the price paid for the real property). These rates have been in effect since 1987.

***How does it work?***

The following example helps illustrate how each of the taxes is determined for a homebuyer.

**Mortgage Registry Tax**

John and Mary Anderson secure a loan on a home with a purchase price of $150,000. The Andersons make a $20,000 down payment on the home. The principal debt on the home is $130,000. How much mortgage registry tax do the Andersons owe?

Principal debt x 0.23% = MRT liability

$130,000 x 0.23% = $299

The Andersons owe $299 in MRT.

**Deed Tax**

John and Mary Anderson record the deed for their new home. The deed is valued at $150,000. How much deed tax must be paid?

Value of the deed recorded x 0.33% = deed tax liability

$150,000 x 0.33% = $495

$495 must be paid when the deed is recorded.

***Who is responsible for paying the tax?***

In the case of the MRT, the mortgagor (borrower) is liable. In the case of the deed tax, the seller is liable. The lender usually collects both of the taxes at closing, and is responsible for remitting them to the county treasurer when the mortgage and deed are recorded.

The amount of deed tax is usually collected from the seller at the time of closing. However, since the deed tax must be paid in order to record the deed, and since it is in the buyer's best interest to record the deed, the tax could fall on the buyer if the dollars were not collected from the seller.

***Who collects the money?***

County treasurers collect these taxes. They remit 97 percent to the state, which is deposited in the general fund. The county retains the other 3 percent for administrative expenses.

***How much is collected?***

The table below shows the MRT and deed tax generated in the state for the past ten years. The increased collections in MRT in the past four to five years has been due partially to low interest rates, which generated more refinancing and purchases, and the strong economy. The total amounts reflect only the state's 97 percent share.

**MRT and Deed Tax Revenue**

| Fiscal Year | Mortgage | Deed | Total | Change Amount | Change Percent |
|---|---|---|---|---|---|
| 1997 | $48.5 | $46.2 | $94.8 | $6.8 | 7.2% |
| 1998 | 67.6 | 52.6 | 120.2 | 25.4 | 26.8 |
| 1999 | 89.8 | 63.0 | 152.7 | 32.5 | 27.0 |
| 2000 | 73.4 | 68.8 | 142.2 | -10.5 | -6.9 |
| 2001 | 88.2 | 71.0 | 159.2 | 17.0 | 12.0 |
| 2002 | 145.1 | 86.1 | 231.2 | 72.0 | 45.2 |
| 2003 | 203.4 | 94.3 | 297.7 | 66.5 | 28.8 |
| 2004* | 230.2 | 120.6 | 350.7 | 53.0 | * |
| 2005 | 162.2 | 124.2 | 286.4 | -64.3 | * |
| 2006 | 173.6 | 136.4 | 310.0 | 23.6 | 8.2 |

* Fiscal year 2004 includes $25.3 million generated by the June 2004 accelerated payment.

***Where is it collected?***

About two-thirds of the statewide collections for MRT and deed tax come from the seven-county metro area; the remaining one-third comes from Greater Minnesota. Using 2005 population, which is the latest available, and the 2006 tax amounts, the statewide average MRT and deed tax per capita was $60, with a metro county average of $76, and a Greater Minnesota average of $42.

***Are there exemptions from the taxes?***

There are many statutory exemptions from each tax. Minnesota Statutes, section 287.04, contains a list of the exemptions from the MRT. The primary ones are contracts for deed, certain agricultural mortgages, marriage dissolution decrees, and certain low- and moderate-income housing mortgages.

Minnesota Statutes, section 287.22, contains a list of the exemptions from the deed tax. Some of the most common are recording an amendment to the mortgage, a plat, a will, a lease, a sheriff's certificate of sale in a foreclosure sale, and a decree or deed involving a marriage dissolution.

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959. Also see the House Research publication *Mortgage and Deed Taxes in Minnesota*, April 2002.

Joel Michael

Updated: March 2007

# Cigarette and Tobacco Excise Taxes and Fees

***Minnesota imposes several taxes and fees on cigarettes and tobacco products***

Minnesota imposes a series of taxes and fees on the sale or possession of cigarettes and tobacco products. The table lists the taxes and fees and their rates. The cigarette taxes and fees are all imposed on a "per unit" basis—i.e., on the number of cigarettes sold, not as a percentage of the sale price. Because the tax is a per unit tax, it does not increase as the price of cigarettes increases. By contrast, the taxes and fees on tobacco products, such as cigars, pipe tobacco, snuff, and chewing tobacco, are imposed as a percentage of their wholesale prices.

| Tax or fee | Per pack of 20 rate | Percent of price |
|---|---|---|
| Cigarette excise tax | 48 cents | NA |
| Tobacco products excise tax | NA | 35% |
| Health impact fee | 75 cents | 35% |
| Fee on cigarettes manufactured by nonsettling companies | 35 cents | NA |
| Tax in lieu of general sales tax (rate for FY2006) | 25.5 cents | NA |

***The 2005 Legislature converted the sales tax to a per pack tax and imposed the health impact fee***

The 2005 Legislature made two changes in cigarette and tobacco products taxation:

- It converted the 6.5 percent state general sales tax on cigarettes to a flat amount per pack tax collected from wholesalers (rather than as a percentage of the retail sale prices, as other products are taxed under the sales tax). The commissioner of revenue annually sets the amount based on a survey of the average retail price of cigarettes. The 2005 legislation set the amount initially at 25.5 cents per pack.
- The 2005 Legislature also imposed a health impact fee of 75 cents per pack of cigarettes and 35 percent of the wholesale price of tobacco products. Combining the Minnesota's excise tax and fee, the burden equals $1.23 per pack and 70 percent of the wholesale price of tobacco products. This fee is imposed and collected in the same manner as the cigarette excise tax.

***Payments made to settle state lawsuits against the tobacco industry have similar effects as excise taxes***

Settlements of the states' lawsuits against the tobacco companies have about the same economic effect as a cigarette tax, since these settlement payments are passed along to consumers (nationally) through higher cigarette prices. However, they do not affect companies that were not part of the lawsuit. To compensate partially for the lower prices of cigarettes produced by nonsettling companies, the 2003 Legislature imposed a 35-cent per pack fee on those cigarettes. Other states have imposed similar fees: Michigan and Utah impose a 35-cent surcharge, and Alaska a 25-cent surcharge.

***The Minnesota Supreme Court upheld both of the fees***

Industry interests challenged both cigarette fees on various grounds. The Minnesota Supreme Court rejected these challenges, upholding the state's power to impose the fees. *Council of Independent Tobacco Mfr. v. State,* 713 N.W.2d 300 (Minn. 2006) *cert. denied* 127 S.Ct. 666 (2006) (fee on nonsettling companies); *State v. Philip Morris,* 713 N.W.2d 350 (Minn. 2006) *cert. denied* 75 USLW 3435 (2007) (health impact fee).

*The taxes and fees are estimated to yield revenues of about $450 million*

For fiscal year 2007, the Finance Department estimates collections from the two excise taxes and the sales tax on cigarettes will be $223.6 million and from the health impact fee, $225.4 million. Revenues from the tobacco products tax are deposited in the general fund. For fiscal year 2007, cigarette tax revenues of $22.25 million go to fund the Academic Health Center, $8.55 million to the medical education and research account, and the rest to the state general fund. The health impact fee revenues are deposited in a health impact fund and are transferred to the general fund after the commissioner of human services certifies that state health programs have incurred tobacco-related costs equal to the fee.

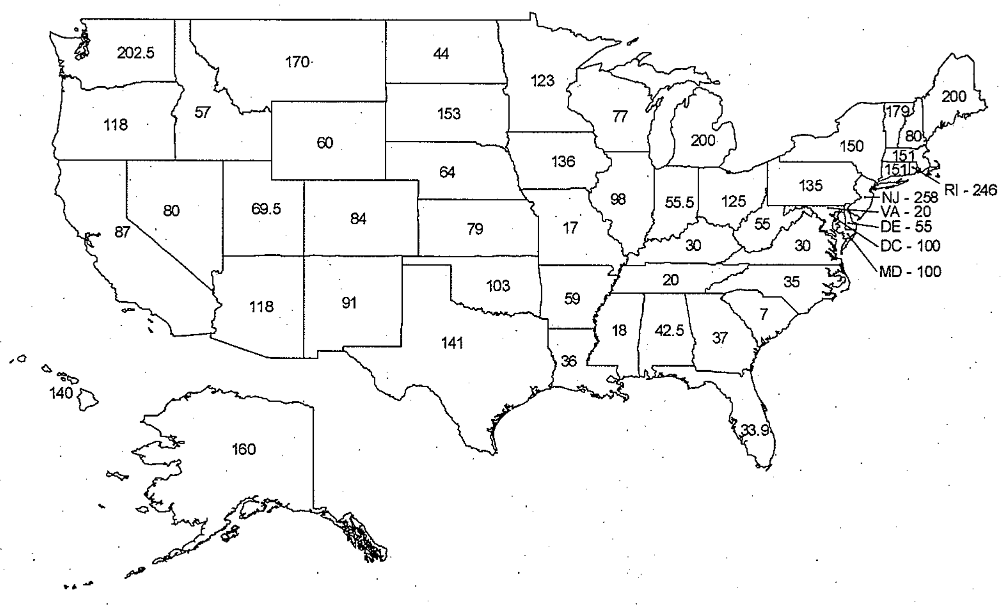
*Neighboring states have significantly lower tax rates*

Because cigarettes can easily be transported, the tax rates in other states (especially border states) are important. Taking into account the combined effects of the tax and fee ($1.23/pack) of Minnesota's bordering states, Wisconsin (77 cents) and North Dakota (44 cents) have lower rates. South Dakota ($1.53) and Iowa ($1.36) have higher rates. All states' rates are shown on the map. The map does not reflect local cigarette taxes; some of these local taxes are substantial (e.g., $2.00 per pack in Chicago). The map does not reflect the effect of general sales taxes (including Minnesota's per pack tax in lieu of the sales tax). Some states have no sales tax or exempt cigarettes from sales taxation, lowering the overall tax burden. Arizona's rate will rise to $2 on May 1, 2007, and Alaska's and Vermont's rates will increase by 20 cents on July 1, 2007. Hawaii's tax is scheduled to increase by 20 cents each July 1 from 2007 through 2011.

**State Cigarette Tax Rates***

as of 4/1/2007

cents per pack




* These exclude some significant local taxes.

Source: Federation of Tax Administrators and other sources

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057.

**Donald Hirasuna**

**March 2007**

# Is Income Inequality Rising in Minnesota?

This short subject summarizes information on the distribution of income in Minnesota from the *Minnesota Tax Incidence Study*, published by the Department of Revenue. These studies use a dataset consisting of the reported incomes of a sample of households constructed from a variety of administrative sources. Between 1994 and 1998, real incomes rose for all percentiles and then fell between 1998 and 2002. Income inequality may have risen during this period, with the richest 10 percent rising in income relative to the poorest 10 percent.

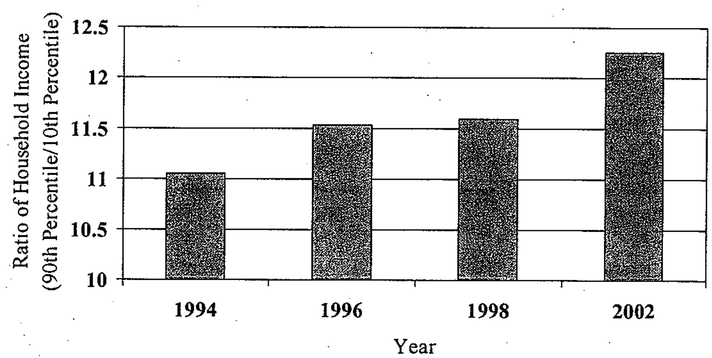
***Income inequality is both a statistical and a policy question***

Statistically, the incomes of Minnesotans vary from low to high, and that spread can be measured over time. The range of income is often measured as the difference between the highest and lowest incomes in Minnesota. If that range increases or decreases over time, it is deemed important for a number of policy debates. Social differentiation, the spread between one group and another within Minnesota's economy, has been used as an indicator of inequality, and as a reason for supporting or opposing a variety of social policies.

***The ratio of income between the lowest and highest incomes has increased***

The following figure graphs income for the 90th percentile relative to the 10th percentile. It shows that estimated income for top decile grew from 11.02 to 12.26 times faster than the lowest, with most of that growth between 1998 and 2002.

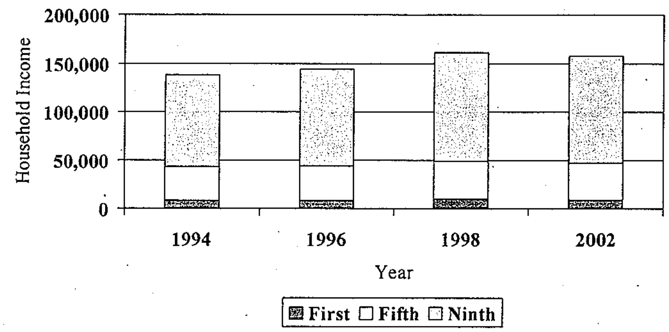
**Ratio of Household Income Between the $90^{th}$ to the $10^{th}$ Percentile**




As shown in the following graph, the share of income of those at the top of the distribution increased relative to those in the middle ($50^{th}$ percentile) or bottom ($10^{th}$ percentile).

**Data source:** The data are from the *Minnesota Tax Incidence Studies* (from 1997, 1999, 2001, and 2005), which compile income from a variety of sources including state income tax records, property tax refund information, unemployment insurance data, and welfare data. The data may be subject to some error, since they are drawn from a sample of households and programs with slightly different measures of income. Also, there some households who do not file income taxes and will not receive assistance from any other state source. The latest information is from 2002; the Minnesota Department of Revenue plans to release a new report in March 2007.

**Percentile Distribution of Household Income in 2005 Dollars**




***Real household incomes rose between 1994 and 1998 and fell in 2002***

Table 1 lists real household incomes for the 10th through 90th percentiles. It shows that real household incomes rose for each percentile between 1994 and 1998 and then fell in 2002.

In 2002, the median household income was $38,366. Median income had risen from $34,184 in 1994 to $38,901 in 1998, before falling in 2002.

**Table 1: Real Household Income (2005 dollars) Selected Years from 1994-2002**

| Percentile | Year | | | |
|---|---|---|---|---|
| | **1994** | **1996** | **1998** | **2002** |
| 10th | 8,585 | 8,666 | 9,723 | 8,983 |
| 20th | 13,287 | 14,195 | 15,915 | 15,123 |
| 30th | 19,625 | 20,121 | 22,628 | 22,272 |
| 40th | 26,368 | 27,502 | 30,356 | 29,786 |
| 50th (Median) | 34,184 | 35,424 | 38,901 | 38,366 |
| 60th | 43,176 | 45,111 | 49,580 | 48,852 |
| 70th | 54,844 | 57,388 | 63,028 | 61,919 |
| 80th | 70,023 | 73,346 | 80,562 | 79,767 |
| 90th | 94,892 | 99,942 | 112,647 | 110,126 |
| Source: MN Dept. of Revenue, *Minnesota Tax Incidence Study* (1997, 1999, 2001, and 2005). | | | | |

***Alternative measures support the finding of increasing inequality***

Income inequality can be more comprehensively measured across the entire population. Given the limited data used here, only a rough inequality measure can be constructed, but this can provide a further verification. Table 2 compares the ratio of income in the top and bottom deciles. It also includes an estimate of the variance of household income. In general, the higher the variance, the wider the disparity in household income. Both measures suggest an increase in income inequality over time.

**Table 2. Two Measures of Income Inequality Minnesota Households (1994-2002)**

| Income Inequality Measure | 1994 | 1996 | 1998 | 2002 |
|---|---|---|---|---|
| Ratio of household income between the 90th and 10th percentiles | 11.05 | 11.53 | 11.59 | 12.26 |
| Estimated variance in household income* | $966 | $1,298 | $1,959 | $2,629 |
| Source: MN Dept. of Revenue, *Minnesota Tax Incidence Study* (1997, 1999, 2001 and 2005). http://www.taxes.state.mn.us/legal_policy/research_reports/content/incidence.shtml<br>* The variance was calculated as $\sum n_j(x_j - \bar{x})^2$ where $n_j$ is the number of persons within each income percentile, $x_j$ is the minimum income for the percentile category, and $\bar{x}$ is the weighted average of income. | | | | |

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038.

**Abigail Johnson and Donald Hirasuna**


**March 2007**

# Earned Income Credit Utilization by Welfare Recipients

***What is the earned income credit?***

The earned income credit is an income tax credit for low-income working individuals and families. The credit is available at both federal and state levels and has been around since 1975, when Congress first approved it to offset the burden of Social Security taxes and to provide an incentive to work. Congress enacted expansions in 1990 and in 1992, which were phased in over a period of years. Since the late 1990s, many states also implemented or expanded their own credits, which are typically calculated as a percentage of the federal credit.

***How does Minnesota's earned income credit work?***

The Minnesota Legislature reformed its earned income credit, the Working Family Credit (WFC), in 1998, creating a two-tiered credit that replaced the earlier single-tier system. Traditionally, the earned income credit phases in with earnings until it reaches a maximum, staying at that maximum until earnings reach what is known as a phase-out floor. After that point, the credit begins to phase out.

Under the Minnesota WFC, instead of reaching a maximum and phasing out, the credit phases into a second and higher maximum, stays at that maximum until earnings reach the phase-out floor, and then phases out from there. Before this change, there was the potential that household earnings would increase, but net income would decline.

In addition to altering the structure of the credit, the legislature also raised the maximum amount of the credit.

***Who takes advantage of the credit?***

For the entire population of eligible EIC recipients, about 80 percent to 85 percent receive the federal earned income credit. Among people enrolled in Minnesota's welfare program, the Minnesota Family Investment Program (MFIP), 54.3 percent of all households and 65.2 percent of households eligible to receive the credit did so in 1999. (These percentages were calculated by merging data on MFIP recipients with Minnesota state income tax returns and other earnings data.)

***What affects whether a person or family receives the earned income credit?***

Using 1992 through 1999 data, researchers found a number of factors that contribute to lower rates of receiving the WFC. Among these factors are the following:

- Barriers to work or to filing a tax return
- Reduced incentives to quickly exit Temporary Assistance for Needy Families (TANF), which is the federal welfare program
- Exemption from TANF work requirements
- Decreased availability of free tax preparation sites
- Decreased access to organizations that inform recipients of the EIC

- Decreased access to family, friends, and neighbors who can inform non-English-speaking recipients of the EIC

In addition, people falling into these groups were less likely to be eligible for more than $50 of the Minnesota WFC. Researchers also found that certain racial and ethnic demographic groups, such as American Indians or Hispanics, were less likely than the average population to take advantage of the Minnesota credit.

***What are the policy implications of these findings?***

By gaining a clearer picture of who is taking advantage of these credits, policymakers can better understand how to bring together the proper mix of services in order to assist people in moving out of poverty. Increasing the maximum earned income credit and providing free tax preparation were both tied to increases in receipt of the EIC, which is a proven tool to obtain and maintain employment and help people increase their income.

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038. This short subject was written by research assistant Abigail Johnson and based on the article "Earned Income Credit Utilization by Welfare Recipients: A Case Study of Minnesota's Earned Income Credit Program," by Donald Hirasuna and Thomas Stinson, *Journal of Policy Analysis and Management*, volume 26, number 1 (2006), pages 125–148.

HOUSE RESEARCH | Short Subjects

Justine Nelson and Donald Hirasuna

June 2007

# Do MFIP Participants Receive Child Support?

Under the Minnesota Family Investment Program (MFIP), child support counts as unearned income, which can reduce the amount of a family's MFIP grant. This short subject provides some statistics on MFIP and child support from 1998 to 2003, including how many MFIP families received child support payments.

***What is child support and how is it established?***

A court may order basic, medical, and child care support for the care of a child. For divorced or legally separated couples, a court may order one or both parents to pay child support. If a child's parents are not married, paternity may need to be established before a court will order child support. In state fiscal year 2003, there were 194,027 cases with court orders for child support in Minnesota, according to the Child Support Division of the Minnesota Department of Human Services (DHS).

***What is the Minnesota Family Investment Program (MFIP)?***

MFIP provides cash and food assistance to low-income families with children. It is the state's Temporary Assistance for Needy Families (TANF) welfare program, and in 2003 the average monthly caseload was 45,017 (DHS).

***Are MFIP participants required to assist with child support enforcement efforts?***

An individual receiving MFIP must provide the child support agency with information about the noncustodial parent unless there is "good cause" for not doing so (e.g., if the pursuit of child support could reasonably result in harm to the child). Persons who fail to comply are sanctioned until they return to compliance or are no longer eligible for MFIP (Minn. Stat. § 256.741, subd. 7). Minnesota statutes require DHS to close cases that are sanctioned for six consecutive months, at which point their food stamp eligibility must be redetermined (Minn. Stat. § 256J.46, subd. 1).

***How much child support did MFIP families receive?***

Among families on MFIP for the first time between 1998 and 2003, 19 percent (11,396 of 60,356) received basic child support for at least one month while on MFIP. MFIP families with child support orders received child support in about half (53 percent) of the months it was ordered (This amount may have been more or less than the amount ordered). The median monthly basic child support payment for MFIP families was $236. ($0 payments were not included in the median calculation; all dollar values are inflation-adjusted to 2005.) See Figure 1 for a regional breakdown of child support receipt.

***How much did child support receipt vary from family to family?***

Between 1998 and 2003, MFIP families with child support orders received between $0 and $1,900 in monthly basic child support payments, with 24 percent of families with an order never receiving basic support while on MFIP and 4 percent of families with an order receiving more than $500 each month (see figure 2). These results may understate the amount of child support receipt by current welfare recipients, since some families with more in child support may become ineligible for MFIP.

Twenty-six percent of MFIP families were owed child support arrears. The median arrears amount was $1,544.

*How many MFIP families received other types of support from 1998 to 2003?*

**Medical support:** Four percent of all MFIP participants received at least one month of medical support to help pay for health insurance while on MFIP (8 percent had a medical support order).

**Child care support:** Two percent of all MFIP participants received at least one month of child care support (3 percent while on MFIP had a child care order). The median monthly child care support receipt was $79.

**Figure 1: Monthly Basic Child Support Receipt by Region (Median)**

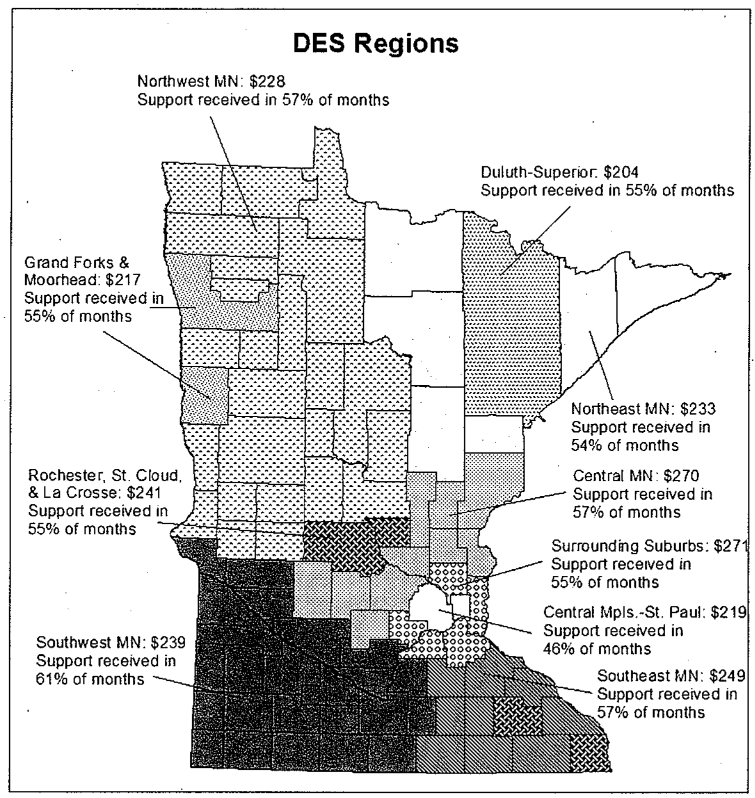
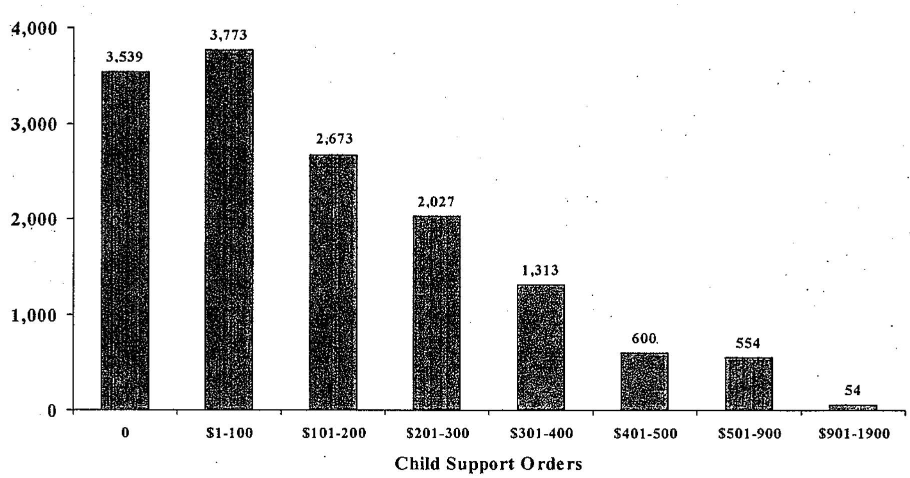



**Figure 2: Distribution of Monthly Basic Child Support Received while on MFIP (1998-2003)**




**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038.

**HOUSE RESEARCH** | **Short Subjects**

**Justine Nelson and Donald Hirasuna** **June 2007**

# Do MFIP Participants Receiving Child Support Differ from Those Not Receiving Child Support? Findings from 1998 to 2003

***What is child support and how is it established?***

A court may order basic, medical, and child care support for the care of a child. For divorced or legally separated couples, a court may order one or both parents to pay child support. If a child's parents are not married, paternity may need to be established before a court will order child support. In state fiscal year 2003, there were 194,027 cases with court orders for child support in Minnesota, according to the Child Support Division of the Minnesota Department of Human Services (DHS).

***How does child support relate to the Minnesota Family Investment Program (MFIP)?***

MFIP provides cash and food assistance to low-income families with children. It is the state's Temporary Assistance for Needy Families (TANF) welfare program, and in 2003 the average monthly caseload was 45,017 (DHS).

- Under MFIP, child support counts as unearned income, which can reduce the family's MFIP grant.
- A court order for child support continues after a parent leaves MFIP. Beginning in January 2007, guidelines base the amount of child support on the incomes of both parents (Minn. Stat. § 518A.34). Prior to 2007, child support guidelines were based on the income of the noncustodial parent.
- An individual receiving MFIP must cooperate with the child support enforcement agency, unless there is evidence of "good cause" for not doing so. Minnesota statutes requires DHS to sanction noncompliant individuals until they are in compliance (Minn. Stat. § 256.741, subd. 7). If individuals are sanctioned for six consecutive months, their case is closed and food stamp eligibility is redetermined.

***Does child support receipt impact MFIP participants' likelihood of exiting MFIP?***

A statistical analysis controlling for more than 30 factors indicates that MFIP participants who received child support or child care support are more likely to exit MFIP than participants not receiving either support.

***Do MFIP participants with and without child support differ demographically?***

Among people who enrolled in MFIP for the first time between 1998 and 2003, median age was 26 or 27, and median years of education was 12. Those who received child support had more children, but were less likely to have ever been married while on MFIP than those who did not receive child support. (A more in-depth analysis might further investigate demographic characteristics and groups, such as differences between married and single parents.)

**Comparisons Between Families That Did and Did Not Receive Child Support while on MFIP: 1998-2003**

| | Families that received child support at least once while on MFIP (N=11,396) | Families that never received child support while on MFIP (N=48,960) |
|---|---|---|
| Age at first enrollment (mean [0])*** | 26 | 27 |
| Education at first enrollment (median[0])*** | 12 years | 12 years |
| Number of children (largest) (median [0])*** | 2 | 1 |
| Ever married while on MFIP (percentage) * | 9% | 12% |

*** $p<0.001$ * $p<0.05$

Note: "p" represents the probability the estimated statistic equals zero given a normal distribution of random values; it is deemed significantly different from zero is it is less than 0.05.

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038. Also see the House Research publication *Do MFIP Participants Receive Child Support?* June 2007.

Matt Burress

Updated: June 2007

# Motor Vehicle Sales Tax

The motor vehicle sales tax (MVST) has become an important funding source for transportation purposes, although it has never been allocated solely to transportation. A constitutional amendment passed by the voters in 2006 will result in 100 percent of MVST revenues going to transportation by fiscal year 2012.

***MVST is the sales tax collected when cars are sold***

The motor vehicle sales tax, or MVST, is a 6.5 percent tax applied to the sale of new and used motor vehicles. Minn. Stat. § 297B.02. It is imposed instead of the general sales tax and is based on the purchase price of the motor vehicle. Some older autos as well as collector's vehicles have a flat tax instead. MVST is collected by auto dealers or when the vehicle is registered.

***Periodic MVST dedication to transportation***

The legislature first began directing a portion of MVST revenue to highways and transit in 1981, with the intent that it supplement other transportation funding sources. Over the ensuing years, the percentage of MVST allocated to transportation was periodically changed and suspended; it was eliminated beginning in fiscal year 1992.

***2000-2001 tax policy changes affecting MVST***

Two changes in tax policy re-established MVST allocation for transportation. First, the 2000 Legislature placed limits on registration taxes (tab fees) for passenger vehicles, which reduced the amount of revenue collected. Registration taxes are dedicated exclusively to streets and highways, and the legislature made up the losses to highway funds by transferring in MVST revenue. Second, the 2001 Legislature prohibited the use of property tax levies for metropolitan transit operations. It replaced property tax revenue with allocations from MVST for both metropolitan and greater Minnesota transit.

Rather than provide new funding for transportation, these MVST allocations to highways and transit were intended primarily to offset reductions in other taxes. One effect was to shift some of the funding from local to state sources.

***2003 re-allocation to transit***

In the 2003 session, the legislature increased the percentage of MVST revenue going to transit, but it was done without increasing the overall MVST allocation to transportation. The additional funding for transit was partially to make up for reductions in general fund appropriations for bus service throughout Minnesota (which was largely due to overall budget cuts), and partly to reduce local responsibility for Hiawatha light rail transit operating costs.

MVST revenue allocated to the highway user tax distribution (HUTD) fund was decreased and transferred to the metro area and greater Minnesota transit funds. Funds in the HUTD are constitutionally dedicated to state, county, and municipal highways and streets. The county state-aid highway fund and the municipal state-aid street fund received direct transfers from MVST revenue in order to offset the reduction of their portions of the HUTD funding. In effect, increased transit funding came from a reduction in the amount of MVST revenue going to the state trunk highway system.

***The MVST constitutional amendment***

At the 2006 general election, the voters approved a constitutional amendment that dedicates all MVST revenue to transportation purposes. The amendment specifies that 63.75 percent must be dedicated to transportation purposes in fiscal year 2008, growing by 10 percent per year until it reaches 100 percent in fiscal year 2012.

The constitutional language also requires that "no more than 60 percent" of the revenue go to the HUTD fund, and "not less than 40 percent" go to public transit assistance. Minn. Const. art. XIV, § 13. These distribution limits, which establish a ceiling for allocation to highways and a floor for the allocation to transit, are referred to as the "60/40 split."

Within the distribution limits, the Constitution allows legislation to set the actual division between highways and transit.

***MVST phase-in and allocation***

2007 legislation established an MVST phase-in schedule. Minn. Stat. § 297B.09. In fiscal year 2012, after the phase-in, the revenues will be distributed 60 percent to highways and 40 percent to transit, with the transit portion divided into 36 percent for the metropolitan area and 4 percent for greater Minnesota.

**MVST Phase-In**

| | FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 | FY 2012+ |
|---|---|---|---|---|---|---|
| Highway user tax distribution fund | 30% | 38.25% | 44.25% | 50.25% | 56.25% | 60% |
| County state-aid highway fund | 0.65 | | | | | |
| Municipal state-aid highway fund | 0.17 | | | | | |
| Metropolitan transit | 21.5 | 24 | 27.75 | 30 | 33.75 | 36 |
| Greater Minnesota transit | 1.43 | 1.5 | 1.75 | 3.5 | 3.75 | 4 |
| General fund | 46.25 | 36.25 | 26.25 | 16.25 | 6.25 | 0 |

***Additional MVST revenue***

For fiscal year 2008, new funds for transportation will amount to $31 million for highways and $19 million for transit. Additional revenue will be about $271 million in fiscal year 2012, once the MVST dedication is fully phased in.

**Additional Revenue from MVST Phase-In**
(amounts in thousands)

| | FY 2008 | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|---|---|---|---|---|---|
| Highway user tax distribution fund | $31,025 | $63,810 | $99,317 | $139,559 | $164,363 |
| Metropolitan transit | 17,374 | 37,765 | 51,699 | 76,254 | 90,987 |
| Greater Minnesota transit | 1,241 | 2,605 | 12,245 | 14,388 | 16,143 |
| General fund | (49,640) | (104,180) | (163,260) | (230,200) | (271,492) |

**Note:** Revenue is based on the February 2007 forecast and assumes a 2-percent growth rate starting in fiscal year 2012.

**For more information:** Contact legislative analyst Matt Burress at 651-296-5045.

# HOUSE RESEARCH | Short Subjects

Matt Burress

Updated: June 2007

# Minnesota Speed Limits

State law sets speed limits on state highways and local roads, establishes penalties, and provides authority for the Department of Transportation (MnDOT) and local governments to change the limit under certain situations (see Minnesota Statutes, section 169.14).

***Basic requirements and speed limits***

Regulation of speeding is part of Minnesota's statewide traffic laws. Speed limits are set based on the type of roadway and can be adjusted under certain circumstances. The speed limits are: 30 m.p.h. for streets and highways in an urban district; 30 m.p.h. for township roads in a rural residential district; 10 m.p.h. for alleys; 65 or 70 m.p.h. for interstates (depending on whether it is, respectively, within or outside an urbanized area of at least 50,000); 65 m.p.h. on multilane, divided highways with controlled access; and a default of 55 m.p.h. on other roads.

An "urban district" is any segment of street or highway that is built up with structures less than 100 feet apart for a minimum distance of a quarter-mile. Minn. Stat. § 169.01, subd. 59. A "rural residential district" is a segment of a township road with residential houses less than 300 feet apart for a minimum distance of a quarter-mile.

The law also requires that "no person shall drive a vehicle on a highway at a speed greater than is reasonable and prudent under the conditions.... In every event speed shall be so restricted as may be necessary to avoid colliding with any person, vehicle, or other conveyance..." Minn. Stat. § 169.14, subd. 1. These conditions place additional restrictions on the statutory speed limits.

***Adjusted limits in speed zones***

MnDOT has the authority to establish speed zones in which the speed limit is higher or lower than the limits set in law; these limits go into effect once signs are posted. Speed zones are established after MnDOT conducts an engineering and traffic investigation that analyzes factors like roadway design, physical characteristics, traffic volume, accident history, and observed speeds. Generally, MnDOT believes the maximum limit should be set near the 85$^{th}$ percentile (the speed at or below which 85 percent of vehicles are traveling).

***Restricted local authority***

Cities, counties, and towns have limited power over setting speed limits, even on their own streets and highways. If requested by a local road authority, MnDOT must perform an engineering and traffic study on a local road. However, MnDOT—not the local authority—determines the safe and reasonable speed limit, as well as whether to establish a speed zone. There are a few exceptions to this general rule.

- If MnDOT has previously established a speed zone for a city street or township road that is at least a quarter-mile long and is within an urban district, the city or town can lower the limit to 30 m.p.h.

- On a segment of road up to a half-mile long that is classified as a local street (referred to in statute as a "residential roadway"), a local road authority may reduce the speed limit from 30 to 25 m.p.h.
- In school zones, a local road authority may prescribe a lower limit that is not less than 15 m.p.h. or more than 30 m.p.h. below the surrounding limit. School zones are defined as a segment of street or highway that abuts school grounds where children have access to the roadway or where a school crossing is established. Minn. Stat. § 169.14, subd. 5a.
- Subject to certain requirements, lower speed limits can also be set on other roadways, including park roads (at not less than 15 m.p.h., or more than 20 m.p.h. below the surrounding limit), on streets that have a bicycle lane (at not less than 25 m.p.h.), and in alleys. Minn. Stat. §§ 160.263, subd. 4; and 169.14, subds. 5c and 5e.

Both MnDOT and local road authorities can set speed limits within their own highway work zones, which are effective while highway workers are on the job. A work zone speed limit cannot be less than 20 m.p.h. or reduce the speed limit by more than 15 m.p.h.

***Penalties for speeding violations***

Speeding is generally a petty misdemeanor punishable by a fine of up to $300 with no prison sentence, but other penalties can apply. An additional surcharge that doubles the amount of the fine is applied if the violation (1) occurs in a work zone or school zone, (2) involves speeds of 20 m.p.h. or more above the posted limit, or (3) occurs when passing a parked emergency vehicle with flashing lights. If a speeding violation is committed in a manner that endangers persons or property, it can be charged as a misdemeanor with maximum penalties of a $1,000 fine and 90 days imprisonment. Minn. Stat. § 169.89, subd. 1. A driver's license will be revoked for at least six months for driving over 100 m.p.h.

Minnesota does not use a point system, which assigns point values to different traffic violations and then requires driver's license suspension or revocation once a driver accumulates a minimum number of points within a time period. However, a third petty misdemeanor in a year can be charged as a misdemeanor, and a third misdemeanor in a year can result in license revocation.

***Speeding violations on a driver's record***

A law first enacted in 1986, known as the "Dimler amendment" (after its author, former Representative Chuck Dimler), governs which speeding violations are recorded on a motorist's driving record. The Department of Public Safety maintains the record. Speeding violations are not placed on the driving record if the driver was traveling:

- no more than 10 m.p.h. above the speed limit in a 55 m.p.h. zone; or
- no more than 5 m.p.h. above the speed limit in a 60 m.p.h. zone.

The prohibition on recording violations does not apply when the speed limit is 65 or 70 m.p.h. The Dimler amendment provisions do not apply if the speeding violation occurred in a commercial motor vehicle or if the driver holds a commercial driver's license (class A, B, or C). Minn. Stat. § 171.12, subd. 6.

**For more information:** Contact legislative analyst Matt Burress at 651-296-5045.

Nina Manzi and Joel Michael

Updated: June 2007

# Minnesota Individual Alternative Minimum Tax

***What is the alternative minimum tax?***

The theory underlying the federal and state alternative minimum taxes (AMT) is to require taxpayers who benefit heavily from some tax preferences to pay a minimum amount of tax relative to their incomes. The first version of the federal tax was enacted in 1969 in response to the revelation that a number of "millionaires" were paying no federal income tax.

***What is the history of the AMT?***

The federal AMT was first enacted in 1969, the state AMT in 1977. For some time during the 1970s and 1980s, both the federal and state taxes were levied as "add-on minimum" taxes, rather than alternative minimum taxes, and required certain taxpayers to pay a fraction of some preferences as an add-on minimum tax. The basic structure of the two taxes has been in place since the 1986 federal reform and 1987 state reform. Both Congress and the legislature have made many changes, both in defining the base of the taxes and their rates.

***How is Minnesota's AMT structured?***

Minnesota's AMT roughly follows the federal AMT. Both follow the model of requiring taxpayers to compute a tentative liability under a second tax structure. This second tax structure, the AMT, has a broader tax base (due to fewer deductions, exemptions, and credits) and lower rates than the regular tax. If the tentative tax is higher than the taxpayer's regular tax liability, the taxpayer pays the difference. In effect, the AMT takes away part of the benefit of tax preferences that lowered the regular tax.

***Who pays the AMT?***

AMT filers fall into three main groups:

- Those who have large amounts of deductions that are allowed under the regular tax but not under the AMT
- Taxpayers with large families whose personal exemptions and standard deduction (or typical itemized deductions) under the regular tax exceed the flat exemption amount allowed under the AMT
- Taxpayers with income above the level at which the AMT exemption is fully phased-out

***How are the federal and state AMTs different?***

The federal and state AMTs have two major differences. The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not. Also, the Minnesota AMT has one flat rate; the federal tax, by contrast, has two rates.

***What are the recent changes to the Minnesota AMT?***

Since tax year 2006, the Minnesota AMT has allowed full deduction of charitable contributions and an increased exemption amount. Before 2006, the exemption was $40,000 for married joint filers and $30,000 for single filers. In 2006 the exemption increased to $60,000 for married joint filers and $45,000 for single filers. It is adjusted annually for inflation and is $62,300 for married joint filers and $46,750 for single filers in tax year 2007.

*How are the Minnesota regular tax and AMT different?*

The Minnesota AMT uses a broader tax base than does the regular tax and applies a single 6.4-percent rate against that base. The following table outlines the parameters of the Minnesota regular and alternative minimum tax.

**Comparison of the Regular Income Tax and Minnesota AMT**
($ amounts are for the 2007 tax year)

| Feature | Regular Tax | AMT |
|---|---|---|
| **Tax base** | Federal adjusted gross income | Federal adjusted gross income |
| **Rules carried over from federal AMT** | | Less generous depreciation rules<br>Incentive stock options<br>Depletion<br>Intangible drilling costs<br>Tax-exempt interest from private activity bonds |
| **Standard deduction** | $10,700 (married joint) | $62,300 for married joint (phased out for taxpayers with income from $150,000 to $399,360) |
| **Personal exemptions** | $3,400 per taxpayer, spouse, and dependents | None |
| **Itemized deductions** | Home mortgage interest | Not allowed (federal allows, with limits) |
| | Charitable contributions | Allowed |
| | Property taxes | Not allowed (same as federal) |
| | Medical expenses | Allowed |
| | Miscellaneous deductions (e.g., employee business expenses) | Not allowed |
| | Casualty losses | Allowed |
| **Tax rates** | 5.35%; 7.05%; 7.85% | 6.4% (federal is 26%; 28%) |
| **Tax credits** | Transit passes | Not allowed |
| | Long-term care insurance | Allowed |
| | Marriage credit | Allowed |
| | Credit for taxes paid to other states | Allowed |
| | Refundable credits (working family, dependent care, and K-12 education) | Allowed, but the K-12 credit is reduced by AMT liability |

*How much revenue does the AMT raise?*

The Minnesota AMT is estimated to raise about $16.5 million in tax year 2007, from about 8,000 taxpayers. The amount of revenue and the number of taxpayers paying the AMT are not expected to increase in future years, since the exemption is indexed annually for inflation.

**For more information:** Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057.

**Nina Manzi and Joel Michael** **Updated: June 2007**

# Penalties for Underreporting Minnesota Individual Income Tax

***What is the civil penalty for failure to pay Minnesota income tax by the due date?***

For calendar year taxpayers, final payments are due on April 15 following the close of the tax year. (Most taxpayers pay on a calendar-year basis; a small number use fiscal years instead.) Income tax not paid by April 15 is subject to a late payment penalty equal to 4 percent of the amount not paid.

An additional 4-percent penalty applies to amounts owed as a result of an assessment order from the commissioner of revenue if the taxpayer either does not pay the amount assessed within 60 days of the order or does not appeal the assessment.

An additional extended delinquency penalty of 5 percent of the tax due applies to income tax not paid within 180 days of an order from the commissioner or the date a return is filed.

***Is there a reasonable cause exception?***

Yes. A taxpayer is presumed to have reasonable cause for underpayment if the taxpayer paid 90 percent of the amount due by the April 15 due date, filed the return by October 15, and paid the balance of the tax due when the return was filed. In this situation, the 4-percent late payment penalty does not apply.

***What is the "additional tax charge"?***

Individuals who expect to owe $500 or more after withholding and credits must make estimated payments, which are due in four installments: April 15, June 15, and September 15 during the tax year, and January 15 following the close of the tax year. If estimated payments and withholding do not equal at least 90 percent of the tax due, or 100 percent of liability for the preceding tax year, the taxpayer is subject to an additional tax charge. The additional tax charge equals 4 percent of the amount underpaid, prorated by the number of days elapsed between the due dates of the four installments and the date of the final payment.

The additional tax charge does *not* apply if the individual was a Minnesota resident in the preceding tax year but did not have tax liability.

***What is the civil penalty for failure to file a return?***

While individual income tax payments are due by April 15 following the close of the tax year, returns are not due until October 15. Taxpayers who fail to file an individual income tax return by October 15 must pay a penalty equal to 5 percent of the tax not paid by October 15.

If an individual is required to file a return and does not file it by October 15 and receives a written demand to file from the Department of Revenue, the individual must file within 60 days or face an additional "extended late file" penalty. The extended late file penalty equals the greater of 5 percent of the tax not paid or $100.

*What other civil penalties are there?*

- **Failure to report changes to the federal return: 10 percent.** When a federal return is amended by the taxpayer or corrected by the Internal Revenue Service, a copy of that return or a letter of explanation must be reported to Minnesota within 180 days. An amended Minnesota return is also required within 180 days. If federal changes are not reported, a penalty of 10 percent of the underpayment of Minnesota tax attributable to the federal change applies.
- **Intentional disregard of laws: 10 percent.** A 10-percent penalty applies if the taxpayer has been negligent or shown intentional disregard of the law or rules for determining liability, but didn't intend to defraud.
- **Substantial understatement of liability: 20 percent.** "Substantial understatement" means underreporting of the correct tax that exceeds the greater of $5,000 or 10 percent of the tax actually owed. A penalty of 20 percent applies to a substantial understatement of liability.
- **Filing a frivolous return: greater of 25 percent or $1,000.** A return is considered frivolous if it is substantially incorrect on its face or lacks information needed to judge the accuracy of the return, and consists of inappropriate conduct or reflects a desire to impede the tax process.
- **Filing a false or fraudulent return: 50 percent.** A penalty of 50 percent applies to the underreported liability and overstated refund claimed if the commissioner can prove the return was fraudulent in order to evade the tax, or if failure to file a return was intended to evade the tax. The 50-percent penalty also applies to fraudulently claimed refundable credits (the dependent care credit, the working family credit, the K-12 education credit, and the property tax refund).

*Does interest apply to underreported tax liability and penalties?*

In addition to the penalties listed, taxpayers who underreport individual income tax liability must pay interest on the amount underpaid and on the associated penalty from the date the tax was due. Penalties and underreported liability bear interest at an annual rate tied to the prime rate. This rate is adjusted annually and is set at 6 percent for 2006 and 7 percent for 2007.

*How are the penalties applied?*

The penalties for underreporting of individual income tax liability are imposed and collected in the same manner as the original taxes.

*Are failing to file and underreporting liability criminal offenses in Minnesota?*

Yes, in certain circumstances. It is a gross misdemeanor to knowingly fail to file a return or pay tax. It is a felony to willfully fail to file a return or pay tax, with intent to evade the tax, and a felony to file a false return concerning a material matter. Penalties for these criminal offenses are in addition to civil penalties.

**For more information:** Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057.

**HOUSE RESEARCH** | **Short Subjects**

**Anna Hovde and Donald Hirasuna**

**June 2007**

# Utilization of Earned Income Tax Credits: Differences Between Urban and Rural Welfare Recipients

Earned income tax credits can increase the incomes of low-income individuals by supplementing their incomes with a tax credit. This short subject explains some recent research on the receipt of Minnesota's earned income credit, the Working Family Credit, among welfare recipients and the differences in utilization between urban and rural areas. Analyses were conducted with data on Minnesota welfare recipients from 1992 through 1999.

***What are earned income tax credits?***

Earned income tax credits (EITC) are state and federal tax credits for low-income individuals. They are designed to provide incentives to work by supplementing earnings. In the federal program, the credit increases as earnings increase until it reaches a maximum. The credit phases out once earnings or income reach a pre-designated floor.

***How is Minnesota's EITC different from other programs?***

Minnesota structured its earned income tax credit, the Working Family Credit, differently in order to "make work pay." For some parents with earnings within the phase-out portion of the federal earned income tax credit, an increase in earnings may combine with a reduction in public benefits and in more income taxes, resulting in a decrease in after-tax, after-benefit income. Legislators designed Minnesota's Working Family Credit to prevent that loss in income. The credit is similar to the federal credit until after it reaches a maximum. The amount of Minnesota's credit increases after the first-tier maximum, creating a second-tier, or bump, in credit dollars before phasing out. The second increase in credit dollars compensates for the loss in income arising from a decrease in benefits and an increase in taxes.

***Who claims earned income tax credits?***

Low-income individuals and families are eligible for earned income tax credits, including welfare recipients. Research by Hirasuna and Stinson shows the following:

- Among individuals eligible for the credits, participation by welfare recipients is relatively low. Eligible welfare recipients claim the EITC between 65 percent and 70 percent of the time, compared to between 75 percent and 85 percent for all eligible households.
- When looking at all welfare recipients regardless of their eligibility, between 38 percent and 65 percent receive the credit.
- Rural welfare recipients are more likely to receive the credits than urban welfare recipients. In Minnesota, only 35 percent of all urban and 46 percent of all rural welfare recipients received Minnesota's Working Family Credit between 1992 and 1999.

***Why do some eligible welfare recipients not claim EITC?***

Several reasons why welfare recipients do not claim the credit include:

- **Income level.** For welfare recipients with a low level of earnings, the inconvenience of completing the paperwork may not be worth the small benefit of receiving the credit. Welfare recipients may have disproportionately low earnings compared to all eligible households, resulting in fewer receipts of earned income tax credits.
- **Information barriers.** Welfare recipients may not know about the credit or underestimate how much they can receive. Some areas have more organizations that provide information on earned income tax credits and free tax preparation.
- **Skill and language barriers.** Some eligible individuals have a limited ability to complete the necessary forms because of skill or language limitations.

***How do rural and urban welfare recipients differ?***

Differences in rural and urban settings have an impact on whether welfare recipients claim the credit:

- **Earnings and unemployment.** Labor market opportunities in rural areas differ from urban areas. The rural poor are more likely than the urban poor to hold one or more jobs, but have lower overall earnings because available jobs pay lower wages.
- **Racial mix.** Urban areas have higher concentrations of African American and Asian American welfare recipients, which may relate to differences in earnings between rural and urban recipients. Rural areas have a higher concentration of American Indians who may work and live on a reservation, which results in no state taxable income and ineligibility for the state earned income credit.
- **Availability of information and other resources.** Free tax preparation sites are more prevalent in urban areas while social services and other organizations may inform recipients of the state's earned income credit in rural areas. Rural workers with limited language skills, such as migrant farm workers, may be especially vulnerable when support is not available in their primary languages.

***What are the policy implications of this research?***

Poverty alleviation programs affect the rural and urban poor differently because of differences in labor markets, demographics, and resources. Understanding these differences can help legislators design a mix of programs that help welfare recipients exit poverty more quickly.

Earned income tax credits may provide an effective incentive for individuals to work more and increase after-tax income. Increasing the amount of the Minnesota Working Family Credit, job growth opportunities, and free tax preparation assistance may increase participation levels in EITC programs.

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038. This short subject was written by research assistant Anna Hovde based on Donald P. Hirasuna and Thomas F. Stinson's "Urban and Rural Differences in the Utilization of Earned Income Tax Credits: A Study of Minnesota's Working Family Credit," forthcoming in the *International Regional Science Review*.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

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**Colbey Sullivan** **June 2007**

# Rural Finance Authority

***What is the Rural Finance Authority?***

The Rural Finance Authority (RFA) is the state's main agricultural lending arm. It was established by the legislature during the farm credit crisis of the 1980s to help eligible farmers restructure mounting debt.

***What does the RFA do?***

The RFA is directed to "develop the state's agricultural resources by extending credit…on terms and conditions not otherwise available from other credit sources." Minn. Stat. § 41B.01. Although the RFA has authority to issue loans directly, in practice it typically partners with private agricultural lenders to provide favorable financing opportunities for eligible farmers.

***How does the RFA extend credit?***

The RFA has official agreements with more than 400 private lenders. These lenders actually issue and administer the loans. The RFA purchases a portion of the loan from the lender and charges the farmer a lower rate of interest on its portion of the debt. As a result, the "blended" interest rate the farmer pays is lower than the market rate charged by the private lender alone. (The blended interest rate is the weighted average of the interest rates charged by the RFA and the lender.) By lowering the farmer's interest costs, this arrangement makes debt financing more affordable.

***Who runs the RFA?***

Although the RFA is a separate public body with its own powers and duties, it is administered by the Minnesota Department of Agriculture. The RFA is a small organization with four employees. The board consists of the commissioners of agriculture (chair), finance (vice chair), employment and economic development, and commerce, as well as the state auditor. The governor appoints an additional six public board members who must be approved by the Senate. No public board member may reside in the seven-county Twin Cities metropolitan area.

***What loan programs are available?***

The RFA currently offers ten different loan programs. Each program has its own specific purpose, borrower criteria, and other details. These programs, along with years of inception and funding sources, are as follows:

- Basic Beginning Farmer (1987, general obligation (G.O.) bonds)
- Seller-sponsored (1989, G.O. bonds)
- Agricultural Development Bond ("Aggie Bond") (1991, federal private activity bonds)
- Agricultural Improvement (1992, G.O. bonds)
- Restructure II (1993, G.O. bonds)
- Livestock Expansion (1994, G.O. bonds)
- Value-added Stock (1994, General Fund (G.F.) appropriation)
- Disaster Recovery (1998, G.F. appropriation)
- Methane Digester (2002, G.F. appropriation)

- Livestock Equipment Pilot (2005, G.F. appropriation)

***Which farmers are eligible?***

In general, a borrower must be the principal operator of farm who is also (1) a Minnesota resident, (2) a member of a family-owned and -operated farm corporation, or (3) a member of a family-owned and -operated farm partnership. Beyond these general requirements, many programs have their own eligibility rules. To focus support on smaller beginning farmers, several programs limit eligibility to those whose net worth falls below an inflation-adjusted threshold.

***How does the RFA use bonds to fund certain loan programs?***

The Minnesota Constitution allows the legislature to borrow money and use the proceeds "to develop the state's agricultural resources by extending credit on real estate security." Minn. Const. art. XI, § 5(h). In essence, the state takes out a loan and then uses the borrowed funds to make loans to eligible farmers. These bonds are considered 100-percent "user-financed" because the RFA is required by law to charge farmers a rate of interest sufficient to meet the debt service obligations on the G.O. bonds. Because the state typically boasts a strong credit rating and G.O. bond interest is generally exempt from federal and state income taxes, the rate the state pays on G.O. bonds—and by extension the rate the RFA charges farmers—tends to be relatively low.

***Do these G.O. bonds require a three-fifths vote of the House and Senate?***

A three-fifths supermajority is not necessary; only a simple majority is required. The Constitution treats these bonds differently than bonds issued to fund conventional capital investment projects. Minn. Const. art. XI, § 5(a) and (h).

***Why are some programs funded with cash instead?***

The Constitution limits the use of G.O. bond proceeds for agriculture development to providing loans secured by a lien on real estate. In other words, RFA loans financed by G.O. bond proceeds must be secured by a mortgage on the borrower's farmland. Loans not tied to the borrower's farmland must be funded by another source. The RFA has authority to raise funds by issuing its own taxable revenue bonds but the legislature has instead chosen to fund these programs with General Fund appropriations. This gives the legislature and RFA greater flexibility in defining loan security requirements and setting interest rates. For instance, the RFA charges no interest on its methane digester loans—a program funded entirely by General Fund appropriations.

***Do other states have similar entities?***

Thirty-five other states have agricultural finance programs similar to the RFA.

**For more information:** To learn more about the loan programs or to apply for financing visit www.mda.state.mn.us/agfinance/default.htm or call the RFA directly at 651-201-6000 or 1-800-967-2474. For legislative matters, contact legislative analyst Colbey Sullivan at 651-296-5047. For more on general obligation bonds, see the House Research publication *State Bonding*, October 2002.

Colbey Sullivan June 2007

# Genetically Engineered Crops

***What are genetically engineered organisms?***

Scientists create genetically engineered organisms (GEOs) by directly manipulating a living creature's genetic makeup, or DNA. This is usually performed by transplanting genetic material from one organism to another or by rearranging an organism's existing genes. Genetic engineering is a common practice in United States agriculture, allowing scientists to create organisms (primarily new crop varieties) with desired characteristics like disease or pest resistance and herbicide tolerance.

***What is an example?***

Bt corn is a corn variety infused with a gene transplanted from the soil bacterium Bacillus thuringiensis. The foreign gene causes the corn plant to produce a protein considered safe when ingested by most insects, mammals (including humans), birds, and fish but fatal to the corn borer, a destructive insect. The federal government and the Minnesota Department of Agriculture (MDA) first authorized the commercial use of Bt corn in 1995.

***Are agricultural GEOs regulated?***

Laws and regulations at both the federal and state levels govern the planting, transportation, and sale of genetically engineered crops. In general, GE crops are developed in secure facilities then—with government approval—planted in outdoor test plots and monitored. If the GEO's owner can demonstrate that the crop does not pose unreasonable harm to humans or the environment, the crop may be deregulated and made available for commercial use.

***What agencies are involved?***

Guided by a "coordinated framework" adopted in 1986, three federal entities share oversight responsibility for agricultural GEOs: the Department of Agriculture (importation, interstate movement, and field trials), the Environmental Protection Agency (GE pesticides and pesticides genetically incorporated into plants), and the Food and Drug Administration (safety of GE food and feed).

When a seed company, university, or other entity intends to release (i.e., transport, plant, or sell) a GE crop in Minnesota, it must first apply to the MDA for approval. In 1991, Minnesota lawmakers directed the state's Environmental Quality Board to regulate genetically engineered organisms. It soon became apparent that GE crops made up most if not all of the GEO activity in the state. In 1994 the legislature transferred oversight of most genetically engineered plants, animals, pesticides, fertilizers, soil amendments, and plant amendments to the MDA. The department has the authority to deny the request or attach additional conditions to the release even if the federal government has cleared the plant for monitored field trials or deregulated commercial use.

*What criteria does the MDA use?*

The MDA's permitting process is designed to "protect humans and the environment from the potential for significant adverse effects [of GEO releases]...taking into account the environmental costs and benefits." Minn. Stat. §§ 18F.01 and 18F.02. The department reviews information provided by the applicant along with any decisions made by federal agencies pertaining to the proposed release. Specifically, the MDA considers such factors as the past performance of similar releases, the potential for the GEO's genetic material to transfer to other organisms, and the likelihood that the GEO will harm nontarget organisms or otherwise negatively affect the environment.

*Which GEOs have been approved and can now be grown by farmers?*

The MDA has okayed GE varieties of the following crops: canola, corn, potato, soybean, sugarbeet, sweet corn, tomato, and squash. In addition, the state has approved a GE version of rhizobium—a soil bacterium capable of fixing nitrogen in the soil.

*Do Minnesota farmers plant GEOs?*

On the whole, farmers in Minnesota and across the country have adopted GE corn and soybeans. According to the USDA, GE varieties comprised nearly three-fourths of all corn planted in Minnesota in 2006. In 2000, GE corn was a significantly smaller share of the total, at 37 percent. For soybeans, Minnesota farmers planted 88 percent of total acres to GE varieties in 2006, up from 46 percent in 2000. Farms nationwide displayed a similar trend over the period, with GE corn growing from 25 percent in 2000 to 61 percent in 2006, and GE soybeans up from 54 percent to 89 percent over the same period.

*How do Minnesota's laws compare to those in other states?*

A 2004 study by the Pew Initiative on Food and Biotechnology found that most states do not have specific regulations or permitting procedures for agricultural GEOs. Of those that do, Minnesota is the only state with a comprehensive set of laws and regulations that create a separate permitting system specifically for GE crops. The MDA may require an applicant to provide any information it sees fit and may attach any conditions it deems necessary to ensure that the release does not pose an unreasonable risk. The department is also authorized to inspect test plots and revoke or amend a permit should it find any violations.

*Are traditional methods considered GE?*

Traditional agricultural practices like the selective breeding of livestock or the hybridization of crops are not considered genetic engineering under Minnesota law.

**For more information:** For policy matters, contact legislative analyst Colbey Sullivan at 651-296-5047. Those interested in releasing a GEO in Minnesota should contact the Minnesota Department of Agriculture directly at 651-201-6000 or 1-800-967-2474.

**Emily Cleveland** **Updated: July 2007**

# Minnesota Clean Indoor Air Act

The Minnesota Clean Indoor Air Act (MCIAA) prohibits smoking in many indoor places (Minn. Stat. §§ 144.411 to 144.417). The legislation was enacted in 1975 in an effort to protect public health, comfort, and the environment. The MCIAA was amended by the Freedom to Breathe Act of 2007 (Laws 2007, ch. 82), which substantially expanded the prohibition of smoking to nearly all indoor areas.

The Freedom to Breathe Act is effective October 1, 2007, and was enacted to provide protection from secondhand smoke, particularly for employees in their workplaces. Additionally, this legislation was enacted to avoid the state from having a patchwork of varying indoor smoking regulations in cities and counties. However, local governments are still free to adopt and enforce more stringent regulations of secondhand smoke exposure and to regulate smoking in outdoor areas.

***Where is smoking prohibited?***

As of October 1, 2007, the MCIAA prohibits smoking in public places, at public meetings, in places of employment, and in public transportation. Places of employment are indoor areas where two or more persons perform services, whether or not the persons are paid. Public places and places of employment include the following:

- Arenas
- Auditoriums
- Banquet facilities
- Bars and other food or liquor establishments
- Bowling establishments
- Common areas of rental apartment buildings
- Employee cafeterias
- Factories
- Libraries
- Lounges
- Museums
- Offices
- Restaurants
- Retail stores and other commercial establishments
- Theaters
- Vehicles used for work purposes during the hours of operation if more than one person is present
- Warehouses

An indoor area is defined as the space between a floor and a ceiling that is bounded by walls covering more than 50 percent of the perimeter of the area. Temporary physical barriers are considered walls, but certain window screens are not.

***Where is smoking permitted?***

Smoking is permitted in the following places:

- Specified rooms in residential health care facilities
- Separated, well-ventilated areas of locked psychiatric units
- Specified areas for use in peer-reviewed scientific studies related to smoking
- Private homes and residences when they are not in use as a place of employment
- Hotel and motel guest rooms

- Tobacco products shops for the purpose of sampling products
- Heavy commercial vehicles
- Farm vehicles and construction equipment
- Buildings on family farms
- Disabled veterans' rest camp

Smoking is also permitted by Native Americans as part of a traditional Native American spiritual or cultural ceremony and by actors as part of a theatrical performance.

The MCIAA permits smoking outside, unless it is limited or prohibited by local government.

***What are the responsibilities of proprietors?***

Proprietors or other people or entities who control the use of a public place, public transportation, place of employment, or a public meeting must make reasonable efforts to prevent smoking inside of these places. Proprietors or other persons or entities in charge of the premises must:

- post signs or employ other appropriate means of prohibiting smoking;
- ask smokers to refrain from smoking;
- ask smokers who do not refrain from smoking to leave the premises; and
- handle smokers who refuse to leave in a manner consistent with other persons acting in a disorderly manner or as a trespasser.

Proprietors and other people or entities are prohibited from providing ashtrays or matches in areas where smoking is prohibited. Proprietors and other people or entities in charge of a restaurant or bar are prohibited from serving an individual who smokes in an area where it is prohibited.

***Who enforces the Minnesota Clean Indoor Air Act?***

The Department of Health (MDH) enforces the MCIAA. MDH can issue fines of up to $10,000 against proprietors who violate the MCIAA. Also, peace officers can cite proprietors and individuals with violating the MCIAA. It is a petty misdemeanor to smoke, or to permit someone to smoke, in an area where smoking is prohibited or restricted by the MCIAA.

***Can local governments enact ordinances that are stricter than the MCIAA?***

The MCIAA authorizes local units of government to enact and enforce more stringent measures than those provided in the MCIAA to protect individuals from secondhand smoke, including limiting or prohibiting smoking in outdoor areas.

**For more information:** Contact legislative analyst Emily Cleveland at 651-296-5808. Also see the House Research publication *Freedom to Breathe Act of 2007*, July 2007.

**Kathy Novak and Nina Manzi** **Updated: July 2007**

# Economic Forecasts, Budget Surpluses, and Budget Shortfalls

***When are economic forecasts prepared?***

The commissioner of finance must prepare a forecast of state revenues and expenditures twice each year—in February and November.

***What are the forecasts used for?***

The November forecast in even-numbered years becomes the basis for the governor's budget recommendations to the legislature. The November 2006 forecast provided the revenue and expenditure projections that the governor used in developing the budget for the fiscal year 2008-2009 biennium. The November 2006 forecast also told if the state was on track to finish the fiscal year 2006-2007 biennium with a balanced budget.

The February forecast in odd-numbered years fine-tunes the preceding November's forecast with data that becomes available early in the calendar year. The February 2007 forecast provided the revenue and expenditure projections that the legislature used in adopting a budget for the fiscal year 2008-2009 biennium. Following the February 2007 forecast, the governor submitted budget modifications developed from the November forecast, which were called "supplemental budget recommendations." The February 2007 forecast also updated the status of revenues and expenditures in the current biennium.

The November forecast in odd-numbered years and the February forecast in even-numbered years also provide updates on revenues and expenditures in the current biennium. Using the projections of the November 2007 forecast, the governor may make additional "supplemental budget recommendations," proposing changes to the fiscal year 2008-2009 budget during the 2008 legislative session. The legislature will use the projections in the February 2008 forecast to ensure that the fiscal year 2008-2009 biennium closes with a balanced budget.

***What if a forecast shows a budget shortfall?***

If a forecast shows a shortfall for the *general fund in the current biennium*, the commissioner of finance may reduce the budget reserve account as needed to balance revenues with expenditures. If there isn't enough money in the budget reserve to balance the general fund in the current biennium, the commissioner may also reduce outstanding appropriations, commonly referred to as "unalloting." Before reducing the budget reserve or unalloting appropriations, the commissioner must obtain the approval of the governor and must consult with the Legislative Advisory Commission. When the legislature is in session, the governor typically makes recommendations to the legislature on how to resolve the shortfall before approving use of the budget reserve or unalloting.

If a forecast shows a shortfall for *any other fund in the current biennium*, the commissioner of finance must reduce the affected agency's allotment to avoid a deficit. As with general fund shortfalls, if the legislature is in session the governor would typically make recommendations on how to resolve the shortfall.

If a forecast shows a shortfall for *the coming biennium*, the governor's budget recommendations must propose revenues and expenditures changes in order for the budget at the close of the coming biennium to be in balance.

***What if the forecast shows a budget surplus?***

If a forecast shows a surplus for the *general fund in the current biennium*, the commissioner of finance must allocate the surplus in priority order as follows:

- to the cash flow account, until it reaches $350 million
- to the budget reserve account, until it reaches $653 million
- to increase the school aid payment schedule to 90 percent
- to restore previous school aid reductions and reduce the property tax recognition shift accordingly

If, as became the case following the February 2006 forecast, all these priorities have been met, the remaining surplus is called a "positive unrestricted budgetary general fund balance."

If the *November forecast in an even-numbered year*, or the *February forecast in an odd-numbered year*, projects a positive unrestricted budgetary general fund balance at the close of the *current biennium* greater than one-half of 1 percent of total general fund revenues for the biennium, the commissioner must designate the entire balance as available for rebate. The commissioner excludes general fund carryforward amounts in calculating the one-half of 1 percent threshold amount. In the November 2006 forecast, the commissioner designated $1.038 billion as available for rebate.

If the projected surplus is less than one-half of 1 percent of total general fund revenues, the commissioner reports it in the forecast as an unrestricted budgetary general fund balance. If a biennium closes with a positive unrestricted general fund balance, the commissioner must transfer that amount to the tax relief account on the last day of the biennium.

If a forecast shows a surplus for *the coming biennium*, the governor's budget recommendations may propose revenue reductions and/or expenditure increases, as long as the proposed changes do not result in a projected budget shortfall.

***What happens when a forecast shows an amount "available for rebate"?***

If the commissioner designates an amount as "available for rebate," the governor must present a plan to the legislature for rebating the amount designated to the taxpayers. The plan must provide for payments to begin no later than August 15. The legislature must enact, modify, or reject the plan by April 15. Because the November 2006 forecast showed a positive unrestricted budgetary general fund balance greater than one-half of 1 percent of total general fund revenues, the governor presented a plan for rebate to the legislature during the 2007 session, providing for payments of the $1.038 billion designated for rebate to begin by August 15, 2007. The legislature had until April 15, 2007, to enact, modify, or reject the governor's plan. The 2007 Legislature did not take up the governor's plan for a sales tax rebate.

**For more information:** Contact legislative analyst Kathy Novak at 651-296-9253 or Nina Manzi at 651-296-5204. Also see the House Research publication *Unallotment*, March 2002.

# HOUSE RESEARCH | Short Subjects



**Emily Cleveland**



**July 2007**


## Freedom to Breathe Act of 2007

The Freedom to Breathe Act of 2007 expands the prohibition of smoking provided in the Minnesota Clean Indoor Air Act (MCIAA) (Minn. Stat. §§ 144.411 to 144.417). It was signed into law May 16, 2007, and goes into effect October 1, 2007. This act was enacted to provide protection from secondhand smoke, particularly for employees in their workplaces. Additionally, this legislation was enacted to avoid the state from having a patchwork of varying indoor smoking regulations in cities and counties. However, local governments are still free to adopt and enforce more stringent regulations of secondhand smoke exposure and to regulate smoking in outdoor areas.

***The Freedom to Breathe Act expands the prohibition of smoking***

Before October 1, 2007, the MCIAA prohibited smoking in public places and at public meetings, but permitted smoking in certain designated smoking areas. It also completely prohibited smoking in all nonresidential health care facilities, day care premises, and public schools.

Under the Freedom to Breathe Act, starting October 1, 2007, smoking is still prohibited in public places and at public meetings, but designated smoking areas are no longer permitted. Also, smoking is prohibited in places of employment and in public transportation.

***Smoking is prohibited in places of employment***

Places of employment are indoor areas where two or more persons perform any type of service under any type of contractual relationship, including places where persons provide volunteer services. Vehicles and private residences used for work purposes during hours of operation are included in the definition.

Places of employment include the following:

- Banquet facilities
- Bars and other food or liquor establishments
- Bowling establishments
- Elevators and hallways
- Employee cafeterias
- Factories
- Libraries
- Lounges
- Museums
- Offices
- Restaurants
- Restrooms
- Retail stores and other commercial establishments
- Theaters
- Vehicles used for work purposes during the hours of operation if more than one person is present
- Warehouses

Under the Freedom to Breathe Act, an "indoor area" is defined as the space between a floor and a ceiling that is bounded by walls, doorways, or windows, covering more than 50 percent of the perimeter of the area. Temporary physical barriers, such as retractable dividers or garage doors, are considered walls, but certain window screens are not.

***Smoking is prohibited in public transportation***

Public transportation includes all public means of transportation, including the following:

- Buses
- Enclosed bus and transit stops
- Limousines and other for-hire vehicles
- Light and commuter rail transit
- Taxis
- Ticketing, boarding, and waiting areas of public transportation terminals

***Smoking is prohibited in private residences used as places of employment***

Generally, the Freedom to Breathe Act does not prohibit smoking in private residences, unless it is being used as a place of employment (Minn. Stat. § 144.4167, subd. 3).

- When homeowners use an area of their private residence exclusively and regularly as a principal place of business and have one or more on-site employees, then smoking is prohibited in that area during hours of operation.

- Similarly, when homeowners use an area of their home exclusively and regularly to meet with patients, clients, or customers, then smoking is prohibited in that area of the home during hours of operation.

- With regard to in-home day care, if the day care provider permits smoking in the home outside of the hours of operation, the day care provider must disclose this to the parents or guardians of the children. This disclosure must include orally informing the parents or guardians and posting a written notice.

***Entities will study the impact on lawful gambling***

The act directs the Gambling Control Board and the Commissioner of Revenue to study the impact of the statewide smoking ban on lawful gambling. The Gambling Control Board will report the results of the study to the governor and the legislature before March 31, 2008. This gives the board six months from the effective date of the ban to study the impacts and prepare their recommendations.

***Act expands eligibility for the dislocated worker program***

The Freedom to Breathe Act expands eligibility for the dislocated worker program to employees of bars, restaurants, and lawful gambling organizations, who become unemployed between October 1, 2007, and October 1, 2009, as a result of the statewide smoking ban.

The dislocated worker program (Minn. Stat. § 116L.17) provides free services to individuals who have lost their jobs through no fault of their own. The program helps people to find new employment through a variety of services, such as career planning and counseling, job search and placement services, and job-related training.

**For more information:** Contact legislative analyst Emily Cleveland at 651-296-5808. Also see the House Research publication *Minnesota Clean Indoor Air Act*, July 2007.

**Abigail Johnson and Donald Hirasuna** **July 2007**

# Do Free Tax Preparation Sites Increase Welfare Recipients' Utilization of State Earned Income Credits?

This short subject summarizes the results of a study by Hirasuna and Stinson (2005) in *State Tax Notes*. In the study, they find that the availability of free tax preparation sites, particularly when they are concentrated in neighborhoods with high poverty rates, may contribute to increased receipt of Minnesota's earned income tax credit, the Working Family Credit.

***Earned income tax credits and welfare recipients***

Federal and state earned income tax credits supplement the earnings of low-income individuals, including families on welfare. The tax credits provide an incentive to work by lowering the amount of income taxes owed and, in some cases, by providing a refund check back to the parents. To be eligible, households must satisfy earnings and unearned income qualifying limits. In addition, households must file a federal return to claim the federal earned income tax credit and a Minnesota tax return to claim Minnesota's earned income tax credit, the Working Family Credit (WFC).

***How free tax preparation sites might help***

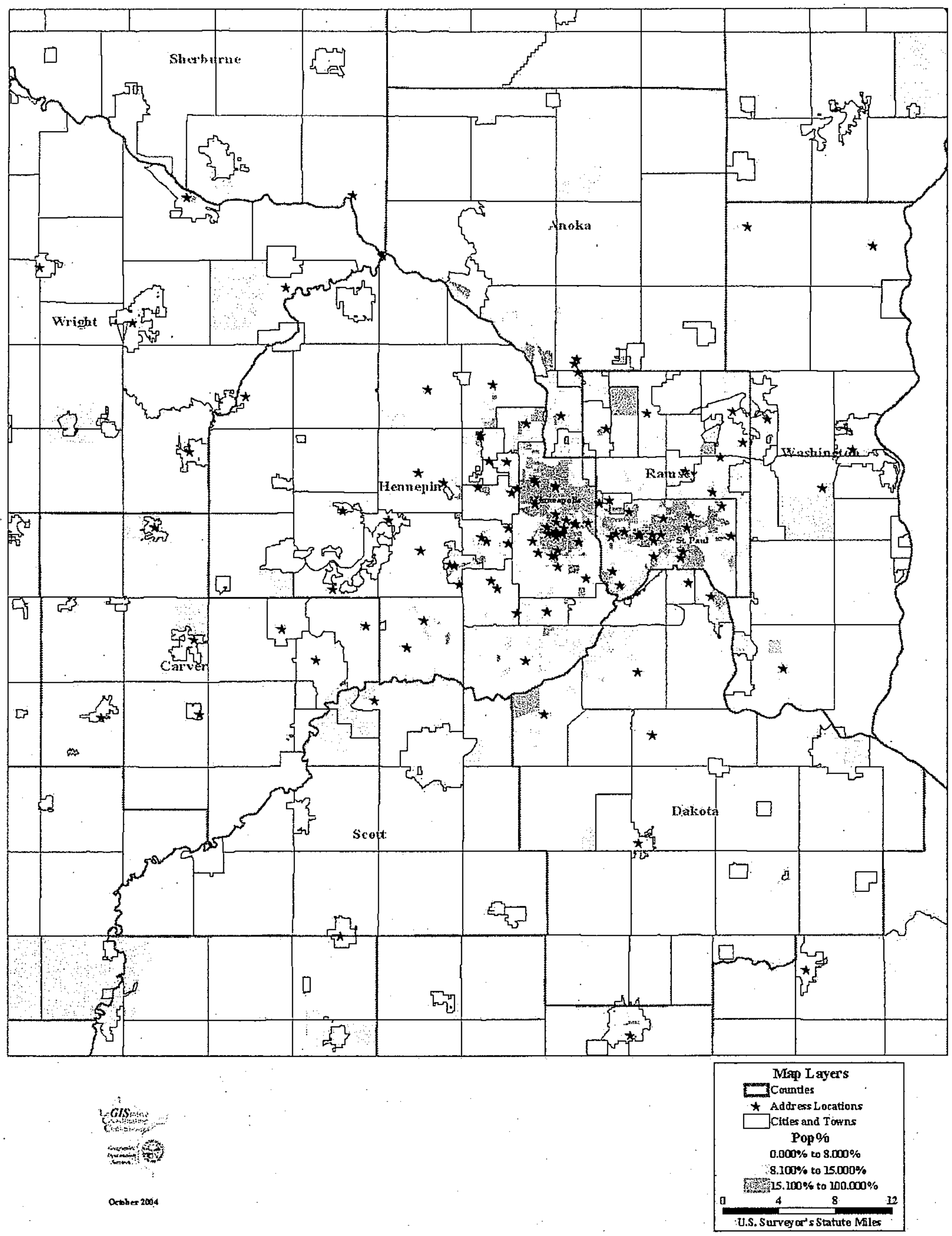
To receive the WFC and the federal earned income tax credit, individuals must file a tax return, a sometimes difficult and time-consuming task. Taxpayers can receive assistance in filling out tax forms by visiting a free tax preparation site. Free tax preparation sites prepare tax returns at no cost to taxpayers who bring in their W-2 and other necessary forms. These sites can help parents and individuals claim earned income and other tax credits. The 2005 Legislature appropriated $250,000 for fiscal years 2006 and 2007 ($125,000 for each year) and added the appropriation to the base budget for future years.

***Effects of the availability of free tax preparation sites on utilization of state credits***

The researchers' findings indicate that an increase in the number of sites and the number of sites per capita noticeably increases the probability of filing an income tax return and of receiving the credit where free tax preparation sites are most concentrated in Hennepin and Ramsey counties. Proximity to areas with high poverty rates showed a particularly high correlation with higher utilization rates. However, an increase in sites within suburban counties decreases the probability a household head files an income tax return and receives the state earned income credit. Here, there may be little correlation because of a wider geographic dispersion of welfare recipients. Also, there are relatively few free tax preparation sites in these areas, thereby increasing the distance an individual must travel to the site.

***Location of free tax preparation sites***

**The following map lists the location of free tax preparation sites in the Minneapolis-St. Paul metropolitan area (in 1999).** These sites are for AccountAbility Minnesota and AARP, which make up the majority of free tax preparation sites within the state. The map shows that most sites are located in neighborhoods with higher poverty rates.




***Policy implications*** Policymakers can better determine whether these types of sites contribute in any significant degree to the financial well-being of low-income families.

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038. This short subject was written by research assistant Abigail Johnson and based on the article "Do State Tax Preparation Sites Increase Use of State Earned Income Credits?" by Donald Hirasuna and Thomas Stinson, *State Tax Notes*, volume 35, number 6 (Feb. 7, 2005).

Karen Baker & Nina Manzi July 2007

# Major State Aids and Taxes: An Overview of the 2005 Update

This provides a brief overview of the report *Major State Aids and Taxes: A Comparative Analysis, 2005 Update*, highlighting major aids provided to the local governments and people in Minnesota and lists the major taxes collected. The per capita amounts were calculated using 2005 population. Some aids are presented on a different basis in other settings (e.g., per pupil for education aid); however, in the report they are presented on a per capita basis to allow comparison of different aids.

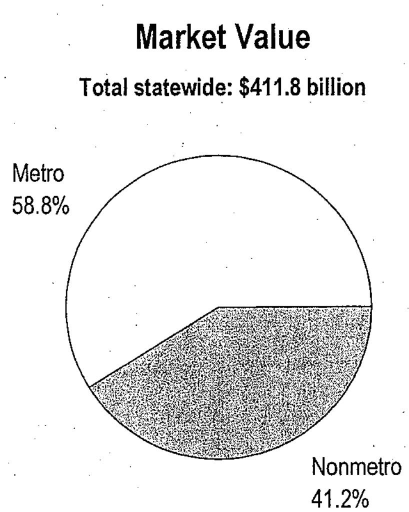
## STATE AIDS

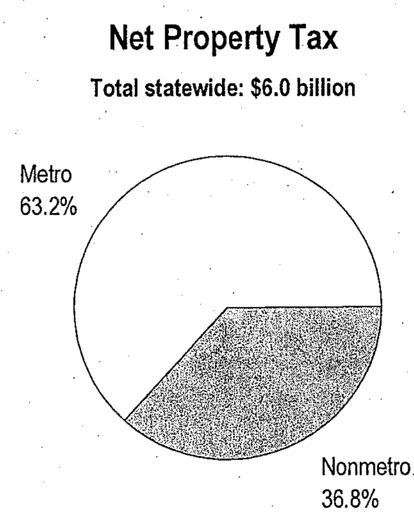
| Program | Year | Amount (millions) | Per Capita |
|---|---|---|---|
| **Education aid**<br>*Aid paid to school districts for all K-12 educational expenses* | 2004/2005 (school year) | **$6,008.5 State**<br>$3,263.8 Metro<br>$2,744.8 Nonmetro | **$1,171 State**<br>$1,188 Metro<br>$1,150 Nonmetro |
| **Human services aid**<br>*State's share of human services aid for various income and medical assistance programs* | 2005 | **$3,569.1 State**<br>$1,889.1 Metro<br>$1,680.0 Nonmetro | **$695 State**<br>$688 Metro<br>$704 Nonmetro |
| **Highway aid**<br>*Distributed to counties, cities with more than 5,000 people, and towns* | 2005 | **$534.7 State**<br>$148.6 Metro<br>$386.1 Nonmetro | **$104 State**<br>$54 Metro<br>$162 Nonmetro |
| **Local government aid**<br>*Provides property tax relief by providing general purpose financial support to cities* | 2005 | **$436.7 State**<br>$151.6 Metro<br>$285.1 Nonmetro | **$85 State**<br>$55 Metro<br>$119 Nonmetro |
| **Disparity reduction aid**<br>*Provides aid to jurisdictions (counties, towns, and school districts) that had inordinately high tax rates in 1998* | 2005 | **$18.7 State**<br>$1.4 Metro<br>$17.3 Nonmetro | **$4 State**<br>– Metro<br>$7 Nonmetro |
| **County program aid**<br>*Includes former county general purpose aids: homestead and agricultural credit, county criminal justice aid, family preservation aid, and attached machinery aid* | 2005 | **$206.2 State**<br>$86.0 Metro<br>$120.2 Nonmetro | **$40 State**<br>$31 Metro<br>$50 Nonmetro |
| **Community corrections funding**<br>*Aid that provides a portion of counties' costs for community correctional services* | 2005 | **$76.7 State**<br>$39.7 Metro<br>$36.9 Nonmetro | **$15 State**<br>$14 Metro<br>$15 Nonmetro |
| **Property tax refund** (excludes targeting)<br>*Partly reimburses homeowners and renters for a portion of property taxes if their taxes exceed a level of income* | 2004 (filed in 2005) | **$296.9 State**<br>$204.0 Metro<br>$92.9 Nonmetro | **$58 State**<br>$74 Metro<br>$39 Nonmetro |
| **Targeting**<br>*Additional property tax refund for homeowners whose property taxes increased over a certain percentage threshold from the previous year* | 2005 | **$4.3 State**<br>$2.6 Metro<br>$1.7 Nonmetro | **$1 State**<br>$1 Metro<br>$1 Nonmetro |

## MAJOR TAXES

| | Year | Amount | Per capita |
|---|---|---|---|
| **Individual income tax**<br>*Imposed on income of state residents and income derived from state sources of nonresidents* | 2004 (filed in 2005) | **$5,815.8 Total**<br>**$5,599.5 Residents**<br>$3,809.9 Metro<br>$1,789.6 Nonmetro | **$1,091 State**<br>$1,387 Metro<br>$750 Nonmetro |
| **Sales and use tax**<br>*Imposed on gross receipts of people who sell, lease, or rent tangible personal property at retail at a rate of 6.5 percent (does not include local sales taxes)* | 2005 | **$4,278.8 (After refunds)**<br>**$3,625.8 Residents**<br>$2,348.7 Metro<br>$1,277.2 Nonmetro | **$706 State**<br>$855 Metro<br>$535 Nonmetro |
| **Motor vehicle sales tax**<br>*Imposed on new and used motor vehicles at the time of sale at the same rate of state sales tax* | 2005 | **$547.2 State**<br>$286.3 Metro<br>$260.9 Nonmetro | **$107 State**<br>$104 Metro<br>$109 Nonmetro |
| **Motor vehicle license tax**<br>*Imposed annually on vehicles licensed in the state* | 2005 | **$493.3 State**<br>$266.7 Metro<br>$226.5 Nonmetro | **$96 State**<br>$97 Metro<br>$95 Nonmetro |
| **Motor vehicle fuels tax**<br>*Imposed on gasoline, diesel fuel, and other motor fuels used by vehicles and on aviation fuels* | 2005 | **$656.7 State**<br>$307.7 Metro<br>$349.0 Nonmetro | **$128 State**<br>$112 Metro<br>$146 Nonmetro |
| **Corporate franchise (income) tax**<br>*Imposed at a rate of 9.8 percent on the net income of corporations* | 2004 | **$580.4 State**<br>$423.7 Metro<br>$156.7 Nonmetro | **$113 State**<br>$154 Metro<br>$66 Nonmetro |
| **State property tax**<br>*Imposed on commercial/industrial/public utility property and seasonal recreational property* | 2005 | **$625.6 State**<br>$407.7 Metro<br>$217.9 Nonmetro | **$122 State**<br>$148 Metro<br>$91 Nonmetro |

## PROPERTY TAX DATA




**For more information:** Contact legislative analysts Karen Baker at 651-296-8959 or Nina Manzi at 651-296-5204. See *Major State Aids and Taxes: Comparative Analysis, 2005 Update* (July 2007) for further details about each aid program and tax and data by county and economic development region.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

**HOUSE RESEARCH** | **Short Subjects**

**Patrick McCormack**

**August 2007**

# Minnesota's Laws on Wine Tasting and Samples of Alcohol

Minnesota Statutes make a distinction between the regulations for the tasting of wine and the provision of free samples of wine, beer, and liquor.

***Free Samples***

Minnesota Statutes section 340A.510 allows a liquor store, bar, or municipal liquor store to either offer free samples directly, or to allow a licensed manufacturer or wholesaler to provide samples on their premises. Sample sizes are limited to 100 milliliters for malt liquors, 50 milliliters for wine, 25 milliliters of liqueur or cordial, and 15 milliliters of distilled spirits. Samples must be of beverages that are otherwise for sale.

Samples may not be offered at retail establishments that do not hold an on-sale, off-sale, or municipal liquor license. Minnesota law is silent on whether brewery tours may offer samples, although there is no direct prohibition, and taxes are not collected on beer served on-site at the brewery (Minn. Stat. § 297G.07, subd. 1 (4)).

A farm winery may give free samples of its products (Minn. Stat. § 340A.315), and in 2007, farm wineries were given permission to hold other licenses, including on-sale licenses in order to operate bars or restaurants.

***Culinary Classes***

A limited on-sale liquor license may be issued to establishments that conduct culinary classes, and under this license participants may be served up to six ounces of wine or 12 ounces of intoxicating malt liquor, for consumption on the premises. As an alternative, a culinary establishment may hold a regular on-sale license and serve beverages under general on-sale laws. Culinary establishments may only hold a regular on-sale license if they are also a restaurant, hotel, etc.

***Tastings***

A holder of an on-sale intoxicating liquor license may hold wine, beer, or distilled liquor tastings as part of the normal operation of the bar or restaurant, and would then charge a fee per glass consumed. Minnesota law does allow charitable, religious, or other nonprofit groups to conduct wine tastings, defined as "an event at which persons pay a fee or donation to participate, and are allowed to consume wine by the glass without paying a separate charge for each glass."

Tastings are limited as follows:

- There is no provision allowing nonprofits or charities to conduct tastings of beer, distilled spirits, or anything other than wine
- A temporary on-sale liquor license must be held by the charity or nonprofit, allowing a tasting for up to four hours per event
- No wine at a wine tasting may be sold, or orders taken, for off-premises consumption

- A charity or nonprofit may conduct a wine tasting at its own premises, a donated premises, or at an establishment run by the holder of a permanent on-sale license
- A licensed wine wholesaler may sell or give wine to the organization and may provide personnel to assist at the event
- Net proceeds must be used for the organization's primary nonprofit purpose, or if two nonprofits cooperate in conducting the event, for either organization's primary nonprofit purposes
- A special provision allows more extensive tastings at food and wine conventions, which may take place over three days

Minnesota Statutes section 340A.419 also allows wine tastings to be conducted by an exclusive liquor store, on the premises of a holder of an on-sale liquor license. The law prohibits the liquor store from selling the wine at the event, but does allow forms indicating wine preferences to be filled out. Fees charged may only be used to defray costs, and cooperation with wine wholesalers is allowed.

**For more information:** Contact legislative analyst Patrick McCormack at 651-296-5048.

**Rebecca Pirius**

**Updated: August 2007**

# Minnesota's Public Defender System

***Who is entitled to a public defender?***

The United States and Minnesota Constitutions both establish the right to an attorney for anyone facing a charge punishable by "loss of liberty." Minnesota law entitles anyone who is financially unable to obtain counsel to a public defender if he or she is charged with a felony, gross misdemeanor, or misdemeanor; or is appealing from a conviction of a felony or gross misdemeanor and has not already had a direct appeal of the conviction.

***Are juveniles entitled to a public defender?***

In most cases juveniles are entitled to a public defender. However, juveniles do not generally have the right to the appointment of a public defender for juvenile petty offenses (e.g., minor alcohol or controlled substance offenses, truancy, minor traffic offenses, etc.).

In CHIPS (Children in Need of Protection or Services) and TPR (Termination of Parental Rights) cases, juveniles have the right to an attorney by state statute. However, the right to counsel is different than the right to a public defender. Only juveniles who are ten years of age or older have the right to be represented by a public defender in child protection cases.

***Who is considered "financially unable" to obtain counsel?***

A defendant is financially unable to obtain counsel if the defendant, or a defendant's dependent (residing in the same household), receives means-tested governmental benefits, or, considering the defendant's liquid assets and current income, the defendant would be unable to pay the reasonable costs charged by a private attorney. The burden is on the defendant to show financial inability to pay. The court must inquire into the financial circumstances of the defendant, and the defendant must submit a financial statement under oath. The defendant is under a continuing duty to disclose any change in financial status.

***How do co-pays work?***

Upon disposition of the case, the defendant must pay a $28 co-payment, unless the court waives the co-payment. The statute does not indicate when a court should exercise its discretion to waive the co-payment. In 2003, the Minnesota Court of Appeals held that a defendant is exempt from the co-payment and the court must waive the co-payment when a defendant is indigent or when the co-payment would cause manifest hardship on a defendant.

***Does the defendant ever have to reimburse the state beyond co-pays?***

The presiding judge must terminate the appointment of a public defender to any person who subsequently becomes financially able to pay, and the judge may order the person to reimburse the state.

***How is the public defender system funded?***

In the last decade, the state has assumed the cost of the public defender system from the counties, with the exception of Hennepin County. In the Fourth Judicial District, costs are shared between the state and Hennepin County.

***How is the Minnesota public defender system governed?***

Although the State Board of Public Defense is part of the judicial branch of government, it is not under the judicial branch's administrative control. The State Board of Public Defense consists of seven members: four attorneys appointed by the Supreme Court and three public members appointed by the governor. The board appoints the state public defender for a four-year term, and, with the advice of the state public defender, appoints a chief administrator. The board also appoints a chief public defender in each of the state's ten judicial districts and a chief appellate public defender.

There are also four legal defense corporations that are funded through grants from the board. The corporations serve primarily minority communities throughout the state.

***What are the duties of the Board of Public Defense?***

The board has four main duties:

- It appoints the state public defender and a district chief public defender in each of the ten judicial districts
- It establishes standards for the public defender offices under its jurisdiction
- It establishes procedures for distribution of state funding to the state and district public defenders and to the public defense corporations
- It recommends a budget to the legislature

***What are the duties of the state public defender?***

The state public defender supervises the statewide public defender system, proposes standards, proposes policies to implement adopted standards, and provides training for public defense attorneys.

***What are the duties of the chief administrator for the Board of Public Defense?***

In addition to attending all board meetings (without voting), the chief administrator enforces all resolutions, rules, regulations, or board orders; presents plans, studies, and reports to the board and the state public defender; and recommends adoption of measures to carry out the board's powers and duties. Further, the chief administrator keeps track of the financial condition of the public defense system and prepares the annual budget. The chief administrator does not need to be licensed to practice law.

***What are the duties of the chief public defenders?***

Chief public defenders supervise the assistant public defenders, staff, and contract attorneys within their districts.

**For more information:** Contact legislative analyst Rebecca Pirius at 651-296-5044.

HOUSE RESEARCH | Short Subjects

Jim Cleary

Updated: August 2007

# Hunting and Fishing by Military Personnel and Veterans

***Firearms Safety Certificate Required***

As required by law, anyone born during or after 1980 must have a firearms safety certificate in order to get an annual license to take wild animals with a firearm in Minnesota. Or instead of the firearms safety certificate, a hunter can have an equivalent certificate issued by Minnesota or another state. An advanced hunter education certificate suffices as an equivalent certificate. (Minn. Stat. §§ 97B.015 and 97B.020)

As defined in statute, wild animals include any type of wild mammal, bird, or waterfowl for which hunting is regulated under Minnesota law and/or Department of Natural Resources (DNR) rules. The terms "taking" and "firearms" are also broadly defined. (Minn. Stat. § 97A.015)

***Active Military Exempt from Safety Certificate Requirement***

A person is exempt from having to have a firearms safety certificate if the person has completed military basic training and is serving in active military service in any branch or unit of the U.S. Armed Forces, including while on regular leave or terminal leave.

Nevertheless, following active military service, the firearm safety certificate is again required. However, anyone who has completed basic military training is exempt from the shooting and field exercise portion of the instruction for that certificate and may take the remainder of the instruction online through the DNR. (Minn. Stat. §§ 97B.015 and 97B.020)

"Active duty" is defined broadly to include federal active service (U.S.C. Title 10), federally funded state active service (U.S.C. Title 32), or state active service (Minn. Stat. § 190.05, subd. 5).

***License Not Needed During Military Leave***

While on any type of military leave, a Minnesota resident serving in the U.S. Armed Forces stationed outside of or returning to Minnesota may hunt and fish in Minnesota without a hunting or fishing license. The person must keep on his or her person while hunting official military leave papers and/or a current valid military ID card showing the person's transitional status or leave. However, the resident must obtain any seals, tags, and coupons required of a licensee, which must be furnished by the license agent without charge. This subdivision does not apply to the taking of moose or elk. (Minn. Stat. § 97A.465, subd. 1.)

***Soldiers and Veterans Can Get Lottery Preference***

Minnesota residents who are currently serving in active military service, or who have served actively at any time during the past 24 months, may receive first preference in drawings for antlerless deer permits and turkey permits. (Minn. Stat. § 97A.465, subd. 5)

***Discharged Service Members Can Get Deer Licenses During the Season***

A Minnesota resident who is discharged from active military service during, or within ten days before the firearms deer season begins, can purchase a firearms deer license during the season. The license is valid immediately upon issuance. (Minn. Stat. § 97A.465, subd. 4) Normally, a deer hunting license issued during the season is not valid until the second day following issuance. (Minn. Stat. § 97A.411, subd. 3) In order to get the license, the hunter must show his or her official discharge papers.

***Disabled Veterans Don't Have to Pay for Certain Licenses***

A disabled veteran can get a permanent fishing license free from the DNR Central Office and free annual licenses to hunt deer and small game from any licensing agent. The veteran must be a Minnesota resident who is a military veteran with a 100-percent service-connected disability rating from the U.S. Department of Veterans Affairs. (Minn. Stat. §§ 97A.441 and 197.447)

No trout stamp is required for the fishing license. In addition, a disabled veteran doesn't need to get a pheasant stamp or Minnesota waterfowl stamp to hunt pheasants or waterfowl, but must have a turkey stamp to hunt turkeys and a federal duck stamp to hunt waterfowl. (Minn. Stat. §§ 97B.715, 97B.721, and 97B.801)

***Nonresident Military Can Get Resident Privileges***

Nonresident military personnel training at Camp Ripley may purchase a resident fishing license. (Minn. Stat § 97A.465, subd. 2) Nonresident military personnel stationed anywhere in Minnesota may purchase resident hunting and fishing licenses (but not for moose or elk). (Minn. Stat. § 97A.465, subd. 3)

***Free License Within Two Years of Serving Abroad***

Any current Minnesota resident who has served in federal active military service within the past two years, as shown by official discharge papers, is eligible to receive one free deer-hunting license from any DNR licensing agent. In addition, any such person may also hunt small game or fish in Minnesota without a license, provided he or she obtains any seals, tags or coupons that may be required for such hunting or fishing. (Minn. Stat. §97A.465, subd. 1b)

***Spouses of Residents on Active Duty Can Get Resident Licenses***

The spouse of any Minnesota resident currently serving in active military duty is entitled to any Minnesota hunting or fishing license at the resident rate, irrespective of whether the spouse is a Minnesota resident. (Minn. Stat. §97A.465, subd. 1a)

***Coding on Driver's License***

When renewing a Minnesota driver's license, a veteran or other person with a firearms safety certificate or an equivalent certificate may request that the driver's licensing agency code that fact onto the person's new driver's license. The person must show proof of certification to the licensing agency upon application. (Minn. Stat. § 171.07, subd. 13)

***Getting a License***

To learn more about these special privileges, active military personnel and veterans should contact the DNR via its web site, www.dnr.state.mn.us, or by phone, 651-296-6753. Information and licenses can also be obtained through DNR's local field licensing agents (e.g., sporting goods stores).

**For more information:** Contact legislative analyst Jim Cleary at 651-296-5053.

**HOUSE RESEARCH** | **Short Subjects**

**Anna Hovde and Donald Hirasuna**

**August 2007**

# Does Child Support Help Families Transition Off of Welfare?

Research suggests that child support payments help reduce reliance on welfare by low-income families by providing an alternative income source. This may be true, but the effects of child support on welfare spells are sensitive to timing issues. If child support is received on a consistent basis, it can be an effective tool, but payments can be inconsistent and there are lags involved with obtaining child support orders and receiving child support.

New research by Donald Hirasuna and Maureen Pirog provides insights into how the timing of child support payments affects the transition off of cash welfare. The study uses administrative data on child support and Minnesota's Family Investment Program (MFIP) from 1998 to 2003. The results do not reflect reforms in the child support program made after 2003.

***When do MFIP recipients receive child support payments?***

Researchers have found that from 1998 to 2003:

- 18.7 percent of recipients receive child support while on MFIP, and
- 21.5 percent receive child support at some time after leaving MFIP.

***When do child support payments helps parents stay off of welfare?***

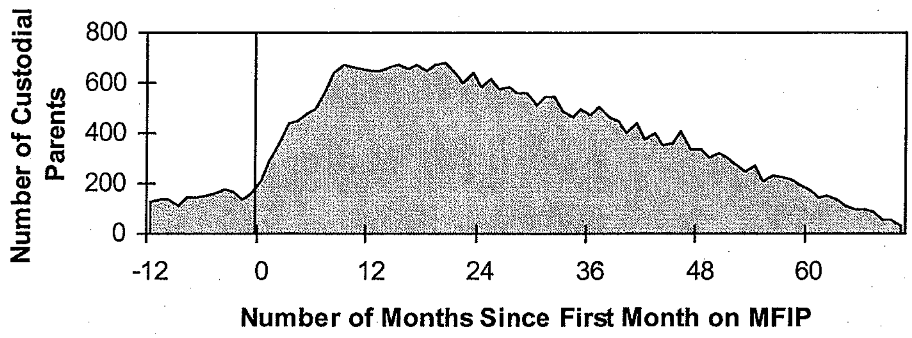
Several factors affect whether child support payments help welfare recipients stay off of welfare:

- **Consistent payments increase the likelihood of leaving welfare.** Regular payments can help parents exit welfare, especially within the first six months after the child support payments begin. The largest effect occurs in the third month. Administratively, the Department of Human Services deems a parent ineligible for MFIP if he or she exceeds the income eligibility limits for three months in a row. This rule may at least partly explain why the largest chances of exit are on the third month of consecutive receipt. However, child support payments tend to increase over time and may contribute to parents eventually exiting MFIP, especially within the first six months.
- **Consistent payments reduce the likelihood of returning to welfare** after the first time parents exit welfare. Payments consistently made during the first six months after a parent has exited welfare are especially effective. Consistent payments are not as helpful if a parent has returned to welfare at least once after leaving the program.
- **Larger payments increase parents' likelihood of exit and reduce their chances of returning to welfare.** Larger payments are especially helpful for parents who have returned to welfare after a previous exit.

***What issues affect the ability of child support to help parents stay off of welfare?***

**Child Support Payment Lags.** Half of current and former MFIP recipients receive their first child support payment 21 months or more after their first month on welfare. Difficulties in locating noncustodial parents, determining paternity, establishing a child support order, and collecting payments may contribute to payment lags (see figure below).

**Figure 1: Frequency Distribution of Months Before Receipt of Child Support**




**Inconsistent Child Support Payments.** Custodial parents receive payments for nine consecutive months less than half the time (see the far right column below).

**Characteristics of Receipt by Consecutive Months of Child Support* (2005 dollars)**

| Number of Consecutive Months** | Average Amount | Amounts Received by Percentile | | | Percent with Too Much Child Support to Qualify for MFIP Cash Grant | Months of Consecutive Payments Received in a Row as a Percent of All Payments |
|---|---|---|---|---|---|---|
| | | 25th | 50th | 75th | | |
| 1 | $246 | $117 | $203 | $326 | 5.9% | 12.9% |
| 2 | 283 | 148 | 246 | 370 | 8.1% | 9.2% |
| 3 | 295 | 158 | 259 | 384 | 8.9% | 7.3% |
| 4 | 305 | 162 | 270 | 397 | 9.5% | 6.2% |
| 5 | 311 | 167 | 275 | 403 | 9.8% | 5.3% |
| 6 | 319 | 173 | 282 | 413 | 10.6% | 4.6% |
| 7 | 325 | 179 | 287 | 421 | 10.9% | 4.1% |
| 8 | 328 | 180 | 292 | 423 | 11.1% | 3.7% |
| 9 | 334 | 184 | 298 | 432 | 11.8% | 3.3% |
| 10 | 337 | 186 | 300 | 434 | 11.9% | 3.0% |
| 11 | 339 | 189 | 302 | 436 | 11.9% | 2.7% |
| 12 or more | 357 | 198 | 321 | 463 | 15.5% | 37.8% |

* Includes basic child support and child care received from the noncustodial parent.
** Whenever a parent goes one month or more without child support, the number of consecutive months goes back to one when receipt begins again.

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038. This short subject was written by research assistant Anna Hovde and Donald Hirasuna based on Hirasuna and Pirog's working paper "Reducing Time on TANF through Child Support: Who Receives It and When It Makes a Difference." For more information about child support in general, see the House Research publication, *Minnesota's Child Support Laws: An Overview*, June 2007. For more information about welfare recipients and child support receipt, see the House Research publications, *Additional Data on Child Support Receipt Among Welfare Recipients in Minnesota*, August 2007; *Do MFIP Participants Receive Child Support?* June 2007; and *Do MFIP Participants Receiving Child Support Differ from Those Not Receiving Child Support? Findings from 1998 to 2003*, June 2007.

# HOUSE RESEARCH | Short Subjects

Joel Michael and Karen Baker

Updated: August 2007

## Property Tax Abatements for Economic Development

***What is economic development property tax abatement?***

Minnesota law authorizes political subdivisions to grant property tax abatements for economic development (e.g., to encourage a business to locate or expand at a location or to redevelop an area). Minn. Stat. §§ 469.1813-469.1815. Abatements may be either permanent forgiveness or temporary deferral of property tax. Abatements can serve similar purposes to tax increment financing (TIF), a widely used development tool. The legislature enacted the abatement law in 1997 to provide an alternative to TIF and to supplement it.

These economic development tax abatements should be distinguished from property tax abatements that are granted by the county board primarily to correct errors (e.g., to reduce the assessor's market value or to change the classification). Minn. Stat. § 375.192.

***For what purposes may abatements be used?***

The law allows abatements to be used for a broad range of projects and purposes, if the political subdivision finds that public benefits exceed the costs. Permitted uses of abatements include the following:

- General economic development, such as increasing the tax base or the number of jobs in the area
- Construction of public facilities or infrastructure (e.g., streets and roads)
- Redevelopment of blighted areas
- Providing access to services for residents (e.g., housing or retail would be common examples)
- Deferring or phasing in a large (over 50 percent) property tax increase
- Stabilize tax base resulting from the updated utility valuation administrative rules

***Which local governments can grant abatements?***

Counties, cities, towns, and school districts may grant abatements of the taxes they impose. The governing body grants an abatement by resolution. For towns, action at the town meeting is not required. Taxes imposed by special taxing districts (e.g., watersheds or regional agencies) cannot be abated. Similarly, the state general property tax (on commercial/industrial and seasonal-recreational properties) cannot be abated. In the Twin Cities metropolitan area and on the Iron Range, the fiscal disparities tax cannot be explicitly abated. However, a political subdivision may increase its abatement amount to reflect the amount of the tax imposed under fiscal disparities. The abatement does not directly enter into the fiscal disparities calculations.

***How long does an abatement apply?***

The political subdivision sets the length of the abatement. State law limits the duration to 15 years. The maximum term is extended to 20 years if only two of the three political subdivisions (city/town, county, and school district) grant an abatement.

***How do the mechanics of abatement work?***

The abatement resolution, approved by the political subdivision, specifies the duration and the amount of property taxes that will be abated. The political subdivision has considerable flexibility in setting the terms of the abatement; for example, it may set the abatement as a percentage of tax payable, a dollar amount, tax attributable to a portion of the parcel's market value, or something else. The local government adds the abatement to its property tax levy for the year. (The abatement levy is not subject to levy limits.) The owner pays property tax on a parcel and the political subdivision uses the payments as provided by the abatement resolution. For example, the abatement may be used to pay bonds or be given back to the property owner.

***May abatements be used to pay bonds?***

The abatement law authorizes the issuance of bonds to be paid back with the abatements. For example, bonds could be issued to construct public improvements or to pay for a site for a business. As the property owner pays the abated taxes, they are directed to pay off the bonds. These bonds can be general obligation bonds or revenue bonds. The abatement bond provisions parallel those in the TIF law: the abatement bonds are not subject to referendum approval and are excluded from debt limits.

***How do abatements compare with TIF?***

The legislature designed the abatement law to provide an alternative to and to supplement TIF. The two programs can be used for similar purposes and both rely upon property tax funding. Both programs have very similar bonding powers. However, abatement and TIF differ in many important respects. Some these differences include the following:

- TIF can be used for longer durations (up to 25 years in some cases) than abatements (typically 15 years)
- TIF requires approval only by the municipality (usually the city) to capture all local property taxes, while abatement requires each city/town, county, and school to approve to capture its taxes
- TIF use is subject to many more legal restrictions than abatement. These include a blight test for redevelopment districts, but-for findings, limits on what increments may be spent on, and so forth. Abatement is more flexible.

***How widely has abatement been used?***

The abatement law does not require reporting of abatements to the state. Property tax levy data reported to the Department of Revenue shows 50 cities provided abatements of $4.3 million of taxes for property taxes payable in 2006, and 21 counties provided $1.8 million in abatements. These amounts do not include abatements by cities with populations under 2,500 and by school districts.

**For more information:** Contact legislative analyst Joel Michael at 651-296-5057 or Karen Baker at 651-296-8959. Also see the House Research publication *Tax Increment Financing*, October 2006.

**HOUSE RESEARCH** | **Short Subjects**

**Anna Hovde and Donald Hirasuna**

**August 2007**

# Additional Data on Child Support Receipt Among Welfare Recipients in Minnesota

Child support may help reduce reliance on cash-grant welfare by providing an alternative source of income for custodial parents. New research by Donald Hirasuna and Maureen Pirog investigates the receipt of child support by Minnesota Family Investment Program (MFIP) cash-grant recipients with data from 1998 to 2003. This short subject supplements an earlier short subject, *Do MFIP Participants Receive Child Support?* (June 2007), which also summarized research on welfare recipients' receipt of child support from 1998 to 2003.

***The Minnesota Family Investment Program (MFIP)***

MFIP is Minnesota's Temporary Aid to Needy Families (TANF) welfare program. The program provides cash grants and food assistance to low-income families. Participation in the cash-grant portion of MFIP is generally limited to 60 months.

***Child support***

Noncustodial parents make child support payments to custodial parents. Child support may be provided as basic child support, child care support, or medical support.

Prior to 2007 in Minnesota, basic child support payments depended on the income of the noncustodial parent. Child care support was determined based on the income of both parents. For court-ordered child support after 2007, basic, child care, and medical support depend on the incomes of both parents. If child support payments result in a noncustodial parent's income falling below 120 percent of the poverty guidelines, he or she is subject to only a minimum monthly payment.

***Child support and MFIP recipients***

Researchers found that 26.1 percent of current and former MFIP cash-grant recipients received child support from 1998 to 2003.

- 18.7 percent received child support while receiving MFIP cash grants.
- 21.5 percent received child support sometime after leaving MFIP cash assistance.

***Child support helps reduce reliance on cash-grant welfare***

Receipt of child support payments seems to increase parents' likelihood of leaving welfare and reduce the likelihood of reentering cash-grant welfare.

- Consistent payments further increase the odds of exit and reduce the likelihood of reentry to welfare.
- Higher payments are associated with higher probability of exit and lower probability of reentry.
- Child care support payments are more effective in preventing reentry than basic child support payments. This is likely because custodial parents receiving child care assistance have work income that prevents them from returning to cash welfare.

***Custodial parents with work barriers are less likely to benefit***

Parents with work barriers are less likely to have a child support order. When there is an order, they are more likely to have lower payments and be owed arrears. The following groups are more likely to face work barriers and are also less likely to receive child support:

- Parents who have been sanctioned for noncompliance with welfare requirements
- Parents who received a hardship extension to the 60-month limit for cash grants
- Parents without a high school diploma
- Parents who are 60 years old or older
- African American or American Indian parents
- Parents with more children
- Parents with limited language skills who need an interpreter

**For more information:** Contact legislative analyst Donald Hirasuna at 651-296-8038. This short subject was written by research assistant Anna Hovde and Donald Hirasuna based on Hirasuna and Pirog's working paper "Reducing Time on TANF through Child Support: Who Receives It and When It Makes a Difference."

For more information about child support in general, see the House Research publication, *Minnesota's Child Support Laws: An Overview*, June 2007. For more information about welfare recipients and child support receipt, see the House Research publications, *Does Child Support Help Families Transition Off of Welfare?*, August 2007; *Do MFIP Participants Receive Child Support?* June 2007; and *Do MFIP Participants Receiving Child Support Differ from Those Not Receiving Child Support? Findings from 1998 to 2003*, June 2007.

**HOUSE RESEARCH** | **Short Subjects**

**Matt Gehring**

**August 2007**

# Judicial Selection in Minnesota

***What are the qualifications for becoming a judge in Minnesota?***

To serve as a supreme court, court of appeals, or district court judge in Minnesota, an individual must be eligible to vote, be at least age 21, and be "learned in the law." Courts have interpreted "learned in the law" to mean that the individual must be a licensed attorney-at-law. Judges are subject to mandatory retirement upon reaching age 70.

Any modification of the requirements for judicial office must be made through a constitutional amendment; qualifications may not be restricted or enlarged by statute.

***How long is a judge's term?***

A full term of office for judges is "six years and until their successors are qualified." A judge may run for re-election.

***How are judicial elections conducted?***

Elections to fill a judicial office are conducted consistent with the same general campaign and election provisions that apply to candidates for other elective office, except that judicial elections are "nonpartisan" elections and subject to the Minnesota Code of Judicial Conduct, Canon 5.

***What does "nonpartisan" mean?***

In this context, "nonpartisan" means that a candidate's name will appear on the ballot, but no party affiliation will be listed. Candidates are, however, permitted to be involved in partisan politics and to seek and accept the endorsement of a political party (see discussion below).

***Are there restrictions on judicial candidate campaign conduct?***

In general, candidates for judicial office are subject to the requirements of the Minnesota Fair Campaign Practices Act (Minn. Stat. ch. 211B).

Candidates are permitted to speak to gatherings, appear in advertisements supporting their candidacy, and distribute campaign literature supporting their candidacy.

As a result of recent court rulings, candidates may also state positions on disputed legal or political issues, solicit contributions generally from an audience of 20 or more people, sign letters for distribution by the candidate's campaign committee soliciting contributions, and seek and accept the endorsement of a political party. These activities, which had been prohibited by the Minnesota Code of Judicial Conduct, Canon 5, are permissible following decisions of both the U.S. Supreme Court and the Eighth Circuit Court of Appeals declaring certain sections of Canon 5 unconstitutional. (See *Republican Party of Minnesota v. White*, 536 U.S. 765 (2002) (striking down the "announce" clause); and *Republican Party of Minnesota v. White*, 416 F.3d 738 ($8^{th}$ Cir. 2005) (*cert. denied*) (striking down the "partisan-activities" and "solicitation" clauses)). See also Minnesota Code of Judicial Conduct, Canon 5 (2007).

***How are judicial campaigns financed?***

Candidates may establish a committee to raise funds and conduct a campaign for their candidacy. A committee may solicit, accept, and manage the expenditure of funds for the campaign, but may not disclose to the candidate the identity of contributors, or those who refused to contribute.

In addition, candidates for judicial office are subject to certain campaign finance reporting requirements established in Minnesota Statutes, chapter 10A. However, candidates for judicial office are not eligible to receive a public subsidy to help fund their campaign under section 10A.31.

Unlike candidates for many other elective offices, current law imposes no limit on contributions made by any individual, political committee, or political fund to a candidate for judicial office.

***What happens if a judicial office becomes vacant?***

If a judicial office becomes vacant, the governor must appoint a qualified person to fill the vacancy until a successor is elected and qualified. The appointee must stand for election for a full six-year term at the next general election that occurs more than one year after the governor's appointment.

In practice, most judges are initially seated through appointment, rather than the electoral process.

***Who may the governor appoint?***

The governor may appoint any qualified person to fill a judicial vacancy. In other words, the individual appointed must meet the standard constitutional qualifications for judicial office: at least age 21, eligible to vote, and learned in the law.

***What is the Commission on Judicial Selection?***

Established by statute, the Commission on Judicial Selection recruits, evaluates, and recommends candidates for appointment to a vacant district court or worker's compensation court of appeals judicial office. Some governors have chosen to use the merit selection process for appellate judges as well.

The commission is composed of nine at-large members and four members from each judicial district. Both the governor and the supreme court appoint members of the commission, which must be composed of both attorneys and nonattorneys.

The commission must recommend to the governor between three and five nominees for each judicial vacancy, no more than 60 days after receipt of notice of the vacancy.

***Is the governor required to follow the commission's recommendations?***

The governor may choose to fill the vacancy by appointing one of the commission's nominees, or the governor may fill the vacancy without regard to the commission's recommendation.

**For more information:** Contact legislative analyst Matt Gehring at 651-296-5052. Also see the House Research publication *The Minnesota Judiciary*, March 2003, for more information on the judicial branch. For more information about campaigns and elections, visit the elections area of our web site, www.house.mn/hrd/issinfo/elect.htm.

# HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: September 2007

## The Minnesota and Federal Dependent Care Tax Credits

***What are the credits?***

The Minnesota and federal dependent care credits partially offset the cost of child care for certain workers. The maximum Minnesota credit is $720 for one child and $1,440 for two or more children. The maximum federal credit is $1,050 for one child and $2,100 for two or more children.

***Are the credits refundable?***

The Minnesota credit is fully refundable. If an individual qualifies for a credit that is greater than his or her tax liability, the excess is paid as a refund. The federal credit is not refundable and may only be used to offset federal income tax liability.

***Who is eligible for the credits?***

Anyone who incurs expenses related to the care of a dependent and related household expenses may be eligible to claim the credits. The claimant must:

- maintain a household that includes the dependent;
- pay for care for a dependent under age 13, or a disabled spouse or adult dependent; and
- pay for care in order to work or look for work.

***What are qualifying expenses?***

Qualifying expenses are amounts paid for the care of a dependent under age 13, or a disabled spouse or adult dependent, but do not include:

- amounts paid to the claimant's spouse or another dependent, or
- amounts paid through a dependent care pre-tax account.

Qualifying expenses may not exceed the claimant's earned income (for married couples filing joint returns, expenses may not exceed the earned income of the lesser earning spouse).

***How are the credits calculated?***

The *federal credit* equals 35 percent of up to $3,000 of qualifying expenses for one child ($6,000 of qualifying expenses for two or more children). The maximum federal credit is $1,050 for one child and $2,100 for two or more children. The federal credit begins to phase down when income exceeds $15,000, with the credit percentage decreasing as income increases. Claimants with incomes over $43,000 qualify for the minimum federal credit equal to 20 percent of qualifying expenses, or up to $600 for one child and $1,200 for two or more children, depending on actual child care costs. For example, a claimant with $50,000 of income and $1,000 of expenses will qualify for a credit of $200 (20 percent of $1,000).

The *state credit* equals the lesser of the federal credit, or $720 for one child ($1,440 for two or more children). The state credit is calculated by reference to the federal credit for which the claimant is eligible, not the amount actually used to offset federal liability. For example, an individual with expenses of $2,000 and income below $15,000 is eligible for a federal credit of $700 (35 percent of $2,000). While this individual will probably not have any federal tax liability and thus will not benefit from the nonrefundable federal credit, he or she will still be eligible for a refundable state credit of $700.

The state credit is subject to a separate phaseout than the federal credit. In tax year 2008, the state phaseout begins when income exceeds $22,200, and the state credit is fully phased out when income exceeds $35,850. The income threshold for the phaseout is adjusted each year for inflation.

***How do filers claim the credits?***

Filers claim the credits when they file their federal and state income tax returns, by completing a separate schedule—Form 2441 for the federal credit and schedule M1CD for the state credit.

***How many Minnesotans claim the credits?***

In tax year 2005, 144,281 Minnesotans claimed the federal dependent care credit and 35,549 claimed the state credit. These claims represent 5.9 percent of all federal returns filed by Minnesotans, and 1.4 percent of all state returns filed.

Because the federal credit is nonrefundable and can only be used to offset tax liability, most of the federal credits are claimed by middle- and upper-income filers who have income over $43,000 and qualify for the minimum credit amount.

Because the state credit is refundable, and in 2005 was only available to filers with incomes below $34,070, most of the state credits are claimed by low-income filers.

***How much is paid out in credits?***

In tax year 2005, Minnesotans claimed $63.6 million of federal dependent care credits. The average federal dependent care credit was $441.

In tax year 2005, Minnesotans claimed $13.4 million of state dependent care credits. The average state dependent care credit was $376.

***How are the credits distributed geographically?***

While about 44 percent of the returns claiming state credits came from the Twin Cities metropolitan area, these seven counties generated about 55 percent of all returns filed. Put another way, in 2005 nonmetro filers were more likely to claim the credit than were metro area filers.

***How does Minnesota compare with other states?***

Nationwide, 4.7 percent of all income tax returns claimed the federal dependent care credit, compared to 5.9 percent in Minnesota. Maryland had the highest percentage of returns claiming the federal credit, at 6.6 percent, and West Virginia had the lowest, at 2.3 percent. Minnesota's percentage of returns claiming the credit may be higher than national figures because Minnesota has a high proportion of two-worker households.

The average federal dependent care credit nationwide in 2005 was $526; it was $441 in Minnesota. The District of Columbia had the highest average credit, at $634, and Montana had the lowest, at $402. Minnesota's average credit amount may be lower than the national averages because state residents have above average incomes.

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Minnesota and Federal Dependent Care Tax Credits*, December 2006.

HOUSE RESEARCH | Short Subjects

Nina Manzi

September 2007

# Sunset of 2001 Federal Tax Law Provisions and Effects on Minnesota Income Tax Revenues

In 2001, Congress passed a federal tax act (the Economic Growth and Tax Relief Reconciliation Act of 2001, or EGTRRA) that included several tax provisions that sunset in 2010.

***Why do provisions of the 2001 federal tax law expire after 2010?***

EGTRRA was passed under the congressional budget reconciliation process. The reconciliation process allows any senator to require a three-fifths majority vote for revenue reductions that extended beyond a ten-year time period. To avoid this possibility, EGTRRA's sponsors chose to sunset its revenue reductions after ten years. Thus, the law included a "sunset" under which all changes expire after tax year 2010. Since 2001, however, Congress has made some of these provisions permanent, including the:

- deduction for restitution received by victims of the Nazi regime;
- modification of pension and IRA provisions; and
- exclusion of investment earnings of qualified tuition programs.

***How does the federal sunset affect Minnesota's income tax calculation and revenues?***

Provisions subject to federal sunset can affect Minnesota's income tax in several ways.

- Since Minnesota's income tax calculation starts with federal taxable income, the expiration of federal deductions or exemptions will result in larger federal taxable income, larger Minnesota taxable income, and higher Minnesota income tax revenues.
- EGTRRA included marriage penalty relief in the federal earned income tax credit, providing for the credit to phase out at higher income levels for married filers than for single parents. While Minnesota's working family credit is not tied directly to the federal credit, Minnesota chose to provide the same relief in the state working family credit and included a sunset that matches the federal sunset.

***Which expiring federal provisions affect federal taxable income and what is the impact on Minnesota income tax revenues?***

Expiring provisions that will affect the most taxpayers and have the largest revenue impact at the state level include:

- *Marriage penalty relief in federal standard deduction.* Under EGTRRA and subsequent federal laws, the standard deduction for married joint filers equals twice the amount allowed for single filers. If this sunsets, the estimated amount allowed for married joint filers will fall from $11,300 in tax year 2010 to $9,650 in tax year 2011, and an estimated 450,000 Minnesota filers will pay an estimated $47 million in additional income tax in tax year 2011.
- *Limit on itemized deductions.* Under current federal law, no limit on itemized deductions applies to high-income taxpayers in 2010. But in

2011, high-income filers will be subject to the pre-EGTRRA limit, and those with incomes over about $170,000 will have up to 80 percent of their itemized deductions disallowed. This will affect an estimated 160,000 returns and result in increased Minnesota income tax revenues estimated at $71 million in tax year 2011.

- *Phaseout of personal and dependent exemptions.* Under current federal law, high-income filers will be able to claim the full amount of personal and dependent exemptions in tax year 2010. But in 2011, taxpayers with incomes over about $250,000 will be subject to the phaseout in effect before EGTRRA was enacted and will have personal and dependent exemptions phased out. This will affect an estimated 94,000 returns and result in increased Minnesota income tax revenue estimated at $44 million in tax year 2011.

If the federal government extends any of these three provisions and if Minnesota conforms to the federal extensions, the state will have to forego the following revenue in tax year 2011 and following years:

- $47 million for the increased standard deduction
- $71 million for eliminating the limit on itemized deductions
- $44 million for eliminating the phaseout of exemptions

***How will taxpayers be affected by the sunset of marriage penalty relief in the working family tax credit?***

Under current law, the income level at which the Minnesota working family tax credit begins to phase out will be $3,180 higher for married couples filing joint returns in tax year 2010 than it will be for other filers. This additional amount matches provisions enacted in EGTRRA and provides some relief for marriage penalties on two-earner households. In 2011, the phaseout threshold for married filers will revert to the level in effect for other filers, and an estimated 36,000 married couples will qualify for smaller working family credits; and the state will pay about $7.8 million less in credits.

***Will sunsets of other federal provisions affect Minnesota tax revenue?***

The 2003 federal tax act (the Jobs Growth and Tax Relief Reconciliation Act of 2003, or JGTRRA) reduced federal tax rates on capital gains income. The reduced rates are scheduled to sunset after tax year 2010. In 2011 the maximum federal rate on capital gains income will increase from 15 percent to 20 percent for most filers, and from 0 percent to 10 percent for lower-income filers.

Past experience with capital gains rate changes indicates that taxpayers will accelerate sales of assets into the year with the lower rate and out of later years in which they expect a higher rate to be in effect. This will lead to the shifting of taxable income into tax year 2010 from tax year 2011 and following years.

Since Minnesota's income tax calculation starts with federal taxable income, the shift will affect state as well as federal revenues. The state economic forecast for February 2007 projects increased individual income tax revenues of $327 million in tax year 2010, with a corresponding decrease in revenues in 2011 and later years.

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204.

HOUSE RESEARCH | Short Subjects

Nina Manzi and Joel Michael

September 2007

# Section 179 Expensing under the Federal and Minnesota Income Tax

***What is section 179 expensing?***

Income tax laws generally require businesses to spread deductions of capital expenditures over the useful lives of the purchased property. Section 179 expensing, which takes its name from a section of the Internal Revenue Code, allows businesses to deduct the entire amount of the cost of qualifying property in the tax year the property is placed in service, rather than claiming depreciation deductions over a number of years. This allows the business to accelerate recognition of the expense from future tax years into the present year. The number of years over which property would otherwise be depreciated ranges from three to 15 years depending on the type of property and its useful life as classified under the Internal Revenue Code.

***How much can be claimed under section 179 expensing under the federal income tax?***

In tax year 2007, businesses can claim up to $125,000 of property expenditures under section 179. If a business places more than $500,000 of qualifying property in service in the tax year, the amount allowed under section 179 is reduced dollar for dollar, so that businesses that place in service more than $625,000 in qualifying property are not eligible for section 179 expensing.

***What are the section 179 expensing allowances under the Minnesota income tax?***

Minnesota does not conform to the federal section 179 expensing amount in effect in tax year 2007. Instead, Minnesota allows the section 179 expensing amount in effect before tax year 2003, when the federal government embarked on a series of increases and extensions to the amount allowed as section 179 expensing.

In tax year 2007, a business may claim up to $25,000 in expensing on its Minnesota return. This amount is reduced dollar for dollar by the cost of property placed in service over $100,000, so that a business that places in service more than $125,000 in qualifying property is ineligible.

If a business claims more than $25,000 in section 179 expensing at the federal level, it must add 80 percent of the additional amount claimed to Minnesota taxable income on its Minnesota return. It is then allowed to subtract one-fifth of the amount added back in each of the next five tax years. In that way the full amount claimed at the federal level is ultimately allowed at the state level—20 percent in tax year 2007 and 16 percent per year in tax years 2008 through 2012.

***What recent federal changes have been made in section 179 expensing?***

Over the last five years, Congress has followed a pattern of providing a series of temporary increases in the section 179 allowances. Before 2003, businesses could claim up to $25,000 in section 179 expensing, and this phased out for businesses with total expenses from $100,000 to $125,000. From 2003 to 2007 Congress has four times enacted legislation that provides temporary increases in the maximum section 179 deductions and the "phase-out" limit and that also indexes the temporarily increased amounts for inflation. This legislation is summarized in the table.

**Summary of Federal Section 179 Legislation 2003-2007**

| Year | Maximum deduction | Phaseout | Indexing | Tax year temporary increases expire |
|---|---|---|---|---|
| 2003 | $25,000 increased to $100,0000 | $100,000 increased to $400,000 | Yes for 2004 and 2005 | 2006 |
| 2004 | No change | No change | Extended to 2006 and 2007 | Extended to 2008 |
| 2006 | No change | No change | Extended to 2008 and 2009 | Extended to 2010 |
| 2007 | Increased to $125,000 | Increased to $500,000 | Yes for 2008 to 2010 | 2011 |

***What is the recent history of section 179 expensing in Minnesota?***

Minnesota conformed to the initial federal increase in section 179 expensing, which was effective for tax years 2003 through 2005. In those years, businesses could claim the same amount under the Minnesota tax as they could under the federal tax. In the 2005 and 2006 legislative sessions, the legislature elected not to conform to the higher federal section 179 allowances.

In 2005 the Minnesota Department of Revenue estimated the fiscal year 2006-07 cost in foregone tax revenue of conforming to the increased federal section 179 expensing amounts at $50.6 million. Instead of conforming Minnesota's tax to the increased federal amounts, the 2005 omnibus tax law required Minnesota taxpayers to add to taxable income 80 percent of the additional amount of expensing allowed at the federal level in the first tax year, and then subtract one-fifth of the amount added back in each of the five following years.

***What are the federal and state allowances?***

**Section 179 Allowances Under Federal and Minnesota Law**

| | Federal | | Minnesota | |
|---|---|---|---|---|
| Tax year | Maximum deduction | Start of phaseout | Maximum deduction | Start of phaseout |
| 2002 | $25,000 | $100,000 | $25,000 | $100,000 |
| 2003 | 100,000 | 400,000 | 100,000 | 400,000 |
| 2004 | 102,000 | 410,000 | 102,000 | 410,000 |
| 2005 | 105,000 | 420,000 | 105,000 | 420,000 |
| 2006 | 108,000 | 430,000 | 25,000 | 100,000 |
| 2007 | 125,000 | 500,000 | 25,000 | 100,000 |
| 2008 | 125,000 + inflation adjustment | 500,000 + inflation adjustment | 25,000 | 100,000 |

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057.

Nina Manzi and Lisa Larson

Updated: October 2007

# The K-12 Education Deduction and Credit: An Overview

***What is the K-12 deduction?***

A state income tax deduction is allowed for K-12 education-related expenses. The deduction is for up to $2,500 for each dependent in grades 7-12, and up to $1,625 for each dependent in grades K-6.

***What expenses qualify for the deduction?***

Qualifying expenses include the following:

- Tuition, including nonpublic school, after-school enrichment, academic summer camps, music lessons, and tutoring
- Textbooks, including instructional materials and supplies, musical instrument rental and purchase, and up to $200 of computer hardware and educational software
- Transportation (paid to others for transporting children to school)

***What is the tax benefit of the deduction?***

A deduction reduces an individual's taxable income. The tax benefit depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has three marginal tax rates: 5.35 percent, 7.05 percent, and 7.85 percent. A taxpayer in the 5.35 percent bracket who claims a $2,500 deduction will pay $133.75 less in state income taxes (5.35% x $2,500). A taxpayer in the 7.85 percent bracket with the same deduction will pay $196.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. In tax year 2008, a typical married couple with two dependents would need to have $24,600 of gross income before owing any state income tax.

***How many people claim the deduction, and how much does it cost?***

In tax year 2008 (fiscal year 2009), an estimated 222,000 returns will claim the deduction at a cost to the state of $16.1 million.

***What is the K-12 education credit?***

A state income tax credit is allowed for 75 percent of K-12 education-related expenses. The credit is for up to $1,000 for each child in grades K-12, with parents allowed to allocate expenses among children as they choose. The credit is subject to an income-based phaseout. It begins to phase out when income exceeds $33,500. For families claiming the credit for one or two children, it is fully phased out when income reaches $37,500. The phaseout extends for an additional $2,000 of income for each additional child claimed (i.e., to $39,500 for three children, $41,500 for four children, etc.).

***What expenses qualify for the credit?***

The same expenses qualify for the credit as for the deduction, except nonpublic school tuition does not qualify for the credit.

***What is the tax effect of the credit?***

The K-12 credit directly reduces tax liability and is fully refundable. If an individual's credit exceeds his or her liability, the excess is paid as a refund.

***Can parents obtain loans to pay for educational services that qualify for the credit?***

Parents may assign payment of the credit to participating financial institutions and tax-exempt foundations. In exchange, parents receive a loan that is paid directly to a third-party provider of educational services and programs. This allows very low-income families to purchase educational products and services in anticipation of receiving a credit when they file their tax return the following year, with the credit paid directly to the financial institution or foundation that accepted the assignment.

***How many people claim the credit, and how much does it cost?***

In tax year 2005, 56,937 Minnesotans claimed a total of $15.3 million in K-12 education credits. The average credit was $269.

***How do taxpayers claim the deduction and credit?***

Taxpayers claim the deduction on form M-1, the Minnesota income tax return. Taxpayers claiming the credit must complete form M1ED and attach it to their state tax return.

***Have the deduction and credit been challenged in court?***

The constitutionality of the dependent education expense deduction was challenged in *Mueller v. Allen* in 1983. The U.S. Supreme Court upheld the statute authorizing the deduction in a 5-4 decision. The Court found that the deduction did the following:

- Offset parents' educational expenses and helped ensure an educated populace
- Helped ensure the financial health of nonpublic schools and relieved the financial burden on public schools
- Promoted "wholesome competition" between public and nonpublic schools and provided a high-quality education for all children

Minnesota's current K-12 education credit has not been subject to legal challenge.

***What do other states provide in terms of income tax credits for education-related expenses?***

To date, five states in addition to Minnesota provide income tax credits for education-related expenses: Arizona, Florida, Illinois, Iowa, and Pennsylvania (Puerto Rico provides a credit similar to those allowed in Arizona, Florida, and Pennsylvania.). **Arizona, Florida, and Iowa** provide tax credits for contributions to nonprofit school tuition organizations that operate like charities. **Iowa** allows the credit for individual filers; the Florida credit is for corporate taxpayers; and Arizona has a credit for both individual and corporate taxpayers. **Pennsylvania** allows a corporate credit for contributions to both nonprofit scholarship funding organizations and innovative public school programs. **Arizona** also allows credits for individuals who pay extracurricular public school fees and who contribute to character education programs at public schools. **Illinois** and **Iowa** both provide individuals with a nonrefundable tax credit for qualified education expenses; Iowa's credit applies to tuition for children attending accredited not-for-profit K-12 schools. Courts in Arizona, Illinois, and Iowa have upheld the permissibility of these education credits.

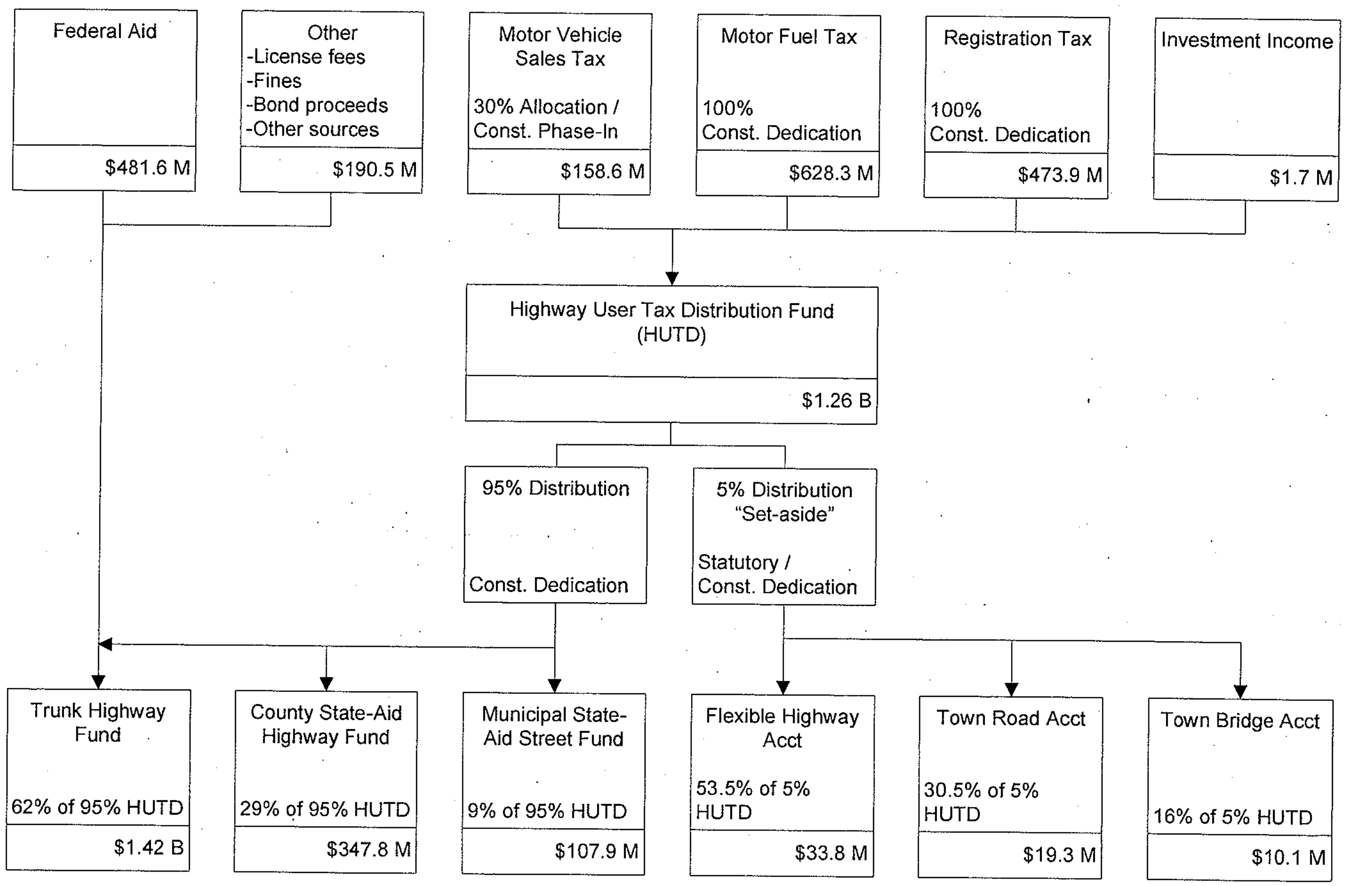
**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204 or Lisa Larson at 651-296-8036. Also see the House Research publication *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2006.

Matt Burress

Updated: November 2007

# Highway Funding Sources and Distribution

The Minnesota Constitution dedicates certain taxes to transportation purposes and establishes a framework for distributing the revenue. State statutes further specify allocation formulas and grant requirements. The chart below summarizes Minnesota's highway funding design, with fiscal year 2006 amounts.




***Constitutional framework***

The Minnesota Constitution contains the basic framework for highway funding. It establishes highway user taxes, which are considered user taxes because payment is based on use of the highway system, and requires that the revenue be "used solely for highway purposes." Minn. Const., art. XIV, § 5. It also specifies how the revenue must be distributed to the state and local units of government.

***Sources of highway funding***

There are three main funding sources established by the Constitution.

**(1) A tax on motor fuel** is 20 cents per gallon for gasoline and diesel fuel. Minn. Stat. §§ 296A.07, 296A.08. For special fuels such as E-85, the rates are based on the energy content of the fuel. A portion of the revenue is attributed to nonhighway use and transferred to special accounts. Minn. Stat. § 296A.18.

**(2) Registration taxes** (also known as tab fees) are imposed on motor vehicles using the highway system. The registration tax for cars, pickup trucks, and vans is a percentage of the original value of the vehicle. There are caps on the maximum amount paid as well as a statutory depreciation schedule that reduces the tax owed based on the vehicle's age. Minn. Stat. § 168.013, subd. 1a. Taxes on trucks, buses, and recreational vehicles are based on the vehicle's weight and age.

**(3) A motor vehicle sales tax (MVST)** applies to sales of motor vehicles, at the same rate as the general sales tax. Until recently, MVST revenue was allocated by statute to both transportation and the general fund. A constitutional amendment adopted in the 2006 election will phase in MVST solely to roads and transit. Starting in fiscal year 2012, after the phase-in, MVST will be statutorily allocated 60 percent to roads and 40 percent to transit. Minn. Stat. § 297B.09. In fiscal year 2006, small amounts of MVST were directly allocated to the county state-aid highway fund (0.65 percent) and the municipal state-aid street fund (0.17 percent).

***Distribution of revenue***

The tax revenue goes into the highway user tax distribution (HUTD) fund to be distributed in two parts. First, a constitutional formula distributes 95 percent of the revenue.

- **62 percent goes to the trunk highway fund** for the construction, maintenance, and administration of the state trunk highway system. The trunk highway fund also receives federal aid and funding from other state sources such as driver's license fees.
- **29 percent goes to the county state-aid highway (CSAH) fund** for construction and maintenance of county state-aid highways. It is allocated among all 87 counties via a statutory formula that includes each county's proportion of construction needs, vehicles registered, and lane miles. Minn. Stat. § 162.07.
- **9 percent is for the municipal state-aid street (MSAS) fund** for construction and maintenance of city's state-aid roads. It is distributed proportionally using a formula of 50 percent construction needs and 50 percent city population. A constitutional provision limits eligible cities to those with a population over 5,000. Minn. Const., art. XIV, § 8.

Second, 5 percent is a "set-aside," to be distributed by statute. It must go to one of the three foregoing funds, and the distribution cannot be changed more than once every six years. Since the last change was in 1998, it can be revised at any time. The set-aside is currently allocated to special accounts within the CSAH fund:

- 53.5 percent to a flexible highway account that can be used for trunk highway projects or for former trunk highways that have been "turned back" to the jurisdiction of cities or counties
- 30.5 percent to an account for town road construction and repair
- 16 percent to a town bridge account for bridge replacement and repair

**For more information:** Contact legislative analyst Matt Burress at 651-296-5045.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

House Research Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

**HOUSE RESEARCH** | **Short Subjects**

**Nina Manzi and Joel Michael**

**Updated: October 2007**

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**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057.

Mark Shepard

Updated: November 2007

# State Elected Officials' Compensation

Salaries for the governor, lieutenant governor, attorney general, state auditor, secretary of state, judges, and legislators are established by state law and by the legislature, depending on the position.

***Salaries for constitutional officers***

As required by the Minnesota Constitution, salaries for constitutional officers are prescribed by law. Art. V, § 4. Current annual salaries are as follows:

| Officer | Salary | % of Governor's Salary |
|---|---|---|
| Governor | $120,303 | --- |
| Attorney General | $114,288 | 95% |
| State Auditor | $102,258 | 85% |
| Secretary of State | $90,227 | 75% |
| Lieutenant Governor | $78,197 | 65% |

The most recent salary increases were in January 2003, when a law took effect establishing salaries for constitutional officers as a percentage of the governor's salary. Laws 2001, 1st spec. sess., ch. 10, art. 1, § 2. The most recent salary increase for the governor was 2.5 percent in January 1998.

The governor can veto legislation establishing compensation for constitutional officers because, according to the constitution, the compensation is set "by law."

***Salaries for judges***

The Minnesota Constitution stipulates that the legislature should establish compensation for judges and that judges' salaries cannot be reduced while they are in office. Art. VI, § 5. The 2007 Legislature increased judges' salaries by 3 percent effective July 1, 2007, and by another 3 percent effective July 1, 2008. Laws 2007, ch. 54, art. 1, § 3. Annual salaries for various judges are as follows:

| Official | July 1, 2007 | July 1, 2008 |
|---|---|---|
| Supreme Court, chief | $155,902 | $160,579 |
| Supreme Court, justice | $141,729 | $145,981 |
| Court of Appeals, chief | $140,222 | $144,429 |
| Court of Appeals, justice | $133,546 | $137,552 |
| District Court, chief | $131,631 | $135,580 |
| District Court, judge | $125,363 | $129,124 |

The constitutional provisions governing judges have been interpreted to mean that the governor may not veto provisions setting judges' compensation because their compensation is prescribed "by the legislature." *Gardner v. Holm*, 241 Minn. 125, 62 N.W. 2d 52 (1954).

***Salaries for legislators***

The Minnesota Constitution provides that legislators' compensation is set by law. The annual salary for representatives and senators is $31,140. The House and the Senate each can designate three leadership positions to receive up to 140 percent of the compensation of other members of the legislature (this is an additional $12,456 per year).

The most recent salary increase for legislators was 5 percent in January 1999. The constitution also says that "no increase of compensation shall take effect during the period for which the members of the existing House of Representatives may have been elected." Art. IV, § 9. Because the constitution says that legislators' salaries are set "by law," the governor can veto legislation setting legislators' compensation.

***Legislative per diem***

In addition to salary, legislators are eligible to receive a per diem payment when engaged in official business. The House rate is $77 per day and the Senate rate, $96 per day.

***The compensation council's role in establishing salaries***

The legislature has established a 16-member compensation council to assist it in establishing the compensation of constitutional officers, judges, and legislators. Minn. Stat. § 15A.082. A new compensation council is created in the fall of each even-numbered year; the new council must make its recommendations to the legislature by May 1 of the odd-numbered year.

By law, the council's recommendations take effect if an appropriation to pay the recommended salaries is enacted after the recommendations are submitted and before their effective date. As a practical matter, when the legislature has increased salaries, it generally has done so either by expressly adopting or modifying compensation council recommendations or by establishing percentages in law without reference to compensation council recommendations.

***Insurance benefits and pension plans***

Constitutional officers, legislators, and judges all are members of the state employee group insurance plan and receive the same insurance benefits as state employees.

Most legislators (all who were first elected after July 1, 1997, and some elected before then) and all constitutional officers are members of a defined contribution pension plan. Under this plan, the member contributes 4 percent of his or her salary and the state contributes 6 percent. This money is invested, and upon leaving state service, the elected official is eligible to receive whatever money is in the account.

Judges belong to a defined benefit pension plan, in which the benefit is determined by multiplying years of service times a service-credit percentage and applying this percentage to the judge's average high-five years of salary.

**For more information:** Contact legislative analyst Mark Shepard at 651-296-5051. For historical information on elected officials' salaries, see the Legislative Coordinating Commission's web site: www.commissions.leg.state.mn.us/lcer/officialssalaries.htm.

**HOUSE RESEARCH** | **Short Subjects**

**Patrick McCormack**

**November 2007**

# Minnesota's Three-Tier System of Liquor Regulation

Liquor is controlled for a number of reasons: to deny access to minors, to limit over-consumption, to ensure public safety via a clean supply, and to allow community control over the type and nature of liquor venues. Liquor is a public concern because a lack of control has caused public problems. Liquor is also regulated as an industry, both to compel the industry to meet the public goals of the state and to ensure fair competition.

***The three-tier system of regulation***

The classic model of liquor regulation creates a three-tier system for supply and distribution. This structure was created after Prohibition in order to modulate the free-wheeling system in place before Prohibition, which was deemed problematic. One aspect of that pre-Prohibition system was the existence of "tied houses"—retailers owned by manufacturers and serving as aggressive sales outlets for those manufacturers.

Minnesota has a much-modified version of the three-tier system. In a pure three-tier, manufacturers make spirits, beer, and wine; wholesalers distribute across and within the state to retailers; and retailers sell to the consuming public.

There are other models for regulating the sale of alcoholic beverages. Some states are "control" states, where wholesalers (18 states) and retailers (14 states) are operated in whole or in part by the State. The other 32, including Minnesota, are "license" states, allowing sales for the most part through independent licensed businesses. In Minnesota, municipal liquor stores do exist at the discretion of the municipality.

***The first tier: Manufacturers***

As of 2006, Minnesota had seven licensed manufacturers. Two of these manufacture distilled spirits and five brew beer. Brew-pubs (18) and wineries (22) have separate licenses and are not considered manufacturers.

***The second tier: Wholesalers***

As of 2006, there were 147 wholesaler permits issued (this number excludes farm wineries). Among the 147 permits, there are only seven liquor wholesalers. The rest are beer or wine wholesalers.

***The third tier: Retailers***

There are over 5,000 retail liquor establishments in Minnesota, divided among a wide variety of types. There are about 2,800 on-sale licensees and almost 500 club licensees. There are over 800 off-sale licensees and just under 1,200 combination off-sale/on-sale licensees. In addition to these categories, there are over 800 wine or wine/strong beer licensees and almost 400 establishments that have consumption and display permits. Finally, there are over 250 municipal on-sale or combination on-off sale licensees.

***Exceptions to the three tiers***

The three-tier system in Minnesota is not pure. The state has granted numerous exceptions, which has created a modified three-tier structure.

Some exceptions apply mostly to manufacturers:

- Brew-on-premises stores: These stores allow consumers to be manufacturers of beer (Minn. Stat. § 340A.33) or wine (Minn. Stat. § 340A.34) for private use

Some exceptions apply mostly to wholesalers:

- Nonprimary source state: Minnesota is the only nonprimary source state, which means that a wholesaler does not have to purchase all product directly from a manufacturer, but can instead buy the manufacturer's product from third parties, essentially other wholesalers, on the global market (Minn. Stat. § 340A.305, subd. 4)

Some exceptions apply mostly to retailers:

- Municipals and nonmunicipals: Minnesota allows municipal liquor stores to operate as a monopoly and also allows local governments to license multiple private stores, creating two different retail systems (Minn. Stat. § 340A.601)
- Bed and breakfast establishments can sell up to two glasses of wine with a stay at their establishment without a license (Minn. Stat. § 340A.4011)
- 3.2 percent malt liquor has separate sales provisions, including allowing sales at grocery stores, convenience stores, etc. (Minn. Stat. § 340A.403)
- Culinary classes are allowed to serve a limited amount of alcohol (Minn. Stat. § 340A.4041)

Some exceptions apply to more than one tier:

- Brew pubs: These retail outlets are allowed to manufacture their own beer, and in some instances, to transport it between multiple locations owned by the same company (Minn. Stat. § 340A.301, subd. 6); they can also sell growlers, or smaller 750 milliliter bottles, for people take home and consume (Minn. Stat. § 340A.301, subd. 7b);
- Farm Wineries (Minn. Stat. § 340A.315): A farm winery in Minnesota can give free samples, sell bottles of their product (Minn. Stat. § 340A.301, subd. 8), even on Sundays, and operate restaurants or wine bars that offer their product (Minn. Stat. § 340A.315)
- Wine over the Internet: Minnesota law allows the purchase and direct shipment (Minn. Stat. § 340A.417) of two cases of wine from a winery, over the Internet, and also allows Minnesota wineries to sell two cases to a given consumer, thereby allowing these manufacturers to act as direct retailers

**For more information:** Contact legislative analyst Patrick McCormack at 651-296-5048.

**Karen Baker and Deborah Dyson** **Updated: November 2007**

# Special Assessments: An Overview

***What are special assessments?***

Special assessments are one of the ways a local government may collect money to pay for local improvements. A special assessment is a charge imposed on real property to help pay for a local improvement that benefits the property.

The Minnesota Constitution gives the legislature the authority to allow local governments to use special assessments. This authority is mainly in Minnesota Statutes, chapter 429.

***What can special assessments be used for?***

Different types of local governments can use special assessments to pay for different types of local improvements. Cities, towns, urban towns, and counties can all use special assessments for the purposes listed in chapter 429. The statute doesn't apply to home rule charter cities if their charters establish other procedures.

Chapter 429 lists improvements that local governments can pay for with special assessments. Some examples include streets and roads, storm sewers, street lights, parks, nuisance abatement, district heating systems, and flood control works. For a comprehensive list, see Minnesota Statutes, section 429.021, subdivision 1.

***How is the amount of a special assessment determined?***

The special assessment cannot exceed the amount by which the property benefits from the improvement. The amount a property benefits from an improvement, called the "special benefit," is measured by the increase in the market value of the land due to the improvement. The assessment must be uniformly applied to the same class of property. A local improvement may benefit properties that are not abutting the improvement, and those properties may also be assessed.

***How are special assessments imposed?***

Local governments generally follow a set of procedures outlined in chapter 429 to impose special assessments. The procedures may vary depending on the purpose for the special assessment. The process can be divided into roughly three phases: (1) initiation and preliminary assessment, (2) detailed analysis, and (3) approval of final assessment roll, certification, and collection.

During the initiation and preliminary assessment, a local government initiates the proceeding, prepares a report on the necessity, cost-effectiveness, and feasibility of the proposed improvement, gives notice of public hearing, conducts a public hearing, and adopts a resolution ordering the improvement.

In the detailed analysis phase, the local government solicits bids, prepares a proposed assessment roll, gives notice of a public hearing, notifies affected properties of the proposed assessment, and conducts a public hearing.

A property owner must file a written objection to a proposed assessment in order to preserve the right to appeal to the district court.

In the final phase, the local government approves and certifies the assessment roll, issues debt to finance the improvement, collects the assessment, and awards a contract for work on the improvement. A property owner has 30 days to appeal the assessment to district court. In order to issue local improvement bonds without an election, at least 20 percent of the project cost must be paid with special assessments.

***Can special assessments be deferred?***

Special assessments can be deferred for senior citizens and people who are disabled ("hardship deferral"), for property that is enrolled in the Minnesota Agricultural Property Tax Program (Green Acres), for unimproved land, and for street or road improvement made outside municipal boundaries.

***How are special assessments different from property taxes?***

Special assessments are a form of taxation and may be paid using the same mechanism and at the same time as property taxes. However, special assessments and property taxes differ on the following:

- The basis for determining the amount charged (market value vs. benefit)
- What real property is subject to charge (taxable property vs. all real property, including tax-exempt property)
- That personal property is not subject to special assessments (but may be subject to property tax)
- Whether there are any statutory limits (debt limits do not apply to local improvement bonds; property tax levy limits have not applied to special assessments)
- Deductibility for income tax purposes (special assessments are generally not deductible for federal or state taxes)

***Who imposes most special assessments and what are the trends?***

Cities account for 71 percent of all special assessments imposed. In general, city use of special assessments decreased from 1980 to 2006, both as a percentage of total revenue, from 13.5 percent to 6.9 percent, and as a percentage of total property tax levy, from 20.5 percent to 10.9 percent.

***Can services and unpaid charges be collected as if they are special assessments?***

Cities and urban towns may impose by ordinance charges to pay for certain services that often are paid for with general revenues (e.g., property taxes). In addition, they may adopt an ordinance to collect unpaid charges imposed on an individual property using the special assessment process. Minnesota Statutes, section 429.101, lists the services that can be paid for with special assessments.

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959 or Deborah Dyson at 651-296-8291. Also see the House Research publication *Special Assessments*, November 2007.

Jim Cleary

November 2007

# Driver's License Record Keeping for DWI Violations

Under current Minnesota law, DWI violations, or impaired driving incidents, are kept on a person's official driving record permanently. Since the mid-1990's, the Minnesota Legislature has revised the required period of time that impaired driving incidents are kept on the official driving record three times.

***Impaired driving incidents are permanently kept on driving records***

Minnesota Statutes require that all DWI violations, or impaired driving incidents, must be kept on the driving record permanently. As defined by statute, an impaired driving incident includes any impaired driving-related loss of license, unless the license action was officially rescinded, and any impaired driving conviction, unless the conviction was overturned. Minn. Stat. §§ 169A.03, subds. 20-22; 609.21.

As a practical matter, the Department of Public Safety (DPS) has been including these incidents on driving records since at least the mid-1990s, so few, if any, DWI violations occurring since the mid-1980s have been purged from Minnesotans' driving records.

***Pre-1995: Initially, incidents were kept on record for five years***

Prior to 1995, the driver's license record-keeping statute did not single out DWI, but instead directed that "the driver's record pertaining to revocations, suspensions, cancellations, disqualifications, convictions, and accidents shall be cumulative and kept for a period of at least five years." Minn. Stat. § 171.12, subd. 3 (1994).

However, the Driver and Vehicle Services Division within DPS kept DWI violations on driving records for at least ten years, and later for 15 years, with the rationale being that records of such violations were needed to administer DWI law. DWI law has long provided for the enhancement of criminal penalties and administrative sanctions for violations occurring within ten years of any prior impaired driving violation (i.e., the "lookback period"). In fact, until 2000, DWI forfeiture law used a 15-year lookback period.

***1995: Time period was increased to 15 years***

A 1995 enactment amended the driver's license statute by specifically referring to violations of regular and commercial DWI law (Minn. Stat. §§ 169.21 and 169.1211, as they were then codified), as well as driving after cancellation. It also required that such violations be kept on the driving record "for a period of at least 15 years." Laws 1995, ch. 259, art. 1, § 37.

***2004: Some records to be purged after ten years***

The next statutory change pertaining to DWI record keeping was made in 2004, along with the enactment of the .08 per se alcohol concentration limit. The 2004 law left the requirement for record retention for most DWI violations as being "for a period of at least 15 years." Laws 2004, ch. 283, § 11. It also directed that a DWI violation must be purged after ten years if:

(1) it was the person's first DWI violation;

(2) the person's alcohol concentration (AC) at the time of the violation was measured as being .08 or .09; and

(3) the person did not commit another impaired driving violation within the following ten years.

***2005: Incidents are permanently retained***

The 2005 Legislature changed the record retention requirement of "at least 15 years" to read "must be retained permanently." Laws 2005, 1st spec. sess., ch. 6, art. 3, § 68. That enactment also repealed the language from the 2004 law requiring that a DWI violation be purged after ten years for a first-time violator having a low AC with no repeat violation during that timeframe. (Officials from the National Highway Traffic Safety Administration (NHTSA) expressed concern that any purging of prior DWI violations would conflict with federal transportation law, which requires a complete lifetime record of all alcohol-driving violations for anyone applying for a commercial driver's license. Consequently, the 2004 law did not actually result in any alcohol-related driving violations being purged from the driving records of first-time, low-AC, nonrepeat DWI violators.)

**For more information:** Contact legislative analyst Jim Cleary at 651-296-5053. Also see the House Research publication *An Overview of Minnesota's DWI Laws*, December 2006.

Karen Baker and Nina Manzi

Updated: November 2007

# Targeting Property Tax Refund

| | |
|---|---|
| ***What is targeting?*** | The "additional" or "special" property tax refund, generally referred to as "targeting," directs property tax relief to homeowners who have large property tax increases from one year to the next. |
| ***Who qualifies?*** | A homeowner qualifies if the property tax on the home has increased by more than 12 percent over the previous year's tax, and if the increase is over $100.<br><br>The homeowner must have owned and lived in the same home for both years. If any improvements were made to the home, that portion of the tax increase resulting from the improvements must be subtracted when determining the refund. |
| ***How does targeting work?*** | The refund equals 60 percent of the increase over the greater of (1) 12 percent of the previous year's tax or (2) $100. The maximum refund is $1,000. The following example shows how the refund is calculated. |

| | |
|---|---|
| Payable 2007 Property Tax<br>Payable 2008 Property Tax | $1,400<br>2,000 |
| 2008 tax increase (over 2007)<br>Taxpayer pays first 12% of increase compared to previous year's tax, which must be at least $100 (12% x 1,400) | $600<br><br>168 |
| Remaining increase eligible for relief ($600 - $168 = $432) | $432 |
| State pays 60% of excess over 12% increase up to a $1,000 maximum (60% x $432 = $259) | $259 |
| Amount of 2008 increase paid by taxpayer ($600 - $259) | $341 |

The taxpayer's $600 increase (i.e., 42.9 percent) is reduced to an out-of-pocket property tax increase of $341 (i.e., 24.4 percent) as a result of the $259 refund.

The taxpayer pays the full $2,000 amount of the 2008 property tax to the county, the first half in May and the second half in October. The taxpayer applies to the state for a targeting refund, which is paid at the same time the regular homeowner property tax refund ("circuit breaker") is paid.

| | |
|---|---|
| ***Does targeting have any other restrictions?*** | No, unlike the regular property tax refund, the targeting refund is not tied to the taxpayer's household income. Under the regular homeowner property tax refund, the taxpayer's household income may not exceed a specified maximum and the amount of household income affects the amount of the refund. |

However, the targeting refund does not use income as a factor, nor is there any limitation on the taxpayer's household income. Therefore, many higher income taxpayers who do not qualify for the regular property tax refund due to income restrictions are eligible for the targeting refund.

***Is targeting a new program?***

No, the first targeting program was enacted in 1980. With the exception of a few years in the 1980s, the program has been in effect for about 25 years, although miscellaneous changes have been made to the program during that time.

***What are statewide amounts?***

The amounts paid out for the targeting program increased substantially from $4.3 million in 2005 to $13.6 million in 2006, with much of the increase occurring in the metro area.

The table below shows the statewide amount, with a breakdown for the metro and the 80 nonmetro counties, for the past four years.

**Targeting Refunds, 2003 – 2006 (dollars in thousands)**

| | Filed 2003 | Filed 2004 | Filed 2005 | Filed 2006 |
|---|---|---|---|---|
| **Total Metro** | $6,335 | $2,463 | $2,636 | $10,224 |
| **Total Nonmetro** | $1,244 | $1,241 | $1,663 | $3,390 |
| **State** | $7,579 | $3,704 | $4,300 | $13,614 |

Some taxpayers (e.g., those who typically don't qualify for the regular property tax refund) may not be aware of the targeting program, resulting in lower total refunds statewide than would be the case if the program were more widely known.

***How are claims filed?***

Refund claims are filed using the Minnesota Department of Revenue Schedule M1PR, the property tax refund form. There is a separate schedule on the back of the M1PR ("Schedule 1 – Special Refund") for the targeting program. The taxpayer files for this refund after receiving his or her property tax statement in February or March. Claims filed before August 15, 2008, will be paid beginning in late September 2008. The deadline for filing claims based on taxes payable in 2008 is August 15, 2009; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf.

**For more information:** Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml. Also see the House Research Short Subject *Homeowner's Property Tax Refund Program*, November 2007, and the Information Brief *Targeting*, December 2007.

# HOUSE RESEARCH | Short Subjects

Nina Manzi Updated: November 2007

# Federal Taxable Income, the starting point for calculating Minnesota income tax

***What is federal taxable income (FTI)?***

Federal taxable income is the tax base used to calculate federal income tax liability. It is also the starting point for calculating Minnesota taxable income, the tax base used to calculate Minnesota income tax liability. Federal taxable income equals federal adjusted gross (FAGI) income after deductions and exemptions.

| Federal adjusted gross income (FAGI) | – | Standard *or* Itemized deductions | – | Personal and Dependent exemptions | = | Federal taxable income (FTI) |
|---|---|---|---|---|---|---|

***What kinds of income are included in FAGI?***

Federal adjusted gross income includes most kinds of income: wages, salaries, and tips; taxable interest; dividends; alimony received by the taxpayer; business income or loss; capital gains or losses; other gains or losses; taxable IRA distributions; taxable pension and annuity distributions (the taxable portion is typically determined by whether or not the contributions to the pension or annuity were included in FAGI when they were made); income from rental real estate, royalties, partnerships, S corporations, and trusts; farm income or loss; unemployment compensation; and taxable Social Security benefits (the amount taxable depends on the individual's income level; at most, 85 percent of benefits are included in FAGI). FAGI does not include child support received by the taxpayer.

***What kinds of income are excluded from FAGI?***

Federal adjusted gross income excludes: deductible IRA, SEP, and SIMPLE contributions; nontaxable employee fringe benefits; student loan interest payments; Health Savings Account contributions and investment income; moving expenses; one-half of self-employment tax; health insurance premiums (for self-employed taxpayers only); penalty on early withdrawal of savings; alimony paid by the taxpayer; and, through tax year 2007, $250 of teacher classroom expenses and $4,000 of tuition expenses for higher education. FAGI does not exclude child support paid by the taxpayer.

***What deductions are allowed from FTI?***

Taxpayers may claim either the standard deduction or itemized deductions. In tax year 2005, the most recent year for which data is available, 54 percent of Minnesotans claimed the standard deduction and 46 percent itemized.

***How much is the standard deduction?***

In tax year 2008, the standard deduction is as follows:

- $10,900 for married couples filing joint returns
- $5,450 for married couples filing separate returns
- $8,000 for head of household filers
- $5,450 for single filers

***What itemized deductions are allowed?***

Itemized deductions are allowed for the following:

- State and local property and payments of income taxes
- Mortgage and interest
- Charitable contributions
- Medical expenses in excess of 7.5 percent of income
- Casualty and theft losses in excess of 10 percent of income
- Job expenses and miscellaneous expenses (most only allowed in excess of 2 percent of income)

***What personal and dependent exemptions are allowed?***

Taxpayers may claim one personal exemption each and one dependent exemption for each dependent claimed. For tax year 2008, the personal and dependent exemptions are $3,500 each. A family of four qualifies for four exemptions, totaling $14,000.

***Are there limits on deductions and exemptions?***

Itemized deductions are limited for taxpayers with incomes over a threshold. Taxpayers subject to the limitation must subtract from total itemized deductions the lesser of:

- 3 percent of income in excess of the threshold; or
- 80 percent of total itemized deductions, excluding deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses to the extent offset by gambling gains.

Personal and dependent exemptions are phased out for taxpayers with incomes over a threshold. Taxpayers subject to the phaseout lose 2 percent of their total exemption amount for each $2,500 of income over the threshold.

| **Tax year 2008** | **Itemized deduction limit begins at** | **Exemption phaseout begins at** |
|---|---:|---:|
| **Married joint filers** | $159,950 | $239,950 |
| **Married separate filers** | $79,975 | $119,975 |
| **Single filers** | $159,950 | $159,950 |
| **Head of household filers** | $159,950 | $199,950 |

The income thresholds for the itemized deduction limit and the personal exemption phaseout are adjusted annually for inflation.

The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 gradually phases out the limitation on itemized deductions and the phaseout of personal and dependent exemptions from 2006 to 2010. In tax year 2008, the limitation and the phaseout will be reduced by two-thirds. The general sunset of EGTRRA provisions would reinstate the full amount of the limitation of itemized deductions and the phaseout of exemptions beginning in tax year 2011.

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publication *Income Tax Terms: Deductions and Credits*, July 2007.

Karen Baker and Nina Manzi Updated: November 2007

# Homeowner's Property Tax Refund Program

***What is the property tax refund program?***

The homeowner's property tax refund program (sometimes called the "circuit breaker" or the PTR) is a state-paid refund that provides tax relief to homeowners whose property taxes are high relative to their incomes. If property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

***Has the program changed?***

The 2001 tax law expanded the homeowner's property tax refund program, effective for refunds based on property taxes payable in 2002. The changes lowered the threshold for determining eligibility and increased the maximum refund allowed. The tax law also limited the amount of tax qualifying for the refund for farmers to the tax attributable to the house, garage, and first acre of property. (Previously the tax amount for farmers also included the tax on the first $600,000 of land and farm buildings.)

***What are the maximums?***

For refund claims filed in 2008, based on property taxes payable in 2008 and 2007 household income, the maximum refund is $1,750. Homeowners whose income exceeds $93,480 are not eligible for a refund.

***How are claims filed?***

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2008, will be paid beginning in late September 2008. The deadline for filing claims based on taxes payable in 2008 is August 15, 2009; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf.

***What is the average refund and total amount paid?***

**Statewide Homeowner Property Tax Refunds**
**Filed in 2006 (based on 2005 incomes and payable 2006 taxes)**

| | Number of returns | Total refund amount | Average per return |
|---|---|---|---|
| Under 65 years old | 185,021 | $115.8 million | $626 |
| Senior/disabled | 116,385 | $74.2 million | $637 |
| Total: all homeowners | 301,406 | $190.0 million | $630 |

***How do refunds vary depending upon the filer's income and property tax?***

The following table shows the refund amount for two example families with different incomes—one family in the metro area and one in greater Minnesota. Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average residential homestead property tax in the metro area is higher than in greater Minnesota. The metro area family has payable 2008 property taxes of $3,068, the estimated average for the metro. The family in greater Minnesota has payable 2008 property taxes of $1,557, the estimated average for greater Minnesota. Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

**Married couple both under age 65, two dependents**

| | | Metro area | | Greater Minnesota | |
|---|---|---|---|---|---|
| | | Taxpayer #1 | Taxpayer #2 | Taxpayer #3 | Taxpayer #4 |
| 1 | Estimated average market value of home | $283,500 | $283,500 | $164,100 | $164,100 |
| 2 | Gross income | $25,000 | $50,000 | $25,000 | $50,000 |
| 3 | Deduction for dependents | $9,180 | $9,180 | $9,180 | $9,180 |
| 4 | Household income (2 – 3 = 4) | $15,820 | $40,820 | $15,820 | $40,820 |
| 5 | Property tax | $3,068 | $3,068 | $1,557 | $1,557 |
| 6 | Statutory threshold percentage | 1.9% | 2.7% | 1.9% | 2.7% |
| 7 | Threshold % x income (4 x 6 = 7) | $301 | $1,102 | $301 | $1,102 |
| 8 | Property tax over threshold (5 – 7 = 8) | $2,767 | $1,966 | $1,256 | $455 |
| 9 | Statutory copay percentage | 30% | 40% | 30% | 40% |
| 10 | Taxpayer copay amount (8 x 9 = 10) | $830 | $786 | $377 | $182 |
| 11 | Remaining tax over threshold (8 – 10 = 11) | $1,937 | $1,180 | $879 | $273 |
| 12 | Maximum refund allowed | $1,520 | $1,290 | $1,520 | $1,290 |
| 13 | Net property tax refund | $1,520 | $1,180 | $879 | $273 |

**For more information:** Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online by clicking on "Where is my property tax refund" at www.taxes.state.mn.us/taxes/individ/index.shtml

**HOUSE RESEARCH** | **Short Subjects**

**Karen Baker**

**November 2007**

# Mining Taxes

***What taxes does the iron mining industry pay?***

Mines and facilities used in the production of taconite are exempt from the property tax. In lieu of the property tax, the iron mining industry pays a **production tax** based on the tons of taconite produced. The industry is also exempt from the corporate income tax and instead pays an **occupation tax**. The occupation tax is similar in structure to the corporate income tax; the tax applies to a synthetic measure of profits from only the corporation's mining operations.

***What is the total tax paid by mining companies?***

The mining industry paid $102.3 million in Minnesota taxes in 2007. The production tax constitutes about 83 percent ($84.5 million) of the total taxes while the remaining 17 percent ($17.8 million) includes the occupation tax, sales tax, and some miscellaneous taxes. In 2007, state general fund aid of $8.6 million was distributed with the production tax revenues, resulting in total taxes and aid of $110.9 million, as reported by Department of Revenue, *Mining Tax Guide*, p. 2 (September 2007). This short subject focuses on the production tax, since it is the primary mining tax.

***Who receives the production tax revenues?***

Because it is in lieu of the property tax, the taconite production tax is paid to local governments and is a major revenue source for counties, cities, towns, and school districts located in the "taconite relief area." The taconite relief area includes all or a portion of Cook, Lake, St. Louis, Itasca, Aitkin, Crow Wing, and Koochiching counties. A portion of the revenue is also paid to the Iron Range Resources (IRR), a state agency charged with conducting a variety of operations on the Iron Range.

***How is the tax determined and distributed?***

The following are some of the key features of the production tax:

- The tax is computed using a **tax rate**, expressed as a dollar amount per taxable ton of taconite production ($2.203 for the 2006 tax, distributed in 2007). The tax rate is set in state law, not by local levy decisions, and is indexed for inflation.
- The **tax base** is taxable tons, computed using a three-year average to keep the tax base stable. For example, tons produced in calendar years 2004, 2005, and 2006 are used to compute taxable tons for the 2006 tax, distributed in 2007 (39.3 million tons).
- The state calculates the tax amounts and notifies each mining company how much to pay the counties and the IRR.
- **Payments** are due in two equal installments, by February 24 and August 24.
- The state notifies the counties of the distribution to each city, town, and school district, and the county then pays each affected local government.
- A 22-cent per ton state general fund payment supplements distributions of production tax revenues. For the 2007 distribution, this amount was $8.6

million. This increased the total distribution by about 10 percent.

***How are the taxes calculated?***

The formula for distributing production tax revenues is a complex one that has evolved over many years. It is specified in statute and is generally defined on a cents-per-taxable-ton (CPT) distribution. The 2007 tax was distributed as follows:

| Distribution | Amounts | Cents per ton distributed |
|---|---|---|
| Cities and townships | $11,087,982 | 28.2 |
| School districts | 16,541,276 | 42.1 |
| Counties | 13,568,536 | 34.5 |
| Property tax relief and misc. | 14,753,800[(a)] | 37.5 |
| Iron Range Resource<br>Includes $11.5 million distribution to the taconite Environmental Protection Fund and $4.0 million distribution to the Douglas Johnson Economic Protection Trust Fund | 24,673,433 | 62.8 |
| Taconite Economic Development Fund (investment credit) | 12,257,357 | 31.2 |
| Other: Range Association of Municipalities and Schools; Hockey Hall of Fame[(b)] | 214,555 | 0.5 |
| **Total** | **$93,096,939**[(c)] | **$236.8**[(d)] |

(a) For 2007 only, instead of depositing this allocation in the property tax relief account, these dollars were distributed to various public works and local economic development projects. The CPT distributed to each project is contained in Laws 2006, ch. 259, art. 12, sec. 13.
(b) Distribution to the Hockey Hall of Fame is through production year 2010.
(c) Beginning in 2000, revenue from the general fund was contributed. For 2007, the state aid amount was $8,645,555.
(d) Includes the state aid of 22 CPT and the reduction for the tax credits to United Taconite and National Kewatin of about 5.4 CPT.

***How has the amount changed over the past years?***

| | | Amount (in millions) | | |
|---|---|---|---|---|
| Production year | Distribution year | Levied on companies | State aid* | Total |
| 1998 | 1999 | $94.3 | -- | $94.3 |
| 1999 | 2000 | 93.1 | -- | 93.1 |
| 2000 | 2001 | 79.8 | -- | 79.8 |
| 2001 | 2002 | 62.3 | 13.0 | 75.3 |
| 2002 | 2003 | 64.4 | 8.0 | 72.4 |
| 2003 | 2004 | 65.8 | 7.6 | 73.4 |
| 2004 | 2005 | 79.2 | 8.2 | 87.4 |
| 2005 | 2006 | 78.6 | 8.3 | 86.9 |
| 2006 | 2007 | 84.5 | 8.6 | 93.1 |

* Amount is based on CPT. For production year 2001, it was 33 CPT; effective for production year 2002 and thereafter, it is 22 CPT.

**For more information:** Contact legislative analyst Karen Baker at 651-296-8959.

**Nina Manzi**

**Updated: November 2007**

# Minnesota Taxable Income

***What is Minnesota taxable income?***

Minnesota taxable income (MTI) is the tax base used to calculate Minnesota income tax liability. Minnesota taxable income equals federal taxable income after Minnesota subtractions and additions.

Federal taxable income (FTI) + Minnesota additions – Minnesota subtractions = Minnesota taxable income (MTI)

***What are Minnesota additions to taxable income?***

Minnesota requires the following *additions* to federal taxable income:

- State income or sales tax deduction. Filers who claimed a federal itemized deduction for state income or sales taxes paid must add that amount back into Minnesota taxable income. Taxpayers making this addition are always allowed to claim at least the full standard deduction for the tax year.
- Bond interest and mutual fund interest dividends paid by non-Minnesota state and local governments. The federal government does not tax state and local bond interest. Minnesota does not tax Minnesota state and local bond interest, but does tax interest on bonds of other states and their local governments.
- Expenses relating to income not taxed by Minnesota. These are mainly expenses deducted at the federal level and attributable to U.S. bond interest income, which is excluded from Minnesota taxable income.
- Capital gain part of lump-sum distributions from qualified retirement plans.
- Various items allowed at the federal level but not the state, including deductions for teacher classroom expenses and higher education tuition and fees.

***What subtractions does Minnesota allow from taxable income?***

Minnesota allows the following *subtractions* from federal taxable income. The estimated cost of most subtractions is taken from the Department of Revenue's *Tax Expenditure Budget for 2006-2009*. Revenue estimates made during the 2008 legislative session differ from the *Tax Expenditure Budget* because they will be based on a more recent economic forecast.

- **State income tax refund** (filers who claimed federal itemized deductions only). The federal income tax allows a deduction for state income taxes. Minnesota requires filers to add back the amount deducted, and allows a subtraction for amounts refunded in order to avoid twice taxing the same income.

- **Subtractions required by federal law.** Federal law prohibits state taxation of these three types of income:
    - U.S. bond interest
    - Railroad retirement benefits
    - On-reservation earnings of enrolled tribal members
- **K-12 dependent education expenses** ($16.0 million in fiscal year 2008). The deduction applies to school-related expenses, including tuition, textbooks, academic tutoring and camps, and instructional materials and supplies. The maximum deduction is $1,625 for each child in grades K-6 and $2,500 for each child in grades 7-12.
- **Compensation for military active service outside of Minnesota** ($6.2 million in fiscal year 2008).
- **50 percent of charitable contributions in excess of $500** ($5.8 million in fiscal year 2008). Allowed only for filers who do not claim federal itemized deductions—those who itemize have already deducted their charitable contributions in computing federal taxable income.
- **Minnesota elderly/disabled exclusion** ($1.2 million in fiscal year 2008). Equals up to $12,000 for low-income elderly and disabled filers with low amounts of Social Security and nontaxable pensions.
- **Job Opportunity Building Zone (JOBZ) income** ($1.6 million in fiscal year 2008). Allowed for net income from a qualified business in a JOBZ, for net income from renting property for use by a qualified business, and for gain from the sale of property used by a qualified business.
- **Organ donation expenses** ($100,000 in fiscal year 2008). Allowed for up to $10,000 of expenses related to organ donation by the taxpayer or a dependent, including lost wages.
- **Federal small ethanol producer credit** ($100,000 in fiscal year 2008). Producers with ethanol production capacity under 30 million gallons may claim a federal credit equal to 10 cents per gallon, but must include the credit in gross income. This subtraction prevents the credit from being included in Minnesota taxable income.
- **Compensation for National Guard and reserve active service in Minnesota** (less than $50,000 in fiscal year 2008). Allowed for state active service and federally funded state active service (generally floods, other disasters, and airport security) but not for drill pay.
- **Gain on sale of farm property for insolvent taxpayers** (less than $50,000 in fiscal year 2008). This subtraction is allowed for taxpayers who use the proceeds of the sale of a farm to pay off a mortgage, contract for deed, or lien on the property.
- **Foreign subnational income taxes.** Taxpayers subject to a foreign subnational income tax may subtract the amount of tax paid to the foreign governmental unit, to the extent the taxpayer did not use the subnational taxes to claim the federal foreign tax credit.

**For more information:** Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publications *Income Tax Terms: Deductions and Credits*, July 2007; and *Minnesota's Elderly Exclusion* (web only) at www.house.mn/hrd/issinfo/tx_inc.htm.

**Nina Manzi and Karen Baker**

**Updated: November 2007**

# Renter's Property Tax Refund Program

***What is the renter's property tax refund program?***

The renter's property tax refund program (sometimes called the "renters' credit") is a state-paid refund that provides tax relief to renters whose rent and "implicit property taxes" are high relative to their incomes. "Rent constituting property taxes" is assumed to equal 19 percent of rent paid. If that rent constituting property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

***What are the maximums?***

For refund claims filed in 2008, based on rent paid in 2007 and 2007 household income, the maximum refund is $1,430. Renters whose income exceeds $50,430 are not eligible for refunds.

***How are claims filed?***

Refund claims are filed using Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2008, will be paid beginning in August 2008. The deadline for filing claims based on rent paid in 2007 is August 15, 2009; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf.

***What is the average refund and total amount paid?***

**Statewide Renter Property Tax Refunds**
**Filed in 2006 (based on 2005 incomes and rent paid in 2005)**

| | Number of returns | Total amount | Average per return |
|---|---|---|---|
| Under 65 years old | 193,900 | $99.8 million | $514 |
| Senior/disabled | 77,499 | $45.8 million | $590 |
| Total: all renters | 271,399 | $145.5 million | $536 |

***How do refunds vary depending upon the filer's income and rent constituting property taxes?***

The following table shows the refund amount for two example families with different incomes—a married couple without dependents in the metro area, and a married couple without dependents in greater Minnesota (a single person living alone would qualify for the same refund amounts). Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average rent is higher in the metro area than in greater Minnesota. The metro area family paid monthly rent in 2007 of $707, the fair market rent for a one-bedroom apartment in the metro area. (19% of $707 x 12 = $1,612, which is their rent constituting property tax.) The family in greater Minnesota paid monthly rent in 2007 of $432, the fair market rent for a one-bedroom apartment in many greater Minnesota counties. (19% of $432 x 12 = $985, which is their rent constituting property tax.) Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

**Married couple both under age 65, no dependents**

| | | **Metro area** | | **Greater Minnesota** | |
|---|---|---|---|---|---|
| | | **Taxpayer #1** | **Taxpayer #2** | **Taxpayer #3** | **Taxpayer #4** |
| 1 | Gross income | $15,000 | $30,000 | $15,000 | $30,000 |
| 2 | Deduction for dependents | 0 | 0 | 0 | 0 |
| 3 | Household income (1 – 2 = 3) | $15,000 | $30,000 | $15,000 | $30,000 |
| 4 | Rent constituting property tax | $1,612 | $1,612 | $985 | $985 |
| 5 | Statutory threshold percentage | 1.4% | 2.4% | 1.4% | 2.4% |
| 6 | Threshold % x income (3 x 5 = 6) | $210 | $720 | $210 | $720 |
| 7 | Property tax over threshold (4 – 6 = 7) | $1,402 | $892 | $775 | $265 |
| 8 | Copay percentage | 20% | 30% | 20% | 30% |
| 9 | Taxpayer copay amount (7 x 8 = 9) | $280 | $268 | $155 | $80 |
| 10 | Remaining tax over threshold (7 – 9 = 10) | $1,122 | $624 | $620 | $185 |
| 11 | Maximum refund allowed | $1,430 | $1,430 | $1,430 | $1,430 |
| 12 | Net property tax refund | $1,122 | $624 | $620 | $185 |

**For more information:** Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online by clicking on "Where is my property tax refund" at www.taxes.state.mn.us/taxes/individ/index.shtml.

**Nina Manzi**

**Updated: December 2007**

# The Federal Earned Income Tax Credit and Minnesota Working Family Credit: An Overview

***What are the credits?***

The federal earned income tax credit (EITC) and Minnesota working family credit (WFC) equal a percentage of the earnings of low-income individuals. The credits are refundable; if the credit exceeds a filer's tax liability, the rest is paid as a refund. Since these credits increase their recipients' earnings, they act as wage supplements and are thought to provide a work incentive.

***Who is eligible for the credits?***

Anyone with wages or self-employment income may be eligible to claim the EITC and the WFC. In tax year 2008, individuals with more than $2,950 in interest income, dividends, rental and royalty income, and capital gain income do not qualify.

***How are the credits calculated?***

The credits equal a percentage of earned income, up to a maximum credit amount, and are phased out when the claimant's total income exceeds a threshold. The maximum credit amounts and income levels at which the credits are phased out vary depending on the number of children in the household and whether the claimants are married. Both the maximum credit and the phaseout threshold are adjusted annually for inflation. In tax year 2008, the maximum credits, phaseout threshold, and income level at which the credits are no longer allowed are as follows:

| | **Maximum credit** | | **Phaseout threshold** | | **Income at which credit fully phased out** | |
|---|---|---|---|---|---|---|
| | EITC | WFC | EITC | WFC | EITC | WFC |
| *Unmarried claimants* | | | | | | |
| No children | $438 | $110 | $7,160 | $7,160 | $12,880 | $12,890 |
| 1 child | $2,917 | $874 | $15,740 | $18,710 | $33,995 | $33,961 |
| 2 or more children | $4,824 | $1,686 | $15,740 | $22,190 | $38,646 | $38,559 |
| *Married claimants* | | | | | | |
| No children | $438 | $110 | $10,160 | $10,160 | $15,880 | $15,890 |
| 1 child | $2,917 | $874 | $18,740 | $21,710 | $36,995 | $36,961 |
| 2 or more children | $4,824 | $1,686 | $18,740 | $25,190 | $41,646 | $41,559 |

***How do filers claim the credits?***

Filers claim the credits when they file their federal and state income tax returns, by completing a schedule or worksheet.

***How many Minnesotans claim the credits?***

In tax year 2005, 272,171 Minnesota returns claimed the EITC and 258,672 claimed the WFC. These claims represent 11.1 percent of all federal returns filed by Minnesotans and 10.4 percent of all state returns filed.

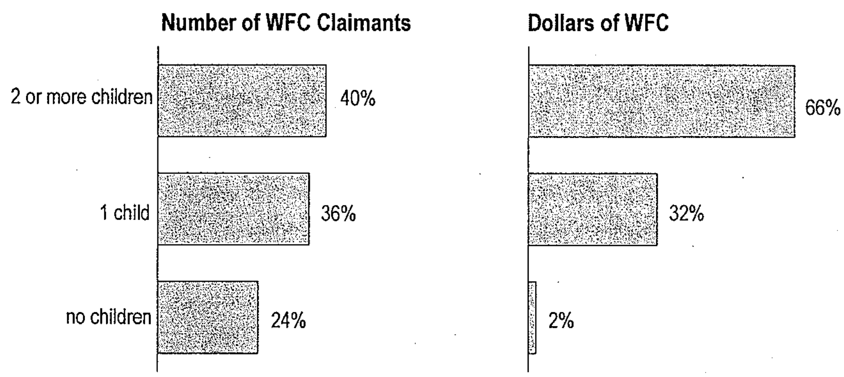
***How much is paid out in credits?***

In tax year 2005, Minnesotans claimed $442 million in EITC, of which $57 million offset tax liability and the remaining $385 million was paid as a refund. The average EITC was $1,624.

Minnesotans claimed an additional $139 million in WFC, of which $26 million offset tax liability and the remaining $113 million was paid as a refund. The average WFC was $537.

***How are the credits distributed among different types of families?***

Seventy-six percent of all earned income credits and working family credits went to families with one or more children. These families received about 98 percent of the total amount of credits paid in 2005. Individuals without children filed 24 percent of returns claiming credits, but received only 2 percent of the total amount of credits. Claimants with children received most of the total amount of credits because these families qualify for a higher maximum credit than do claimants without children.




***How are the credits distributed geographically?***

While over 47 percent of the returns claiming credits came from the Twin Cities metropolitan area, these seven counties generated about 55 percent of all returns filed. Put another way, in 2005 nonmetro filers were more likely to claim the credit than were metro area filers.

***How does Minnesota compare with other states?***

Nationwide, 16.8 percent of all income tax returns claimed the EITC, compared to 11.1 percent in Minnesota. The average EITC nationwide in 2005 was $1,874; it was $1,624 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above-average incomes.

Twenty-two other states and the District of Columbia have enacted a state version of the EITC. In most cases the state credit equals a percentage of the federal EITC.

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*, December 2007.

Anita Neumann

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# Minimum Wage

***What is the state minimum wage?***

Under Minnesota's minimum wage law, employers who do at least $625,000 of business in a year must pay their employees at least $6.15 per hour. Employers who do less than $625,000 of business in a year must pay least $5.25 per hour. An exception for employees under age 20 during their first 90 days of work allows employers to pay them $4.90 per hour.

***What is the federal minimum wage?***

As a result of legislation passed by Congress and signed by the president earlier this year, the federal minimum wage will increase to $7.25 per hour in three steps. The first step, effective July 24, 2007, increased the wage to $5.85 per hour. On July 24, 2008, the wage will increase to $6.55 per hour. The third and final step, effective July 24, 2009, will result in a minimum wage rate of $7.25 per hour.

***Are employees covered by state law, federal law, or both?***

As a general matter, the federal law covers all employees of establishments that have at least $500,000 in gross receipts per year. Further, any employee of an establishment that does not meet the $500,000 minimum is covered if that employee's individual work involves transactions that in some way involve interstate commerce. The way these provisions are interpreted, most employees are covered by the federal law.

The state law covers most employees in Minnesota, unless they are specifically exempt. Therefore, unless they fit into one of the specific exceptions, most people who work in Minnesota are covered by both state and federal law.

***What are the state and federal exemptions?***

Many of the specific exemptions from minimum wage requirements are the same in federal and state law. Some exemptions are broad, such as the one that applies to executive, administrative, and professional employees, which appear in both state and federal law, and some are narrow, such as the federal exemption of employees who work at home making evergreen wreaths. State and federal regulations generally provide the boundaries of these categories.

***If an employee is covered by both state and federal law, which prevails?***

The short answer is that the higher wage prevails. If one law mandates a minimum of $5.85 and one mandates a minimum of $6.15, for instance, the employer can comply with both only by paying at least $6.15. Minnesota has a two-tier minimum wage. For small employers—those with annual sales volumes of less than $625,000—the Minnesota minimum wage rate is $5.25 per hour. For large employers ($625,000 or more in annual sales), the state minimum wage rate is $6.15. The state minimum wage rate for large employers is currently higher than the federal minimum wage rate. Thus, large employers covered by both state and federal law must pay at least $6.15 per hour. As of July 24, 2008, however, the federal minimum wage rate will exceed the state rate, so the federal minimum wage of $6.55 will apply.

For some businesses considered to be small employers by Minnesota's standard, the change in the federal minimum wage had an immediate effect when the rate increased in July 2007. For those small employers with an annual sales volume of at least $500,000 or who engaged in interstate commerce, the federal rate of $5.85 applies because it is higher than the first-tier state minimum wage rate of $5.25.

***What about employees who receive tips?***

Minnesota does not allow a "tip credit," so tipped employees in Minnesota who are subject to the state minimum wage provisions must be paid the regular state minimum hourly wage by the employer, regardless of whether they also receive tips. Further, the employer cannot require employees to share tips with the employer or with other employees, because the tips are the exclusive property of the person who receives them.

This differs from federal law, which allows a partial tip credit as long as the employer can prove that the employee actually receives enough tips to make up the difference between the lower hourly wage the employer pays and the statutory minimum wage.

***When was the minimum wage last increased?***

The most recent increase in the federal minimum wage became effective in July 2007. The most recent increase in the state minimum wage became effective in August 2005.

***How does Minnesota's minimum wage compare to the minimum wage in other states?***

According to information published by the U.S. Department of Labor in July 2007, five states have no minimum wage laws, 31 states and the District of Columbia have minimum wages higher than the federal minimum (including Minnesota), ten states have minimum wages the same as the federal minimum, and four states have minimum wage rates lower than the federal minimum.

***Who enforces minimum wage laws?***

Minimum wage laws are enforced in Minnesota by the Minnesota Department of Labor and Industry and the U.S. Department of Labor.

**For more information:** Contact legislative analyst Anita Neumann by e-mail at: anita.neumann@house.mn.

**Nina Manzi & Emily Cleveland** **Updated: December 2007**

# Long-term Care Insurance Income Tax Credit

***What is the credit?***

The Minnesota long-term care insurance credit offsets the cost of long-term care insurance premiums by providing a credit against state income tax liability. The maximum Minnesota credit is equal to the lesser of $100 or 25 percent of the amount paid for each beneficiary. The maximum total credit is $200 annually on a joint return or $100 for individual filers.

This credit was enacted in 1997 and took effect in tax year 1999.

***What is the rationale for this tax credit?***

The Minnesota long-term care tax credit provides an incentive for Minnesotans to purchase long-term care insurance coverage. If more Minnesota residents purchase long-term care insurance, there may be a decrease in the cost to the state in providing for the long-term care of residents who are unable to afford long-term care services.

***Is the credit refundable?***

The Minnesota credit is a nonrefundable credit and may be used only to offset tax liability. If an individual qualifies for a credit that is greater than her or his tax liability, the excess will *not* be paid as a refund.

***Who is eligible for the credit?***

A Minnesota taxpayer who purchases insurance to provide long-term care coverage, such as nursing home or home care coverage, for the taxpayer or spouse is eligible for the credit. To qualify for the credit, the long-term care policy must:

- qualify for the federal itemized deduction for medical expenses, disregarding the 7.5 percent income test; and
- have a lifetime long-term care benefit limit of $100,000 or more.

***How is the credit calculated?***

The Minnesota credit equals 25 percent of qualifying long-term care insurance premiums for one beneficiary, up to a maximum of $100 for individuals and up to $200 for married couples filing jointly who both have coverage. A taxpayer may claim only one policy for each qualified beneficiary. It is *not* necessary that the taxpayers filing jointly have separate policies or premiums. The amount of premiums used to calculate the credit must be reduced by any premiums claimed as a medical expense deduction on the taxpayer's federal return.

Filers claim the credit on their Minnesota income tax return using Schedule M1LTI.

***How many Minnesotans claim the credit?***

For tax year 2005, 54,633 Minnesota returns claimed the credit. These claims represent about 2 percent of all state returns filed by Minnesotans.

***How much is paid out in credits?***

In tax year 2005, Minnesotans claimed $7.5 million of long-term care insurance credits. The average long-term care tax credit was $137 in tax year 2005.

***How does Minnesota compare with other states?***

This table includes all states that offered a long-term care insurance tax credit in 2005, but not those states that offer a long-term care insurance tax deduction. Data on number of claimants and cost by state is for 2005. In addition to the states listed, Mississippi has enacted a credit that will take effect in tax year 2007, equal to 25 percent of premiums with a maximum of $500.

| | Maximum Credit | Credit Rate* | How many returns claimed the credit? | What is the cost to the state for the tax credit? |
|---|---|---|---|---|
| **Colorado**[1] | $150 | 25% | not available | not available |
| **Maryland** | Varies by age: $220-$500 | 100% | 11,750 | $5.25 million |
| **Minnesota** | $100 | 25% | 54,633 | $7.5 million |
| **Montana**[2] | $5,000 | Varies by income: 20% to 30% | 50 | $55,000 |
| **New York** | No maximum | 20% | 128,000 | $86 million |
| **North Dakota** | $100 | 25% | 500 | $70,168 |
| **Oregon** | $500 | 15% | 26,353 | $5.8 million |

* The credit rate is the percentage of premiums, which is usually the amount not deducted under the itemized deduction, but not always.

[1] Colorado does not track the credit separately but instead combines it with other tax credits.

[2] The June 2006 update of this short subject mistakenly listed 114,000 claimants and $80.3 million claimed for both Montana and New York. These figures were correct for New York, but the correct figures for Montana were 41 claimants and $30,000 claimed.

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204, Joel Michael at 651-296-5057, or Emily Cleveland at 651-296-5808. (**Note:** Research assistant Anna Hovde provided help with this publication.)