Short Subjects

Minnesota House of Representatives, House Research

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HOUSE RESEARCH | Short Subjects

Nina Manzi and Joel Michael

Updated: January 2010

Capital Gains Taxation: Federal and State

What is capital gains income?

When a taxpayer sells a capital asset, such as stock holdings, a home, or longer-lived business assets, 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 and invested in 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?

The maximum federal income tax rate for most net long-term capital gains income is 15 percent in tax year 2010. There is no tax on capital gains income in 2009 and 2010 for taxpayers in the 10 percent or 15 percent bracket for ordinary income—in tax year 2010 the 0-percent rate applies for married joint filers with taxable income under $67,100. The amount of net capital gains income that qualifies for the maximum 15- or 0-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 0-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 ($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. Beginning in January 2009, the exclusion is apportioned based on the amount of time in which the home was used as the principal residence, from January 2009 to the time of sale.

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 all 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 recognize the federal exclusion of up to $250,000 of gain realized on the sale of the taxpayer's home ($500,000 for married joint taxpayers) and the exclusion of part of the gain on qualified small business stock.

How do other states that impose an individual income tax treat capital gains income in tax year 2009?

- 23 states, including Minnesota, do not provide preferential treatment for capital gains income
- Seven states (Arkansas, Montana, New Mexico, North Dakota, South Carolina, Vermont, and Wisconsin) exclude a portion of capital gains income or allow a credit
- Four states exclude all or part of the gain on property located in the state (Colorado, Idaho, Iowa, and Oklahoma); the exclusion also applies to gains on sale of stocks of in-state companies in Colorado and Oklahoma
- Six states exclude all or part of the gain for certain investments, such as in new businesses or low-income housing (Arkansas, Missouri, Montana, Nebraska, New York, and Utah)
- Three states exclude gains on some or all state and local bonds (Connecticut, Kentucky, and Ohio)
- Rhode Island applies lower rates to capital gains income, depending on how long the taxpayer has held the asset
- Kentucky excludes gains resulting from eminent domain

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

In tax year 2007, about 24 percent of all returns filed by Minnesota residents reported some capital gains income. Married taxpayers filing joint returns received 78 percent of capital gain income. Filers with incomes over $100,000 received over 86 percent of capital gain income, and capital gain income made up over 15 percent of total income for those returns reporting capital gains.

Federal adjusted gross income	$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
			returns with capital gains only	
Less than $50,000	$618	5.7%	15.3%	$2,758
$50,000 to $99,999	$858	7.9%	6.6%	$4,841
$100,000 to $500,000	$3,030	27.8%	9.8%	$17,492
Over $500,000	$6,387	58.6%	28.5%	$418,117
All incomes	$10,893	100.0%	15.5%	$18,470

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

Almost half of taxpayers aged 65 and older reported some capital gains income in tax year 2007. The table shows the percent of gains by age of taxpayer.

Taxpayer age	$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
			returns with capital gains	
Less than 25	$144	1.3%	17.5%	$2,712
25 to 39	$661	6.1%	7.7%	$7,924
40 to 64	$6,606	60.6%	14.5%	$22,890
65 or older	$3,483	32.0%	22.6%	$21,135
All ages	$10,893	100.0%	15.5%	$18,470

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

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Anita Neumann January 2010

ADA Amendments Act of 2008

Title I of the federal Americans with Disabilities Act (ADA) prohibits employment discrimination on the basis of disability. The ADA Amendments Act signed into law on September 25, 2008, and effective January 1, 2009, made significant changes in the law by overturning previous court decisions and directing that changes be made in the regulatory language that limited the scope of the ADA.

What is a disability under the ADA?

The Americans with Disabilities Act defines a disability as:

- a physical or mental impairment that substantially limits one or more major life activities;
- a record of such an impairment; or
- being regarded as having an impairment.

What is the purpose of the 2008 amendments?

In 2008, the U.S. Congress decided the courts and federal regulators had been too restrictive in interpreting the definition of a disability for the purposes of the ADA. The language of the 2008 amendments states that court decisions "have narrowed the broad scope of protection intended to be afforded by the ADA, thus eliminating protection for many individuals whom Congress intended to protect."

What changes do the 2008 amendments make to the ADA?

The new law redefined terms used in ADA regulations and changed the standards of when ADA applies. It directs the Equal Employment Opportunity Commission (EEOC) to revise its regulations defining the term "substantially limits" to conform with the new standards outlined in the act, and it changes the definitions for the terms "major life activity" and "regarded as having an impairment." It also establishes that an impairment that is episodic or in remission is a disability if it would substantially limit a major life activity when active.

The law also reverses U.S. Supreme Court decisions that Congress cited as establishing "inappropriately high" levels of limitation for coverage under the ADA. It directs that the determination of whether an impairment substantially limits a major life activity be made without regard to the "ameliorative effects of mitigating measures."

These items are discussed separately below.

What does "mitigating measures" mean?

The amendments direct that the determination of whether an impairment substantially limits a major life activity must be made "without regard to the ameliorative effects of mitigating measures." Mitigating measures include items like medication; medical supplies, equipment, or appliances; mobility devices; assistive technology; low-vision devices (excluding ordinary eyeglasses or contacts); prosthetics; hearing aids or implants; oxygen therapy equipment and supplies; reasonable accommodations or auxiliary aids or services (including interpreters, readers, and taped text); or learned behavioral or adaptive neurological modifications.

What are "major life activities"?

In the past, major life activities included caring for oneself, performing manual tasks, seeing, hearing, eating, sleeping, walking, standing, lifting, bending, speaking, breathing, learning, reading, concentrating, thinking, communicating, and working.

The inclusion of bodily functions in the definition of major life activities was not, however, as clear-cut. Consequently, the 2008 amendments added bodily functions to the definition of major life activities and provided a nonexhaustive list of those functions including the following:

- functions of the immune system
- normal cell growth
- digestive, bowel, and bladder functions
- neurological and brain functions
- respiratory and circulatory functions
- endocrine functions
- reproductive functions

What does "being regarded as having an impairment" mean?

Under the act, a person is regarded as having an impairment if the person establishes that he or she has been subject to an action prohibited under the ADA as a result of an "actual or perceived physical or mental impairment whether or not the impairment limits or is perceived to limit a major life activity."

These protections, however, don't apply to impairments that are "transitory and minor." The act defines transitory impairments as those with an actual or expected duration of six months or less.

What are reasonable accommodations and modifications?

The ADA Amendments Act did not change the definition of reasonable accommodation but specified that those who meet the definition of impaired only under the "regarded as having an impairment" category are not entitled to accommodation.

For more information: Contact legislative analyst Anita Neumann at anita.neumann@house.mn.

Lisa Larson

February 2010

Federal Race to the Top Grant

Minnesota has applied for federal Race to the Top grant funds

Race to the Top (RTTT) is a $4 billion competitive education grant program under the federal 2009 American Recovery and Reinvestment Act. The program is intended to create state education reform. Minnesota, along with 39 other states and the District of Columbia, applied for grants in January. Ten to 15 of the first round of applicants are expected to receive a grant in April; states that do not receive a grant may apply in the second round in June.

The U.S. Department of Education issued RTTT guidelines to advise states interested in applying for a grant. The guidelines place states in one of five funding categories, based on states' population of children ages five to 17. Minnesota is in category four, which has a suggested budget range for grants of between $60 million to $175 million.

States must meet federal guidelines in six different areas

The federal guidelines assigned a total of 500 points to the following six selection criteria that each state must address in its application:

- **State success factors** (125 points). These must articulate a state's education reform agenda and school districts' role in implementing that reform in four core areas, build statewide capacity to implement and sustain a state's reform agenda, and demonstrate significant state progress in raising student achievement and closing academic achievement gaps.
- **Standards and assessments** criteria (70 points). These require a state to adopt a common set of core English-language arts and math standards, develop and implement common assessments aligned with the standards, and support the transition to these standards and assessments.
- **Data systems** criteria (47 points). These require a state to fully implement a statewide longitudinal data system, and access and use state data to improve instruction, among other uses.
- **Great teachers and leaders** criteria (138 points). These require a state to provide alternative routes for licensing teachers and principals, use student performance data to improve teacher and principal effectiveness, ensure equitable distribution of effective teachers and principals, improve teacher and principal preparation programs, and provide support to teachers and principals.
- **Turnaround struggling schools** criteria (50 points). These require a state to intervene in and turn around the lowest achieving schools and districts.
- **General selection criteria** (55 points). These require a state to make education funding a priority, ensure successful conditions for high-performing charter schools and other innovative schools, and demonstrate other significant reform conditions.
- An **optional science, technology, engineering, math (STEM) emphasis** (15 points) requires a state to have a plan to offer a rigorous STEM course

of study, cooperate with community-based STEM partners, and prepare students for STEM advanced study and careers.

A successful state must allocate at least 50 percent of its RTTT grant to districts

Federal reviewers will review and rate each state's application. A successful state applicant must allocate at least 50 percent of the grant to local school districts, based on their relative share of federal Title I funding provided to districts for at-risk students living at or near poverty. A district must use the grant funds it receives in a manner that is consistent with the state's RTTT reform plan and any applicable district agreements. The remainder of the state grant must be used to support the state's RTTT reform plan.

Only school districts that sign a memorandum of understanding (MOU) are eligible to receive funds. Even districts that do not sign an MOU must comply with some statewide elements of the RTTT plan. For example, all districts must adopt common core standards.

Minnesota's application includes proposals for a number of policy changes in the K-12 education system

Minnesota's RTTT application, among other things, proposes to:

- adopt a common set of nationwide core K-12 standards in English-language arts and math that build toward college and career readiness and to participate in a consortium working to develop high quality assessments aligned with these standards;
- have the state Board of Teaching and the state Board of School Administrators amend their rules to support alternative licensure programs consistent with RTTT guidelines and adopt a three-tiered licensure structure;
- implement a teacher and principal evaluation system premised on using student growth data as a "significant" factor in making employment-related decisions;
- implement an enhanced and more uniform Q-Comp plan for districts that would, among other things, include principals, require peer assistance and review, grant tenure to effective teachers based on evaluation outcomes, use individual, class, and school-level student growth data to evaluate teachers, and use school-level student growth data to evaluate teachers and principals;
- use financial and nonfinancial incentives to provide greater flexibility in placing and retaining highly effective teachers and principals in high-need schools and subject areas throughout the state;
- have the state Board of Teaching amend its rules to require that all approved teacher preparation programs with 20 or more program graduates provide the state with student proficiency and growth data and other data related to program graduates; and
- use an Office of Turnaround Schools that is separate from the Minnesota Department of Education and the newly enacted site-governed schools model to intervene in the persistently lowest-achieving schools and in districts in improvement or corrective action status.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

HOUSE RESEARCH | Short Subjects

Joel Michael

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Single Sales Apportionment of Corporate Franchise Tax

Apportionment is a key feature of state corporate taxes

Apportionment formulas are important features of state corporate income taxes. They determine how much of a business's income is taxable and affect the incidence and competitiveness of the tax. Minnesota apportions corporate income using the Minnesota proportions of the corporation's sales, payroll, and property factors to determine corporate franchise tax.

Minnesota is phasing in single sales apportionment

Under legislation enacted in 2005, Minnesota is phasing in single sales apportionment over an eight-year period beginning in tax year 2007. The table shows the phase-in schedule for the transition to single sales apportionment from 2010 to 2014.

Tax year	Sales	Property	Payroll
2010	87%	6.5%	6.5%
2011	90%	5.0%	5.0%
2012	93%	3.5%	3.5%
2013	96%	2.0%	2.0%
2014	100%	0.0%	0.0%

Effects vary by type of business

The effects of adopting single sales apportionment vary by business. The crucial variables are the business's Minnesota apportionment factors:

- The taxes of businesses with all of their property, payroll, and sales in Minnesota will be unaffected.
- Minnesota businesses whose Minnesota sales factor is lower than the average of their Minnesota property and payroll factors will receive a tax cut. The larger the disparity, the bigger the benefit is. A classic example is a business with most of its operations (headquarters, plants, and so forth) in Minnesota, but most of its sales outside of Minnesota.
- Businesses with higher Minnesota sales factors than their average Minnesota property and payroll factors will have tax increases. One example is a national consumer products company with few facilities in Minnesota.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is an economic development argument: It makes Minnesota more competitive in attracting investment in plant and equipment. Sales are determined by the buyer's location. All other things being equal, increasing non-Minnesota sales will reduce the amount of Minnesota taxable income, since more income will be attributed to or apportioned outside of Minnesota. Thus, increasing the weight for the sales factor creates an incentive for companies to invest in Minnesota property or to hire more employees (or reduces the tax's disincentive to do so) to sell products outside of Minnesota. Empirical studies have found some support for the idea that single sales apportionment encourages in-state investment.

Policy concerns with single sales apportionment: equity and tax theory

Opponents of single sales apportionment argue that it shifts the burden of the tax from capital (the property factor) to consumption, reducing the progressivity of the tax. Some also question as an empirical matter whether it has the desired effects on competitiveness. Tax theorists argue that if the corporate tax is to be a benefits tax (i.e., based on businesses' use of government services) or if it is to be based on production of income, apportionment should take into account where the business's property and employees are located. These factors are important contributors both to the production of income and the consumption of government services.

Sales-weighted apportionment reduces revenues

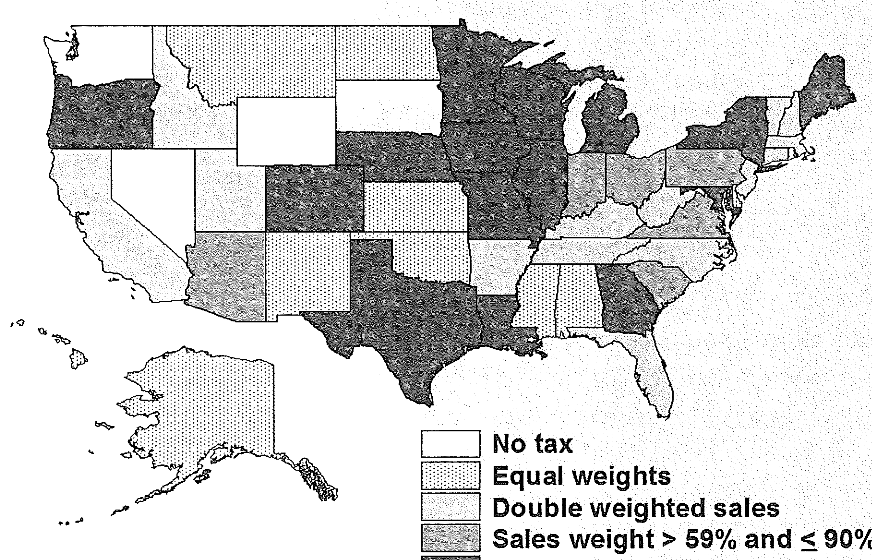
Compared with equally weighting each of the apportionment factors, weighting sales more heavily reduces Minnesota tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2010) shows an expenditure cost of $111 million for fiscal year 2010, rising to $214 million in 2013.

Trend in other states to heavier sales weighting

States have been increasingly shifting their apportionment formulas to more heavily weighted sales. Effective for tax year 2010, 14 states will use or allow single sales as their apportionment formula for manufacturers. This is up from seven states for tax year 2005. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Iowa, Michigan, Missouri, Nebraska, and Wisconsin. California and Indiana are scheduled to use single sales in 2011, South Carolina in 2013, and Virginia (in addition to Minnesota) in 2014. The map below shows the apportionment formulas for manufacturers as of tax year 2010. Some states allow elections between two formulas. The map shows these with the highest permitted sales weighting.

Apportionment of Corporate Income

Applicable to Manufacturers



Source: Federation of Tax Administrators and CCH

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *Apportionment of Corporate Franchise Tax*, October 2008.

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Kathy Novak Updated: February 2010

Financial Aid for Higher Education: Minnesota State Grant Program

Minnesota's state grant program provides need-based financial aid to Minnesota undergraduates to attend a public or private postsecondary institution located in Minnesota. Administered by the Office of Higher Education (OHE), the state grant program is not an entitlement but available up to the limits of state appropriations.

Who is eligible for a state grant?

Undergraduate students must apply for a state grant within 30 days after the start of the term. Eligible students are Minnesota residents who are high school graduates or age 17 or older and able to meet admission requirements of a participating postsecondary institution. Students must demonstrate financial need and must not be in default on student loans or in arrears for child support.

A Minnesotan must meet one of the following residency criteria: lived in the state for one year without attending a postsecondary institution; be a dependent of a resident; a graduate of a Minnesota high school, or GED recipient, while living in Minnesota and physically attending an eligible institution; in the military on active service in Minnesota or a spouse or dependent; relocated to Minnesota due to a declared disaster interrupting postsecondary education; or a legal refugee residing in Minnesota.

Financial need is based on the student's ability to meet the cost of attending the selected postsecondary institution according to the standard for federal financial aid, including the Pell grant program.

How much aid is available through the state grant?

State law requires grant awards to be based on a shared responsibility for paying for the recognized cost of attendance with:

- students responsible for 46 percent of the cost of attendance;
- a deduction for the federal contribution through the Pell Grant; and
- the family's financial share determined by the federal needs analysis (FAFSA).

The cost of attendance is equal to the amount of tuition and fees up to a cap set in law plus an allowance, also set in law, for living and miscellaneous expenses (LME). For academic years 2009-10 and 2010-11, the tuition maximums are $10,488 for four-year programs and $5,808 for two-year programs. The LME allowance for two- and four-year programs is set at $7,000 per year. The LME allowance is used to calculate the state grant award and is not a separate payment category. Minnesota law requires OHE to increase the LME if it has excess appropriations above what are needed to fund grants.

Except for the Minnesota GI Bill and private and institutional aid, the state grant is the last aid contribution to the cost of attendance. In fiscal year 2009, 84,518 received a state grant. The law sets the minimum state grant at $100. In fiscal year 2009, the overall average state grant was $1,698. The average grant varies by type of institution: $858 at Minnesota State Colleges and Universities (MnSCU) two-year; $1,246 at private for-profit; $1,854 at MnSCU four-year; $3,076 at private nonprofit; and $3,300 at the University of Minnesota.

Are part-time students and independent students eligible?

Part-time students are eligible for a state grant based on the cost of attendance, prorated for the number of credits the student is taking. Independent students (generally students who are not dependents for tax purposes) are also eligible, but are responsible for a larger share of the cost of attendance.

How is the state grant program funded?

The legislature appropriates money from the general fund to OHE for the state grant program based on OHE's estimate of what is needed to fully fund projected grant awards. State law allows OHE to carry a balance from the first year of the biennium to the second year and authorizes the transfer of money to and from other financial aid programs. Surplus appropriations must be used to increase the LME.

Are eligible students entitled to a state grant?

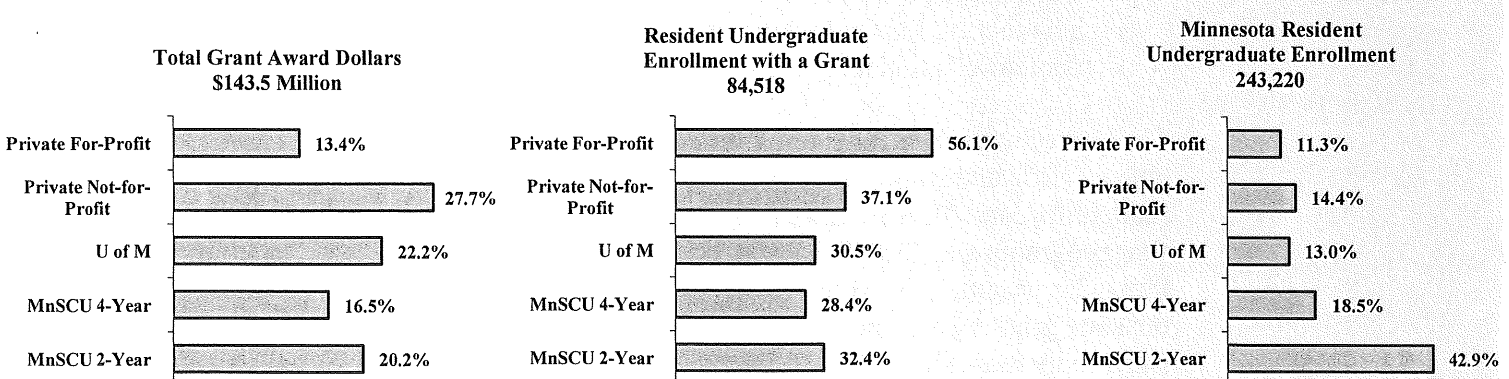
Under state law, the state grant program is not an entitlement. OHE must award grants based on available funding. If funding is insufficient to make full awards, OHE is required, by law, to reduce all grants by adding a surcharge to the family responsibility and increasing the student's responsibility by a percentage.

How do grants compare to enrollment at state postsecondary institutions?

The graphs below summarize participation in the state grant program in fiscal year 2009 and compare it to resident enrollment. In fiscal year 2009, $143.5 million in state grant awards were distributed to 84,518 recipients. Thirty-five percent of the 243,220 resident undergraduate students who attended participating Minnesota public and private postsecondary institutions received a state grant.

Public two-year colleges receive a much smaller share of grant dollars (20 percent) than their share of enrollment (43 percent). All other higher education sectors receive more grant dollars than their respective share of resident enrollment, as shown in the graphs below.

Distribution of State Grants and Minnesota Resident Enrollment by Institution Type
Fiscal Year 2009



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Nina Manzi and Joel Michael

Updated: April 2010

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 2010, businesses can claim up to $250,000 of property expenditures under section 179. If a business places more than $800,000 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 $1,050,000 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 2010. 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 2010, 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 $200,000, so that a business that places in service more than $225,000 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 2010 and 16 percent per year in tax years 2011 through 2015.

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

Over the last eight 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 $200,000 to $225,000. From 2003 to 2010, Congress has seven times enacted legislation that provides temporary increases in the maximum section 179 deductions and the "phase-out" limit; the legislation also indexes the temporarily increased amounts for inflation. This legislation is summarized in the following table.

Summary of Federal Section 179 Legislation 2003-2010

Year	Maximum deduction	Phaseout	Indexing	Expiration
2003	$25,000, increased to $100,0000	$200,000, 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
2008 and 2009	$250,000	$800,000	No	2010
2010	$250,000	$800,000	No	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, 2006, and 2008 legislative sessions, the legislature elected not to conform to the higher federal section 179 allowances.

Instead of conforming Minnesota's tax to the increased federal amounts, the 2005, 2006, and 2008 omnibus tax laws require 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	$24,000	$200,000	$24,000	$200,000
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	200,000
2007	125,000	500,000	25,000	200,000
2008-2010	250,000	800,000	25,000	200,000

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HOUSE RESEARCH | Short Subjects

Lisa Larson

May 2010

School Improvement Grant (SIG) Program

SIGs are designed to rapidly improve states' persistently lowest-achieving schools

Federal school improvement grants (SIG) are available to state education departments and local school districts under the American Recovery and Reinvestment Act and the Elementary and Secondary Education Act. These voluntary onetime federal grants are designed to help states and districts intervene in and support "persistently lowest-achieving schools" and to rapidly improve those schools. Only the lowest 5 percent of persistently lowest-achieving Title I schools, secondary schools that are eligible for but do not receive Title I funds, and Title I secondary schools with a high school graduation rate below 60 percent are eligible to receive SIG funds.

Minnesota received a $34-million grant to turn around its persistently lowest-achieving schools

The Minnesota Department of Education (MDE) applied to the U.S. Department of Education for SIG funds in February 2010. The application required the department to indicate how it would identify Minnesota's persistently lowest-achieving schools as measured by rates of student proficiency and growth in reading and math and high school graduation rates. In March 2010, Minnesota received an initial grant of $34 million. Minnesota must use the grant money to turn around its persistently lowest-achieving 5 percent of Title I schools and charter schools by September 30, 2013. The department anticipates receiving an additional $4 million to $5 million in SIG funds in fiscal year 2011.

No Child Left Behind imposes sanctions on schools not making adequate yearly progress for two or more years

The 2001 federal No Child Left Behind Act (NCLB) imposes sanctions on Title I schools and school districts not making adequate yearly progress (AYP) toward student achievement targets. A school that does not make AYP for two or three consecutive years is in need of improvement. A school that does not make AYP for four consecutive years is in corrective action. A school that does not make AYP for five consecutive years is subject to restructuring in the subsequent two years. Eligible low-achieving schools identified for improvement, corrective action, or restructuring can use SIGs to help make AYP and thereby change their status. According to a 2008 Center on Education Policy report, in the 2007-2008 school year 3,500 schools in the United States, or 7 percent of all Title I schools, were subject to restructuring.

Low-achieving schools that receive SIG funds must implement one of four school intervention models

Persistently lowest-achieving Title I schools identified for improvement, corrective action, or restructuring under NCLB and Title I high schools with a graduation rate below 60 percent can apply to the MDE for SIG funds. To effect the rapid school improvement envisioned under the SIG program, participating schools must adopt one of four school intervention models:

- The turnaround model calls for replacing the school principal and at least 50 percent of the school staff
- The restart model calls for converting or reopening a school and then

placing it under a charter school operator, a charter management organization, or an education management organization

- The school closure model calls for closing a school and enrolling the students who attended the school in other, higher achieving district schools
- The transformation model calls for replacing the principal and implementing a new evaluation system to identify and reward educators who improve student outcomes and to remove educators who do not improve student outcomes

Schools that receive SIG funds must begin implementing an approved school intervention model in the 2010-2011 school year.

Circumstances may prevent using a particular school intervention model

Some policymakers argue that the inflexibility of the four school intervention models prevents these models from being equally available or appropriate in all schools. For example, circumstances in rural areas may limit or preclude access to qualified school staff, management contractors, or school leaders. Schools providing students with targeted programs leading to high school graduation that extend beyond traditional graduation guidelines also may be poorly accommodated under this program.

SIG schools are arranged into three tiers to prioritize funding

To prioritize the allocation of SIG funds, states must identify three tiers of Title I schools that qualify for SIGs, giving greatest priority to the lowest tier of chronically low-achieving schools.

- Tier I schools are those Title I schools under NCLB that are in improvement, corrective action, or restructuring, and are identified by MDE as one of the state's persistently lowest-achieving schools
- Tier II schools are eligible for but do not receive Title I funds and are identified by MDE as a persistently lowest-achieving school
- Tier III schools are those Title I schools under NCLB that are in need of improvement, corrective action, or restructuring, and are not Tier I schools

SIG-funded interventions and supports may vary by tier.

2010 omnibus K-12 bills included provisions addressing the "persistently lowest-achieving school" designation

Some policymakers were concerned about unintended consequences related to a school's designation as a persistently lowest-achieving school and the inflexibility of the school intervention models. To address these concerns, legislators included a SIG provision in the 2010 omnibus K-12 education bills directing the education commissioner, at the request of an affected school, to seek a federal exception to that school's lowest-achieving school designation if the affected school showed high student growth in the 2007-2008 through the 2009-2010 school years and was identified as a persistently lowest-achieving school based on its high school graduation rate or because it provided a graduation incentives program. The legislature failed to pass an omnibus K-12 education bill in the 2010 regular or special session and the SIG provision was not enacted.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036. Also see the House Research publication *Adequate Yearly Progress Under the No Child Left Behind Act*, November 2003.

HOUSE RESEARCH | Short Subjects

Patrick McCormack

Updated: June 2010

Minnesota's Laws on Tastings and Samples of Alcohol

Minnesota Statutes make a distinction between events for the tasting of alcoholic beverages and the provision by vendors of free samples of wine, beer, and liquor.

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 allows charitable, religious, or other nonprofit groups to conduct tastings, defined as "an event at which persons pay a fee or donation to participate, and are allowed to consume wine, distilled spirits, or intoxicating malt liquor by the glass without paying a separate charge for each glass."

Tastings are limited as follows:

- Nonprofits or charities may conduct tastings of beer, distilled spirits, and 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 alcohol may be sold, or orders taken, for off-premises consumption
- A charity or nonprofit may conduct a tasting at its own premises, a donated premises, or at an establishment run by the holder of a permanent on-sale license
- A licensed wholesaler may sell or give wine or distilled spirits 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 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 alcohol at the event, but does allow forms indicating alcohol preferences to be filled out. Fees charged may only be used to defray costs, and cooperation with wine or distilled spirits wholesalers is allowed.

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 may hold other licenses, including on-sale licenses in order to operate bars or restaurants. A new law in 2008 allows farm wineries to produce distilled spirits and to give 15-milliliter samples of each variety produced.

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.

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

Joel Michael

Updated: July 2010

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 taxes and fees are set on a per-unit basis, they do not increase as the prices of cigarettes increase. (The tax in lieu of the general sales tax on cigarettes is annually indexed for inflation in the price of cigarettes so it increases with overall increases in cigarette prices.) 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. Thus, these taxes fluctuate as the prices of the products change.

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 effective August 1, 2010)	34.6 cents	NA

A per-pack tax applies in lieu of the state general sales tax

Since 2005, cigarette sales have been exempt from state and local general sales taxes. A per-pack tax applies instead of the state tax. The commissioner of revenue annually sets this in-lieu tax based on a survey of retail prices of cigarettes in the state. The rate is set as an average of these prices and is reset each August 1 (starting in 2011, it will be reset each January 1). The in lieu tax does not replace local sales taxes, although cigarette sales are exempt from these local taxes.

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. Michigan and Utah also impose a 35-cent surcharge on these cigarettes.

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. The United States Supreme Court in both instances declined to hear the cases. *Council of Independent Tobacco Mfr. v. State,* 713 N.W.2d 300 (Minn. 2006) *cert. denied* 549 U.S. 1052 (2006) (fee on nonsettling companies); *State v. Philip Morris,* 713 N.W.2d 350 (Minn. 2006) *cert. denied* 549 U.S. 1206 (2007) (health impact fee).

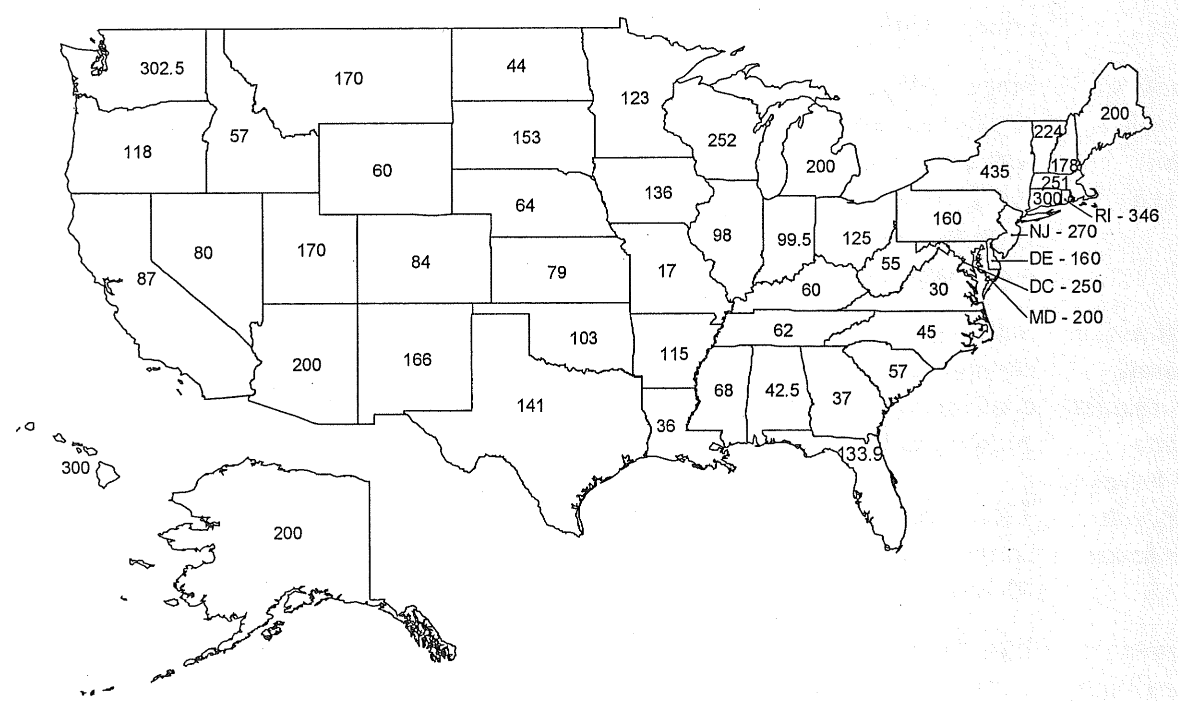
The taxes and fees are estimated to yield revenues of over $406 million in FY 2011

For fiscal year 2011, Minnesota Management and Budget estimates collections from the two excise taxes and the sales tax on cigarettes will be $210.8 million and from the health impact fee, $195.4 million (February 2010 forecast). Revenues from the tobacco products tax are deposited in the general fund. Each fiscal year, 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 higher 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 Minnesota's tax and fee ($1.23/pack), three bordering states have higher rates: Wisconsin ($2.52), South Dakota ($1.53), and Iowa ($1.36). North Dakota (44 cents) has a lower rate. All states' rates are shown on the map below. The map does not reflect local cigarette taxes; some of these local taxes are substantial (e.g., $1.50 in New York City and $2.68 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.

State Cigarette Tax Rates*
as of 7/1/2010
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.

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HOUSE RESEARCH | Short Subjects

Mark Shepard

Updated: July 2010

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 most recent salary increases for judges were 3 percent, and took effect in July 2008 as required under a 2007 law. Laws 2007, ch. 54, art. 1, § 3. Annual salaries for various judges are as follows:

Official	Salary
Supreme Court, chief	$160,579
Supreme Court, justice	$145,981
Court of Appeals, chief	$144,429
Court of Appeals, justice	$137,552
District Court, chief	$135,580
District Court, judge	$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 5 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.

Lisa Larson

Updated: July 2010

Minnesota's High School Graduation Requirements

Students must meet state and local high school graduation requirements

To graduate from a Minnesota public high school, a student must meet the state's course credit and testing requirements and any additional local requirements established by the school district. State graduation requirements are outlined in Minnesota Statutes, chapter 120B, and Minnesota Rules, chapter 3501. Students also must pass three standards-based tests in reading, math, and writing.

Minnesota requires students to complete 21.5 required and elective course credits

State course credit requirements for graduating from high school require students to complete 21.5 course credits:

- four language arts credits
- three math credits in algebra, geometry and statistics, and probability; students in the class of 2015 and later also must complete an algebra II credit (or its equivalent) as part of this three-credit requirement
- three science credits that include one biology credit; students can use an agriculture science course to meet a general science credit, and students in the class of 2015 and later also must complete one physics or chemistry credit as part of this three-credit requirement
- three-and-a-half social studies credits in U.S. history, geography, world history, economics, and government and citizenship, or three social studies credits in U.S. history, geography, world history, government and citizenship, and half a credit in economics taught in the social studies, business, or agriculture education department of a high school
- one art credit
- seven elective credits

Beginning in the 2012-2013 school year, students must also have physical education, based on standards developed by the National Association for Sport and Physical Education.

A course credit signifies that a student successfully completed an academic year of study in a particular subject area or the district otherwise determined that the student mastered the subject area. Students may use a career and technical education course to meet a general science, math, or art credit.

State graduation requirements apply to ELL students and children with disabilities

Students with limited English proficiency, or English language learners (ELL), must meet the same graduation requirements as all other students. Children with disabilities must be given accommodations that are appropriate to their strengths and needs, and that permit equal access to and work toward grade-level content standards.

Students also must complete local graduation requirements

The state requires each district to establish standards in local graduation requirements for health, and also for physical education until the 2012-2013 school year when state physical education standards apply. Districts also must establish standards in career and technical education and world languages, and must offer elective courses in these two subject areas. Districts may impose additional local graduation requirements.

Students must pass the GRAD writing, reading, and math tests; limited exceptions apply to some students

To graduate from high school, a Minnesota public school student who entered grade 8 in the 2005-2006 school year or later must pass three standards-based Graduation Required Assessment for Diploma (GRAD) tests: writing in grade 9; reading in grade 10; and math in grade 11. The few remaining who entered grade 8 in the 2004-2005 school year or earlier who have not yet graduated must pass three minimum-competency Basic Skills Tests (BSTs): reading and math in grade 8; and writing in grade 10. A student who does not pass may retake a test according to an established retest schedule. Students in the classes of 2010 through 2014 who do not pass the math GRAD test may still graduate if they meet all other specified requirements.

Students with limited English proficiency who first enroll in a Minnesota public school in grade 9 or above need not pass the GRAD tests to graduate. Other public school students in unique situations must pass the GRAD reading, math, and writing tests; those students include dual enrollment students, foreign exchange students, open enrollment students, postsecondary enrollment options students, district-placed students, students attending school under a tuition agreement, students without an individualized education program (IEP) placed for care and treatment, and students without an IEP program in a correctional facility.

GRAD test items that students must pass to graduate are embedded in the reading and math MCA-IIs

The GRAD reading and math test items that students must pass to graduate in Minnesota are embedded in the reading and math Minnesota Comprehensive Assessments-Series II (MCA-IIs). Students' GRAD test scores and MCA-II test scores are reported separately. The state and districts use students' GRAD test scores to determine whether students graduate. The state and districts use students' MCA-II test scores to comply with a federal requirement that districts demonstrate adequate yearly progress sufficient to have all students proficient in reading and math by the 2013-2014 school year. Also to comply with federal law, many 11th grade ELL students take the Mathematics Test for English Language Learners (MTELL), which assesses the same grade-level math standards as the math MCA-II.

MTAS is an alternative assessment for students with significant cognitive disabilities

Students with IEPs and significant cognitive disabilities can take the Minnesota Test of Academic Skills (MTAS) instead of the GRAD reading and math tests. The MTAS is an alternative assessment in reading, math, and science that is based on alternative achievement standards and measures the extent to which students are making progress in the general curriculum. Students with IEPs and significant cognitive disabilities also can take the Alternative Assessment for Writing, which is an alternative assessment for the GRAD writing test.

The MCA II high school science test is not a graduation requirement

Although the federal No Child Left Behind Act requires states to administer a science test to high school students, students do not need to pass the high school science MCA II to graduate. State law prohibits the education commissioner from requiring students to receive a passing score on high school science assessments as a condition of receiving a diploma.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

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Lisa Larson

July 2010

Voluntary School Integration: 2007 U.S. Supreme Court Decision

The U.S. Supreme Court ruled that districts with voluntary integration plans may not use race in assigning students to public schools

The most recent voluntary school integration case decided by the U.S. Supreme Court, *Parents Involved in Community Schools v. Seattle School District No. 1*, 551 U.S. 701 (2007), and a companion case, *Meredith v. Jefferson County Board of Education*, challenged school districts' race-conscious attendance policies under the Equal Protection Clause of the Fourteenth Amendment.

The Fourteenth Amendment serves to prevent and remedy segregation and eliminate the inequitable separation of races. It also gives equal opportunity to every person regardless of race and protects against denying a person an opportunity because of race. The Court struck down the districts' voluntary integration plans under a strict-scrutiny analysis, ruling that the district plans were not narrowly tailored to the districts' asserted interests and that "the way to stop discrimination on the basis of race is to stop discriminating on the basis of race." The Court uses strict scrutiny in cases where government action "distributes burdens or benefits on the basis of individual racial classifications."

Districts used racial balancing to decide school admissions and reflect the racial composition of the district

In Seattle, the school district's open choice policy allowed incoming ninth graders to choose which high school they wanted to attend. The district used two tie breakers to decide which students to admit to an oversubscribed high school: whether a sibling already attended the high school; and whether a student would disrupt the school's racial balance. In Louisville, after a court removed a decree ordering the Jefferson County schools to desegregate, the county adopted a voluntary student assignment plan, assigning kindergarteners, first graders, and transfer students based on available space and racial guidelines and denying admission to middle school and high school students who disrupted those racial guidelines.

The Court concluded that racial diversity was not a compelling government interest to justify race-based admissions

The Court rejected the two school desegregation plans based on a strict-scrutiny analysis that requires government actions to be narrowly tailored to achieve a compelling government interest. In these cases, the Court considered whether the student assignment plans were narrowly tailored and whether the goal of racial diversity among students was a compelling government interest. The Court concluded that districts' interest in achieving student diversity, while a worthy goal, did not allow districts to discriminate based on race and did not subject their racial classifications to anything less than strict scrutiny.

The Court allows public schools to use race-based assignments to remedy past discrimination

According to the Court, public schools may use race to assign students to public schools to: remedy past intentional segregation; or create educational diversity in higher education, consistent with *Grutter v. Bollinger*, a case about whether a law school may use race-conscious admissions criteria. The Seattle school district had no history of forced segregation and Jefferson County was not required to desegregate schools after its desegregation decree was removed. In *Grutter*, however, the Court allowed the University of Michigan to consider an applicant's race among other factors when deciding who would benefit its law school by contributing to a more diverse experience. The university could include race as a basis for admission to its law school because it evaluated student applicants as individuals and not as members of a racial group.

The Court found the school admissions plans were tied to racial demographics

A plurality of justices held that racial diversity in elementary and secondary schools was not a sufficiently compelling government interest to justify race-based admissions. These justices were not persuaded by the Seattle district's argument that its admissions plan served a compelling government interest both in undoing the school segregation caused by the city's housing patterns and in providing a superior, racially diverse learning environment. The justices rejected the district argument, finding that the schools' admissions plans were tied to "specific racial demographics, rather than to any pedagogical concept of the level of diversity needed to obtain the asserted educational benefits."

A plurality of the Court concluded that promoting racial diversity in schools was not a compelling interest

From the Court's perspective, the districts impermissibly engaged in racial balancing, using students' race to manipulate school admissions in an effort to better reflect the racial composition of the district. According to the Court, the Fourteenth Amendment requires government to "treat its citizens as individuals, not as simply components of a racial, religious, sexual, or national class"; the Court would not create an exception based on a goal of promoting racial diversity. This construction parallels an assertion in *Brown v. Board of Education*, that differential treatment of students based on race alone is detrimental to the students' education and unconstitutional under the Fourteenth Amendment.

Justice Kennedy suggested that schools may use race-conscious alternatives to achieve racial diversity without discrimination

The Court also found that the districts' race-based admissions plans were not narrowly tailored, which a strict-scrutiny analysis requires, and that the districts had failed to consider race-neutral alternatives as a way to achieve racial diversity in schools. Furthermore, unlike *Grutter* where race had been one of a number of factors for determining admission, the districts used race as a primary or the sole factor in assigning students.

Justice Kennedy, whose concurrence serves as the controlling opinion, suggested that diversity for the purpose of offering all students equal educational opportunity may be a compelling interest and that schools may achieve diversity through race-neutral alternatives such as strategically placed new schools, demographically sensitive attendance zones, and the allocation of resources for special programs. According to Justice Kennedy, these race-conscious alternatives, which can achieve racial diversity in schools without racial discrimination, would be constitutionally permissible. Justice Kennedy's concurring opinion may allow districts to consider race in limited circumstances when making school assignments.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

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HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: July 2010

Survey of State and Local Gasoline Taxes

This short subject shows state and local gasoline taxes in each state, as of July 1, 2010. Because of the interrelationship in many states between per-gallon gasoline taxes and gasoline sales taxes, and between state and local gasoline taxes, a compilation of all such taxes is necessary to reflect the total tax burden on gasoline in each state. While all states impose per-gallon taxes, eight states also impose sales taxes (which fluctuate based on price) and ten states allow local gas or sales taxes to be imposed. Minnesota's total tax burden on gasoline, which includes the 27.5-cent per-gallon excise tax plus the 2.1-cent per-gallon Petrofund cleanup and inspection fees, places it 15th highest based on state taxes only and 17th highest based on total state and local taxes.

Gasoline taxes include state and local taxes

The columns in the table below represent the following:

- State excise tax: Per-gallon tax on gasoline imposed at the state level
- State sales tax: State retail sales tax applied to gasoline; in some states, the sales tax rate is prefigured and prepaid at the wholesale level rather than being calculated and paid at the pump
- Other state tax/fee: Leaking underground storage fees, inspection fees, various environmental fees; in some states, including Minnesota, these are "blink-on" taxes that are imposed whenever a specified fund reaches a certain level; the table assumes these blink-on taxes apply
- Total state taxes: Combined per-gallon tax, sales tax, other state taxes and fees;
- Local excise tax: Locally imposed per-gallon taxes in the largest city in the state (previous editions used an average of these taxes)
- Local sales tax: Local retail sales taxes that apply to gasoline in the largest city in the state (previous editions used an average of these taxes)
- Total local tax: Combined local gas taxes and sales taxes
- Total tax: Combined state and local taxes

For price-based taxes, the AAA Daily Fuel Gauge Report for June 28, 2010, was used for the applicable city. This price was adjusted in those states that impose a sales tax on gasoline, but exclude state or federal per-gallon taxes from the taxable price.

Total State and Local Taxes on Gasoline as of July 1, 2010

	State Excise Tax	State Sales Tax	Other State Tax/Fee	Total State Tax	State Rank	Local Excise Tax	Local Sales Tax	Total Local Tax	Total State and Local Tax	Total Taxes Rank
Alabama	$0.160		$0.049	**$0.209**	36	$0.010		**$0.010**	**$0.219**	35
Alaska	0.080			**0.080**	50				**0.080**	50
Arizona	0.180		0.010	**0.190**	40				**0.190**	41
Arkansas	0.215		0.003	**0.218**	34				**0.218**	36
California	0.180	$0.228		**0.408**	2		$0.079	**0.079**	**0.486**	4

Total State and Local Taxes on Gasoline as of July 1, 2010										
	State Excise Tax	State Sales Tax	Other State Tax/Fee	Total State Tax	State Rank	Local Excise Tax	Local Sales Tax	Total Local Tax	Total State and Local Tax	Total Taxes Rank
Colorado	0.220			**0.220**	32				**0.220**	33
Connecticut	0.250		0.162	**0.412**	1				**0.412**	5
Delaware	0.230		0.011	**0.241**	24				**0.241**	27
Florida	0.040	0.160	0.022	**0.222**	31	0.126	0.027	**0.153**	**0.375**	7
Georgia	0.075	0.104		**0.179**	44		0.078	**0.078**	**0.257**	23
Hawaii	0.170	0.137	$0.055	**0.362**	7	$0.165	0.017	**0.182**	**0.544**	2
Idaho	0.250		0.010	**0.260**	19				**0.260**	22
Illinois	0.190	0.162	0.011	**0.363**	6	0.110	0.078	**0.188**	**0.550**	1
Indiana	0.180	0.170	0.010	**0.360**	8				**0.360**	9
Iowa	0.210		0.010	**0.220**	33				**0.220**	34
Kansas	0.240		0.010	**0.250**	20				**0.250**	24
Kentucky	0.227		0.014	**0.241**	23				**0.241**	26
Louisiana	0.200			**0.200**	37				**0.200**	38
Maine	0.295		0.015	**0.310**	14				**0.310**	16
Maryland	0.235			**0.235**	28				**0.235**	30
Massachusetts	0.210		0.025	**0.235**	29				**0.235**	31
Michigan	0.190	0.171	0.009	**0.369**	4				**0.369**	8
Minnesota	**0.275**		**0.021**	**0.296**	**15**				**0.296**	**17**
Mississippi	0.180		0.004	**0.184**	42				**0.184**	43
Missouri	0.170		0.006	**0.176**	45				**0.176**	45
Montana	0.270		0.008	**0.278**	18				**0.278**	20
Nebraska	0.271		0.009	**0.280**	16				**0.280**	18
Nevada	0.240		0.008	**0.248**	21	0.100		**0.100**	**0.348**	10
New Hampshire	0.180		0.016	**0.196**	39				**0.196**	40
New Jersey	0.105		0.040	**0.145**	48				**0.145**	48
New Mexico	0.170		0.019	**0.189**	41				**0.189**	42
New York	0.080	0.116	0.167	**0.363**	5		0.142	**0.142**	**0.505**	3
North Carolina	0.319		0.003	**0.322**	13				**0.322**	15
North Dakota	0.230			**0.230**	30				**0.230**	32
Ohio	0.280			**0.280**	17				**0.280**	19
Oklahoma	0.160		0.010	**0.170**	46				**0.170**	46
Oregon	0.240			**0.240**	25	0.030		**0.030**	**0.270**	21
Pennsylvania	0.120		0.203	**0.323**	11				**0.323**	13
Rhode Island	0.320		0.010	**0.330**	9				**0.330**	11
South Carolina	0.160		0.008	**0.168**	47				**0.168**	47
South Dakota	0.220		0.020	**0.240**	26				**0.240**	28
Tennessee	0.200		0.014	**0.214**	35				**0.214**	37
Texas	0.200			**0.200**	38				**0.200**	39
Utah	0.245			**0.245**	22				**0.245**	25
Vermont	0.190		0.048	**0.238**	27				**0.238**	29
Virginia	0.175		0.006	**0.181**	43				**0.181**	44
Washington	0.375			**0.375**	3				**0.375**	6
West Virginia	0.205		0.117	**0.322**	12				**0.322**	14
Wisconsin	0.309		0.020	**0.329**	10				**0.329**	12
Wyoming	0.130		0.010	**0.140**	49				**0.140**	49

Note: The table does not include special tax rates for alcohol-gasoline blends or for gasoline used in commercial vehicles.
Sources: AAA Daily Fuel Gauge Report; Commercial Clearing House, *State Tax Guide*; Federation of Tax Administrators; American Petroleum Institute; and state revenue agency websites.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn.

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

Karen Baker and Steve Hinze

Updated: July 2010

Minnesota's Green Acres Program
And Other Property Tax Preference Programs for Rural Lands

What is the Green Acres program?

The Green Acres program, formally called the Minnesota Agricultural Property Tax Law, allows eligible agricultural property to be taxed at a value less than its full market value. Under Green Acres, when the market value of agricultural property is influenced by other potential uses of the property, such as residential or retail development, or for recreational purposes, the assessor is required to value the property based only on its agricultural value.

How does the program work?

The county assessor annually determines the property's full estimated market value (based on its "highest and best use") and its agricultural value, and computes property taxes for both valuations. The landowner's property taxes are based on the agricultural value, and most special assessments are deferred. When enrolled property is sold or transferred, it may be reenrolled by the new owner if it continues to qualify, and no back-taxes are due at the time of the transfer. When property is withdrawn from the program or is no longer eligible, the landowner must pay back-taxes equal to the difference in taxes for the current year and the two previous years, plus deferred special assessments.

What is the level of participation across the state?

Based on a report by the Office of the Legislative Auditor, 13 percent of the total farmland in the state was enrolled in Green Acres in 2007, with 51 of the 87 counties participating. (*"Green Acres" and Agricultural Land Preservation Programs*, Office of the Legislative Auditor (Feb. 8, 2008)) Taxes on enrolled lands were approximately $35 million less than they would have been without the program, with other taxpayers in jurisdictions where the property is located bearing the increased tax burden.

How is land enrolled in the program?

Landowners apply for the program through their county assessor. The program must be offered in all counties where the market value of the land is influenced by nonagricultural factors.

What kind of land may be enrolled?

Prior to May 1, 2008, land of at least ten acres was eligible for enrollment, provided it was classified as agricultural homestead, or as agricultural nonhomestead as long as it was owned by the same person/entity for at least seven years.

After April 30, 2008, the land must also be in agricultural production (cropland or pasture land; class 2a), in addition to the ownership requirements mentioned above. Land enrolled under the pre-2008 law that no longer qualifies (land now classified as 2b rural vacant land) may remain in the program through 2012, provided it has not been sold or otherwise transferred to an unrelated person.

What changes have been made in the program recently?

Due to perceptions that some of the enrolled land may not have been the kind of land the legislation was intended to protect and that the law was not being applied uniformly across the state, the legislature altered the program in 2008. The primary change was to clarify that, at least in the long run, only property in agricultural production (class 2a) would be eligible for Green Acres. In 2009, the legislature further modified the program by "grandfathering" previously enrolled nonproductive land in the program until 2013 and created a new program for rural vacant land (class 2b) called the Rural Preserve program, with benefits similar to Green Acres.

How are existing enrollees affected by the changes?

Existing enrollees with land that is no longer eligible (class 2b) must withdraw the land prior to January 2013. No back-taxes are due if the land is withdrawn prior to August 16, 2010, or if the land is enrolled in the new Rural Preserve program.

How will the new Rural Preserve program work?

Beginning with taxes payable in 2012, rural vacant land that is part of an agricultural homestead or that was previously enrolled in Green Acres, may be enrolled in the Rural Preserve program. To qualify, the landowner must sign an irrevocable covenant for a minimum of eight years pledging that the land will remain undeveloped and unfarmed; the landowner also must have a conservation assessment plan prepared for the land. Rural preserve land must be valued for tax purposes no higher than the average value for class 2a agricultural land in the area. As with Green Acres, back-taxes are due when the property is withdrawn from the program (i.e., when the covenant is terminated) equal to three years of difference between the taxes based on market value and taxes based on "rural preserve" value.

Are there other programs similar to Green Acres?

The Metro Agricultural Preserves program operates in the seven-county metro area and works somewhat like Green Acres. Taxes are based only on the agricultural value of the property. But unlike Green Acres, under agricultural preserves: (1) the local government must designate the area for long-term agricultural use, (2) the landowner must sign a covenant pledging that the land will be used only for agriculture for at least eight years, (3) most special assessments are prohibited, (4) participating landowners receive a small property tax credit to further reduce the taxes, and (5) no back-taxes are due at the time of withdrawal. There are other nonfinancial benefits as well, related to issues of land use.

A similar program called the Agricultural Land Preservation Program exists in Greater Minnesota, but only three counties (Waseca, Winona, and Wright) currently participate. The program differs from Green Acres and Metro Agricultural Preserves in that taxes are based on full market value rather than a reduced agricultural value, but landowners receive a property tax credit of $1.50 per acre. As with the Metro program, landowners must sign a restrictive covenant agreeing to continue using the land as agricultural property. Many of the nonfinancial benefits available in the Metro program also apply.

For more information: Contact legislative analysts Karen Baker (karen.baker@house.mn) or Steve Hinze (steve.hinze@house.mn).

Kathy Novak and Nina Manzi **Updated: August 2010**

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of Minnesota Management and Budget 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 2010 forecast will provide the revenue and expenditure projections that the governor will use in developing the budget for the fiscal year 2012-2013 biennium. The November 2010 forecast will also show if the state is on track to finish the fiscal year 2010-2011 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 2011 forecast will provide the revenue and expenditure projections that the legislature will use in adopting a budget for the fiscal year 2012-2013 biennium. Following the February forecast, the governor will submit modifications to the budget developed from the November forecast, which are called "supplemental budget recommendations." The February 2011 forecast will also provide an update on 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 2011 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2012-2013 budget during the 2012 legislative session. The legislature will use the projections in the February 2012 forecast to ensure that the fiscal year 2012-2013 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 Minnesota Management and Budget 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, and if a balanced budget has been enacted for the biennium, then 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 Minnesota Management and Budget 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 revenue and expenditure changes in order for the budget to be in balance at the close of the coming biennium.

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 Minnesota Management and Budget 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
- to restore the $15 million transferred in 2008 from the state airports fund to the general fund
- to restore the additional $10.7 million transferred in 2010 from the fire safety account in the special revenue fund to the general fund

If all these priorities have been met, the remaining surplus is reported in the forecast as a "positive unrestricted budgetary general fund balance." Recent budget balancing actions affect the priorities and distribution of surplus funds. By the end of fiscal year 2011, the commissioner of Minnesota Management and Budget must cancel $84 million of the unobligated balance in the cash flow account to the general fund, reducing it below the required level of $350 million. The budget reserve has been reduced to zero as part of balancing the fiscal year 2010-2011 budget. The school aid payment schedule was set at 73 percent for fiscal year 2010, 70 percent for fiscal year 2011, and restored to 90 percent for fiscal year 2012. Any positive unrestricted budgetary general fund balance in future forecasts would go first toward restoring the cash flow account to $350 million and then to restoring the budget reserve account, until it reached $653 million.

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.

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: Executive Branch Power to Reduce Spending to Avoid a Deficit,* March 2008.

Jeff Diebel

Updated: July 2010

Overview of Criminal Sexual Conduct Crimes

What is "criminal sexual conduct?"

Minnesota law classifies the crime of criminal sexual conduct into five categories: first- through fifth-degree criminal sexual conduct, with first-degree carrying the most severe penalties and fifth-degree the least. Minn. Stat. §§ 609.342 to 609.3451. Generally speaking, the first-degree and third-degree crimes apply to sexual conduct involving sexual **penetration** of the victim; the second-, fourth-, and fifth-degree crimes apply to sexual conduct involving sexual **contact** with the victim without sexual penetration.

Criminal sexual conduct in the first and second degree typically apply to conduct involving personal injury to the victim; the use or threatened use of force, violence, or a dangerous weapon; or victims who are extremely young. Criminal sexual conduct in the third, fourth, and fifth degree typically address less aggravated conduct and apply to other situations in which the victim either did not consent to the sexual conduct, was relatively young, or was incapable of voluntarily consenting to the sexual conduct due to a particular vulnerability or due to the special relationship between the offender and the victim.

Penalties Applying to Criminal Sexual Conduct

Name of crime	Type of activity	Maximum penalty provided by statute	Presumptive Sentencing Guidelines Sex Offender Grid sentence (no criminal history)
1st degree criminal sexual conduct	Sexual penetration; certain sexual contact with victim under 13 years old	30 years; $40,000 fine	144 months in prison. Statutory law presumes an executed sentence of 144 months for all violations.
2nd degree criminal sexual conduct	Sexual contact	25 years; $35,000 fine	90 months in prison; 36 months stayed sentence for "statutory rape."* Statutory law presumes an executed sentence of 90 months for crimes where the perpetrator uses or threatens to use force or violence, causes injury, uses a dangerous weapon, or creates significant fear on the part of the victim of imminent great bodily harm.
3rd degree criminal sexual conduct	Sexual penetration	15 years; $30,000 fine	48 months in prison; 36 months stayed sentence for "statutory rape"*
4th degree criminal sexual conduct	Sexual contact	10 years; $20,000 fine	24 months stayed sentence; 18 months stayed sentence for "statutory rape"*
5th degree criminal sexual conduct	Sexual contact; certain lewd conduct	1 year; $3,000 fine (gross misdemeanor). Certain repeat violations punishable by 5 years; $10,000 fine	15 months stayed sentence. Sentencing guidelines do not apply to gross misdemeanor violations.

* As used in this chart, "statutory rape" means a criminal sexual conduct crime that has the following elements: (1) sexual conduct; (2) a victim of a certain age; and, for certain crimes, either (3) a familial relationship between the actor and the victim; or (4) use of a position of authority by the actor. The term "statutory rape" is not defined or otherwise used in statute.

What other mandatory sentencing provisions apply?

Convicted predatory offenders also are subject to certain mandatory sentencing laws that are designed to minimize their recidivism risk.

Repeat or Violent Predatory Offenders. Certain dangerous sex offenders may be sentenced to life-without-release or indeterminate life sentences if aggravating factors are found. Such factors include conviction of certain clauses of first- or second-degree criminal sexual conduct involving force or violence, the existence of heinous elements, and previous sex offense convictions.

Minimum Conditional Release Term. If a court sentences a felony-level sex offender to prison, the court must also sentence the offender to serve a minimum period of "conditional release" after release from prison. The mandatory conditional release period is ten years, except for offenders who were sentenced to indeterminate life sentences due to aggravating factors and certain repeat offenders, who are both subject to lifetime conditional release.

Mandatory Predatory Offender Assessment and Treatment. The court must order a predatory offender treatment assessment for any person convicted of criminal sexual conduct (any degree), surreptitious intrusion, obscene phone calls, or indecent exposure. The court may waive the assessment if the offender is eligible for a presumptive prison sentence or has already been assessed. If the assessment indicates the offender is in need of and amenable to treatment, the court must order the offender to undergo treatment if it places the offender on probation.

What other laws are predatory offenders subject to?

Predatory offenders are subject to a number of laws. The purpose of these laws is to aid law enforcement in detecting crime and furthering public safety.

DNA Analysis. The court must order persons convicted of or adjudicated delinquent for a sex offense to provide a biological sample for DNA analysis, unless the offender has already done so. This requirement also applies to persons convicted of other violent crimes listed in the law. If an individual was not ordered to provide this specimen at the time of sentencing, the offender must provide the specimen before release.

Predatory Offender Registration. The Predatory Offender Registration (POR) law is a system under which an individual convicted of predatory offenses (i.e., sex offenses) is required to register with the Bureau of Criminal Apprehension (BCA) for a period of time, usually ten years. The law applies both to adults and juveniles.

Community Notification. The Community Notification law requires assignment of a risk level to predatory offenders (i.e., sex offenders) who are released from prison and required to register under the Predatory Offender Registration law. Based upon the offender's risk level, law enforcement must share certain information and may share other information about the offender with certain individuals and entities in the area where the offender lives, works, or attends school.

For more information: Contact legislative analyst Jeff Diebel at 651-296-5041.

Matt Burress July 2010

Transit Systems in Minnesota

Public transit systems in Minnesota are marked by variation in their size, geographic coverage area, and service offerings. While the state assists transit operators with funding and planning, the systems are operated at a local or regional level primarily by public entities, such as counties and cities.

Forms of service

The public transportation systems vary with respect to forms of service provided to its riders. The basic forms are:

- **Regular route bus** service, operating primarily in urban settings on fixed routes and standard schedules and typically with a high frequency of stops;
- **Express bus** service (including bus rapid transit), which generally follows longer fixed routes and has fewer stops compared to regular route buses;
- **Demand response or "dial-a-ride,"** in which riders (usually in areas not served by regular route transit) can arrange for specific trips upon request;
- **Route deviation**, bus service on typically regular schedules that generally follows fixed routes but with small deviations upon rider request;
- **Paratransit**, which provides door-to-door transport for people who are unable to use regular bus service (required under the federal Americans with Disabilities Act (ADA) to complement any fixed route bus service area); and
- **Rail transit**, which operates on railroad track and includes street cars, light rail transit (LRT), commuter rail, and intercity passenger rail.

Systems in greater Minnesota

There are over 60 transit systems throughout greater Minnesota. Each one is classified under state law into one of four categories based on its location and system characteristics, as summarized in the table below. Minn. Stat. § 174.24.

Class	Count	Forms of Service	Service Areas	Examples
Urbanized	6	Mainly regular route	One or a few cities	Duluth, Moorhead, St. Cloud
Small urban	13	Dial-a-ride, deviation	One or a few cities	Hibbing, Northfield, Winona
Rural	41	Dial-a-ride, deviation	Various	Arrowhead, Becker, Steele
Elderly/disabled	5	Paratransit	Matches regular route	E. Grand Forks, Rochester

Although there are commonalities (particularly within each classification), the transit systems vary in some of their key characteristics. Service is most often operated by cities and counties but some systems are run by joint powers boards, tribal governments, other forms of local government, and nonprofits. Fixed route service and paratransit are only found in more densely populated urban areas. Route deviation or dial-a-ride service, or both, are offered in small urban and rural settings. While transit systems in an urban area typically cover one or a couple of cities, rural systems can cover part of a county, be countywide, or be regional (extending across multiple counties). Service in a few counties only exists within a city, and seven counties lack any transit offerings. Hours of bus service usually cover the working day, but in rural areas it often does not run later into the evening and is not always offered over the weekend. Bus frequency also varies and might not be daily. Some privately operated (but federally subsidized) intercity bus routes cross transit provider coverage areas and connect more distant cities.

Systems in the metropolitan area

The metropolitan area is served by a number of transit options, consisting of:

- **Metro Transit**, encompassing an extensive bus system as well as the state's only light rail transit line and only commuter rail line;
- **Metro Mobility** paratransit for those with disabilities or health conditions;
- **Transit Link dial-a-ride** minibus or van service for the general public in those parts of the metropolitan area not served by regular route transit;
- **"Opt-out"** systems consisting of seven suburban transit providers that replace Metro Transit service in several metropolitan cities; and
- **Independent operators**, as in Ramsey Star and the University of Minnesota.

The Metropolitan Council

The Metropolitan Council's transportation division consists of Metro Transit and Metropolitan Transportation Services (MTS). MTS manages contracts with public and private entities to operate (1) Metro Mobility, (2) Transit Link dial-a-ride service, and (3) additional regular bus routes (mainly for commuters into the central cities). The council's rail and regular route bus service constitutes the largest transit system in Minnesota, accounting for over 87 percent of calendar year 2009 ridership. The council maintains most metropolitan park-and-ride lots, which link motorists to bus and rail service. In addition to being a transit operator, the Metropolitan Council performs regional transportation planning and management.

Opt-outs

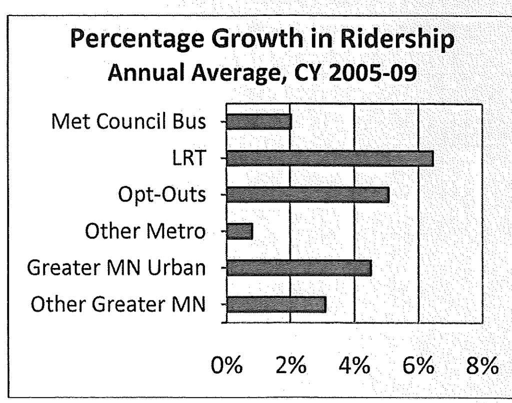
The opt-outs are operated by a range of agencies including counties and cities (independently or through a joint powers agreement) as well as nonprofits. Service offerings vary, covering regular route circulator service within specific communities, dial-a-ride, and express bus service. Bus service provided by the opt-outs replaces that offered by the Metropolitan Council (although there is some overlap in coverage areas due to commuter service to the central cities).

Ridership

The charts below show ridership and its growth from calendar years 2005 to 2009.

Category	CY 2009 Ridership	CY 2005-09 Growth
Met Council Bus	68.1 M	5.1 M
LRT	9.9	2.0
Opt-Outs	4.8	0.8
Other Metro	6.1	0.2
Greater MN Urban	7.2	1.1
Other Greater MN	3.8	1.9
Total	**99.9**	**9.7**

Notes
Amounts are in millions.
CY is calendar year.



HOUSE RESEARCH | **Short Subjects**

Mark Shepard & Patrick McCormack **Updated: July 2010**

Regular Sessions of the Minnesota Legislature

The legislature is required to meet regularly

The Minnesota Constitution requires the legislature to meet each biennium, during the two-year term of office of members of the House of Representatives. The constitution leaves the timing of these "regular" legislative sessions to be prescribed by law. The law says that regular sessions are to begin just after newly elected legislators commence their term of office on the first Monday in January of the odd-numbered year.

Each regular session is conducted by a distinct legislature

The convening of each new regular session marks the end of one legislature and the beginning of another, because all representatives, and sometimes all senators, are starting a new term of office. Sessions, and legislatures, are numbered in sequence. The first regular session and the first state legislature convened in December 1857. The regular session beginning in January 2011 is the 87th regular session, and the legislature that meets then is the 87th Legislature.

The constitution allows only one regular session in a biennium

Once convened in regular session, the houses of the legislature continue the session simply by adjourning from one day to another. The regular session ends when the houses adjourn *sine die* (without setting a date for reconvening). After a legislature adjourns *sine die,* it may not meet again in regular session that biennium. The legislature continues to exist and may be called into a "special session" by the governor, but the regular session for that biennium is finished.

The constitution regulates the length of the regular session

Three provisions of the constitution regulate the length of the regular session.

The session is limited to 120 legislative days, as that term is defined by law. The law defines a legislative day as a day on which either house is called to order—that is, meets in a "floor session" in its chamber in the Capitol. Legislative committees may meet without consuming a legislative day, as long as neither house meets on the floor that day.

The legislature normally must use at least two legislative days each week. The constitution does not allow either house to adjourn for more than three calendar days (excepting Sunday) without the consent of the other house. Although the two houses could agree to frequent long adjournments, in practice they do not. Both routinely comply with the constitutional requirement by scheduling a minimum of two floor sessions each week, even when there is little floor business to conduct.

The legislature may not meet in regular session after a specified day in May. The constitution forbids the legislature to meet in regular session after the first Monday following the third Saturday in May in any year. This provision confines regular sessions to the first five months of any year.

Apart from these requirements, each legislature may schedule its regular session as it pleases

These constitutional and statutory regulations establish what is called a "flexible biennial session." The session is flexible because each legislature may schedule its regular session meetings as it pleases, as long as it does not exceed 120 legislative days or meet outside of the January-to-May period. The session is biennial because each legislature is allowed, though not required, to meet in both years of the biennium: when it closes the regular session in the first year, the legislature can choose to adjourn either *sine die* or to a date it specifies in the following year.

Every legislature since 1973, when these regulations took effect, has chosen to spread its regular session over both years. The result is this typical configuration:

- *First year:* The session begins on the prescribed day, early in January of the odd-numbered year. The session continues for nearly five months, until the constitutional deadline in May, when both houses adjourn until a date they specify in the following (even-numbered) year.
- *Second year:* On the specified date in the following year usually sometime in January or February, the two houses reconvene to continue the regular session. The session in the second year typically lasts three or four months when both houses bring the regular session to an end by adjourning *sine die*.

Historically, the legislature met annually at first, then in alternate years, and now in flexible biennial sessions

1857-1878: Annual sessions. The 1857 state constitution limited neither the frequency nor the duration of legislative sessions. The first legislatures met annually in sessions lasting as long as four or five months. An 1860 constitutional amendment limited each annual session to 60 days. Accordingly, in 1861 the legislature began meeting each year for 60 calendar days, from early January to early March.

1879-1972: Alternate-year sessions. An 1877 constitutional amendment retained the 60-day limit but directed the legislature to "meet biennially." So beginning in 1879, and for nearly 100 years thereafter, the legislature met only in odd-numbered years. An 1888 constitutional amendment changed the 60-day limit to 90 "legislative days"—which was understood to mean that Sundays and legal holidays could be disregarded in reckoning the 90-day span of the session. A 1962 constitutional amendment raised the limit of legislative days from 90 to 120 and replaced the constitutional direction to "meet biennially" with a more explicit direction confining regular session to "each odd-numbered year."

1973-present: Flexible biennial sessions. The flexible session amendment to the constitution, adopted in 1972, removed the provision confining regular sessions to odd-numbered years, added the May adjournment deadline, and directed that "legislative day" be defined by law. A 1973 law defined legislative day as a day when either house convenes in a floor session. Since then, the legislature has met in a single regular session spread over both years of each biennium.

For more information: Contact Mark Shepard at 651-296-5051 or Patrick McCormack at 651-296-5048. Also see the House Research publication *Special Sessions of the Minnesota Legislature*, July 2010.

Mark Shepard & Patrick McCormack **Updated: July 2010**

Special Sessions of the Minnesota Legislature

The governor may call the legislature into special session on extraordinary occasions

Besides requiring the legislature to meet in *regular* session during a part of each biennium (two-year period), the Minnesota Constitution permits the legislature to meet in *special* session "on extraordinary occasions."

Some state legislatures are allowed to call themselves into special session. The Minnesota Constitution does not permit this: only the governor can call the legislature into special session. (Statutory law purports to allow the legislature to call itself into special session, but only when the state is under attack by enemies of the United States.)

Statutory law directs the governor to call a special session by means of a proclamation, to notify all legislators of the time of the meeting, and to inform the legislature of the purpose of the session. The governor's proclamation is filed with the secretary of state and is printed in the journal of each house and in the *Laws of Minnesota* (a compilation of legislative actions published each year).

Special sessions permit legislative action at any time of the year

Special sessions permit legislative action, if necessary, at times when the legislature is not meeting, or allowed by the constitution to meet, in regular session (generally, the summer and autumn months). Typically governors call special sessions for two reasons:

- The legislature has not completed work on vital legislation during the time allowed for the regular session
- Changed circumstances require urgent legislative action after the regular session ends

It is possible for a special session to run concurrently with a regular session—either because a special session continues after the start of a regular session, or because the governor chooses to call a special session during a regular session. This overlapping of special and regular sessions has occurred only once, in 1981.

Special sessions have become more frequent in recent decades

Special sessions once were rare but have become more frequent. According to information complied by the Legislative Reference Library, governors called three special sessions during the first half century of statehood (1857-1906), ten in the succeeding half century (1907-1956), and 32 since 1957. As many as six special sessions have been called during a single legislative biennium (in 1981-82).

Each special session is discrete

Each special session is a separate, free-standing meeting of the legislature, independent of the regular legislative session and any other special session. All legislation to be considered must be introduced as new bills. The legislature may not act on bills from the regular session or another special session.

The legislature determines the length and scope of a special session

Legislators decide what issues and legislation to consider in a special session and how long to meet. Governors initiate special sessions but have no authority to limit their scope or duration. Nor does the constitution regulate the length of special sessions, as it does regular sessions. Once they are called into a special session, legislators could decide to take up a large agenda and meet for a lengthy period—even, in theory, until legislative terms of office end and a new legislature convenes in regular session, in January of the next odd-numbered year.

Most special sessions are quite concentrated and short

Despite the legislature's unbridled authority to determine the scope and length of special sessions, long rambling ones are rare. The length of most is best measured in hours or days. Seldom does one extend beyond a single week. The longest in history—by far—occurred in 1971, when a special session convened in late May and did not adjourn finally until the end of October.

Two common practices contribute to the brevity of most special sessions.

First, the governor and legislative leaders seek agreement on the business of the session before the governor calls it. Some agreement on the general scope of the session usually is possible. This is announced publicly before the session and reflected in a general way in the language of the governor's proclamation. A typical proclamation these days recites the need for essential laws in specified subjects and calls for the prompt conclusion of legislative business, with a limited agenda and as much prior agreement as possible. Besides seeking agreement on the general scope of the session, the leaders also may attempt to reach more detailed agreements about the content of legislation.

Second, the legislature usually uses expedited procedures to pass legislation. During special sessions, the House and the Senate often pass bills shortly after they are introduced. This is accomplished by declaring an "urgency" and suspending both the constitutional requirement that each bill be considered on three different days in each house and the requirement of legislative rules that each bill be referred to a committee when it is introduced. The two-thirds vote required in each house to expedite passage in this way usually is forthcoming, because legislators generally wish to curb the length of the session.

For more information: Contact Mark Shepard at 651-296-5051 or Patrick McCormack at 651-296-5048. Also see the House Research publication *Regular Sessions of the Minnesota Legislature*, July 2010.

HOUSE RESEARCH | Short Subjects

Matt Burress

Updated: August 2010

Minnesota Speed Limits

Minnesota's traffic laws include regulation of speeding. State law sets speed limits on state highways and local roads, establishes penalties, and authorizes the Department of Transportation (MnDOT), and in some case local governments, to change the limit. *See* Minn. Stat. § 169.14.

Basic requirements and speed limits

Speed limits set in statute are default maximums, but under some circumstances MnDOT and local government can modify them. The statutory speed limits are: 30 m.p.h. for city streets and town roads in an "urban district," which is any segment of a city street or town road that is built up with structures less than 100 feet apart for a minimum distance of a quarter-mile; 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 divided highways with controlled access; 10 m.p.h. for alleys, mobile home parks, and campgrounds; and a default of 55 m.p.h. on other roads. Minn. Stat. §§ 169.011, subd. 90; 169.14, subd. 2; 327.27, subd. 2.

Under a 2009 change, the speed limit was increased by 10 m.p.h. when passing on two-lane highways with a posted limit of at least 55 m.p.h. Minn. Stat. § 169.14, subd. 2a. A 40-m.p.h. minimum speed limit applies on interstates.

State 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." Minn. Stat. § 169.14, subd. 1. This condition can place an additional obligation on a motorist to lower the speed of travel, particularly if there are dangerous conditions like snow or the presence of a pedestrian.

Adjusted limits in speed zones

MnDOT has the authority to establish speed zones in which the speed limit is higher or lower than the default limits set in law; such 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, crash history, and observed speeds. MnDOT's policy is that the limit should normally be set near the 85th 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 of the road. However, MnDOT—not the local authority—determines the safe and reasonable speed limit as well as whether to establish a speed zone. This general rule has a few exceptions.

- If MnDOT has established a speed zone for a city street or town road in an urban district that is at least a quarter-mile long, the city or town can lower the speed limit to 30 m.p.h. Minn. Stat. § 169.14, subd. 5b.
- In a rural residential district, a local road authority may reduce the speed limit to 35 m.p.h. A "rural residential district" is a segment of a city

street or town road with houses spaced less than 300 feet apart for a minimum distance of a quarter-mile. Minn. Stat. § 169.011, subd. 69a.

- On a residential roadway, a local road authority may reduce the speed limit to 25 m.p.h. A "residential roadway" is a city street or town road whose total length is up to a half-mile. Minn. Stat. § 169.011, subd. 64.
- 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: (1) park roads (at not less than 15 m.p.h., or more than 20 m.p.h. below the surrounding limit); (2) on streets that have a designated bicycle lane (at not less than 25 m.p.h.); (3) in alleys; and (4) in mobile home parks. Minn. Stat. §§ 160.263, subd. 4; 169.14, subds. 5c and 5e; 327.27, subd. 2a.

Both MnDOT and local road authorities can set speed limits within highway work zones, which are effective while workers are present, and MnDOT can set temporary construction zone limits along long-term construction projects.

Penalties for speeding violations

Speeding is generally a petty misdemeanor punishable by a base fine normally ranging from $40 to $150 and no prison sentence. The amount of the fine is doubled 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. In addition, a $75 court surcharge is imposed for speeding convictions and there can be a law library fee. 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, 90 days' imprisonment, or both. 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. Minn. Stat. § 169.14, subd. 1a. Minnesota does not use a point system, which assigns points to traffic violations and removes driving privileges if too many points accumulate. However, multiple speeding or other traffic violations within a year can lead to loss of a license. Minn. Stat. §§ 169.89; 171.17.

Speeding violations on a driver's record

A law first enacted in 1986 known as the "Dimler amendment" governs which speeding violations are recorded on a motorist's driving record maintained by the Department of Public Safety and accessed by insurance companies (but records are still kept by the courts). Speeding violations are not placed on the driving record if the driver traveled:

- 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.; 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.

Pat Dalton

Updated: August 2010

Minnesota Sales Tax Rate

The state general sales tax rate is 6.875 percent

Minnesota first imposed a state sales tax August 1, 1967. At that time the rate was 3 percent. The state last increased the rate in 2009. Below is a table showing how the rate has changed over time.

Period	Rate
August 1, 1967 – October 31, 1971	3.0%
November 1, 1971 – June 30, 1981	4.0%
July 1, 1981 – December 31, 1982	5.0%
January 1, 1983 – June 30, 1991	6.0%
July 1, 1991 – June 30, 2009	6.5%
July 1, 2009 – Present	6.875%

The 1991 increase was initially enacted as an "optional" county sales tax rate on top of the 6 percent state rate. All counties imposed the tax because of aid penalties if the tax was not imposed. In 1994, this "optional" tax was officially rolled into the state tax rate.

The 2009 increase resulted from a state constitutional amendment imposing an additional three-eighth cent general sales tax, which the voters approved at the 2008 general election. The rate increase is effective for 25 years with the revenues dedicated to funding outdoor heritage, clean water, parks and trails, and historical and cultural heritage.

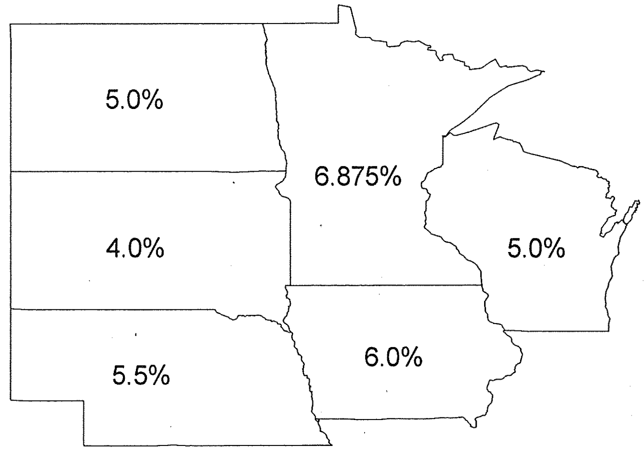
Minnesota has one of the highest state sales tax rates in the country

Of the 45 states and the District of Columbia that impose a sales tax, six other states have a tax rate higher than Minnesota. The states are:

- California 8.25%
- Mississippi 7.0%
- Rhode Island 7.0%
- Tennessee 7.0%
- Indiana 7.0%
- New Jersey 7.0%

Minnesota's tax rate, as indicated on the following map, is the highest in the region. Although Minnesota has a relatively high tax rate, it also has one of the narrower tax bases because it does not tax clothing, food for home consumption, or a number of services. All the other states in the region impose sales taxes on clothing. South Dakota also taxes food for home consumption. South Dakota and Iowa tax a number of services not subject to the Minnesota sales tax.

Sales Tax Rates
(as of July 2010)



Minnesota taxes motor vehicle purchases and rentals differently

Sales of motor vehicles are exempt from the general sales tax and are instead subject to the motor vehicles sales tax (Minn. Stat., ch. 297B). The motor vehicle sales tax rate remains at 6.5 percent since it was not increased as part of the 2008 constitutional amendment.

Both short- and long-term leases of motor vehicles are subject to the 6.875 percent general sales tax, instead of the motor vehicle sales tax. In addition, short-term motor vehicle rentals (defined as a lease or rental of no more than 28 days) are subject to an extra tax of 6.2 percent and a 5 percent fee. The combined sales tax rate and fee on short-term motor vehicles is 18.075 percent but the rental companies retain the revenue from the 5 percent fee to offset their payments of motor vehicle registration taxes.

The number of local sales taxes in Minnesota has increased over time

In 2000, the state allowed 12 local governments to impose a local sales tax, mainly to fund specific capital projects. The rates were either 0.5 or 1.0 percent. In recent years the number of authorized local sales taxes has grown. All counties located in the seven-county Twin Cities metropolitan area may now impose a 0.25 percent sales tax to fund transit improvements (five of the counties do), while the remaining 80 counties may impose up to a 0.5 percent sales tax to fund specific transportation projects (currently none have imposed the tax). An additional 27 city and county local sales taxes are also currently imposed.

The combined state and local sales tax rates in Minnesota range between 6.875 and 7.875 percent. The city of Duluth and Cook County have the highest combined rate at 7.875 percent. The city of Minneapolis has a combined rate of 7.775 percent while the rate in the city of St. Paul is 7.625 percent.

For more information: Contact legislative analyst Pat Dalton at 651-296-7434. For more information on authorized local sales taxes, also see the House Research publication *Local Sales Taxes in Minnesota*, August 2010.

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 Karen Baker **Updated: August 2010**

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 (this was reduced to 15 percent for 2009 refunds only under the June 2009 unallotment, which the 2010 Legislature enacted into law). If 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 2011, based on rent paid in 2010 and 2010 household income, the maximum refund is $1,520. Renters whose income exceeds $53,539 are not eligible for refunds.

How are claims filed?

Refund claims are filed using Minnesota Department of Revenue (DOR) Schedule M1PR. Schedule M1PR is filed separately from the individual income tax form. Claims filed before August 15, 2011, will be paid beginning in August 2011. The deadline for filing claims based on rent paid in 2010 is August 15, 2012; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions."

What is the average refund and total amount paid?

Statewide Renter Property Tax Refunds, Filed in 2009
(based on 2008 incomes and rent paid in 2008, most recent data available)

	Number of returns	Total amount	Average per return
Under 65 years old	219,898	$125.0 million	$569
Senior/disabled	84,604	$55.0 million	$650
Total: all renters	304,502	$180.0 million	$591

Do special rules apply for refunds based on rent paid in 2009?

Under Gov. Tim Pawlenty's June 2009 unallotment, the percentage of rent constituting property taxes was reduced from 19 percent to 15 percent for refunds based on rent paid in 2009 only. In a subsequent lawsuit about the unallotment, the Minnesota Supreme Court did not rule directly on the PTR change, although its ruling in effect invalidated the entire unallotment. The 2010 Legislature enacted the percentage reduction in the unallotment. This is estimated to have reduced 2009 refunds by $52.3 million, or about 27 percent.

How do refunds vary depending on income and property taxes?

The following table shows the refund amount for two example families (married couples without dependents). Although the threshold percentage, 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 2010 of $741, the fair market rent for a one-bedroom apartment in the metro area. The family in greater Minnesota paid monthly rent in 2010 of $490, the fair market rent for a one-bedroom apartment in many greater Minnesota counties. 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
Example refunds for claims to be filed in 2011,
based on rent paid in 2010 and 2010 household income

		Metro area		**Greater Minnesota**	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #1**	**Taxpayer #2**
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	$1,689	$1,689	$1,117	$1,117
5	Statutory threshold percentage	1.4%	2.2%	1.4%	2.2%
6	Threshold % x income (3 x 5 = 6)	$210	$660	$210	$660
7	Property tax over threshold (4 – 6 = 7)	$1,479	$1,029	$907	$457
8	Copay percentage	15%	30%	15%	30%
9	Taxpayer copay amount (7 x 8 = 9)	$222	$309	$136	$137
10	Remaining tax over threshold (7 – 9 = 10)	$1,258	$721	$771	$320
11	Maximum refund allowed	$1,520	$1,520	$1,520	$1,520
12	Net property tax refund	$1,258	$721	$771	$320

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.taxes.state.mn.us.

HOUSE RESEARCH | Short Subjects

Lisa Larson

Updated: August 2010

Federal Race to the Top Grant

Minnesota applied for federal Race to the Top grant funds

Race to the Top (RTTT) is a $4 billion competitive education grant program under the federal 2009 American Recovery and Reinvestment Act. The program is intended to create state education reform. Minnesota, along with 39 other states and the District of Columbia, applied for grants in January 2010. Only Delaware and Tennessee won grants in this first round. States that did not receive a grant in the first round were able to apply in the second round in June. Minnesota did not apply for a grant in the second round.

The U.S. Department of Education issued RTTT guidelines to advise states interested in applying for a grant. The guidelines place states in one of five funding categories, based on states' population of children ages five to 17. Minnesota is in category four, which has a suggested budget range for grants of between $60 million to $175 million.

States must meet federal guidelines in six different areas

The federal guidelines assigned a total of 500 points to the following six selection criteria that each state must address in its application:

- **State success factors** (125 points). These must articulate a state's education reform agenda and school districts' role in implementing that reform in four core areas, build statewide capacity to implement and sustain a state's reform agenda, and demonstrate significant state progress in raising student achievement and closing academic achievement gaps.
- **Standards and assessments** criteria (70 points). These require a state to adopt a common set of core English-language arts and math standards, develop and implement common assessments aligned with the standards, and support the transition to these standards and assessments.
- **Data systems** criteria (47 points). These require a state to fully implement a statewide longitudinal data system, and access and use state data to improve instruction, among other uses.
- **Great teachers and leaders** criteria (138 points). These require a state to provide alternative routes for licensing teachers and principals, use student performance data to improve teacher and principal effectiveness, ensure equitable distribution of effective teachers and principals, improve teacher and principal preparation programs, and provide support to teachers and principals.
- **Turnaround struggling schools** criteria (50 points). These require a state to intervene in and turn around the lowest-achieving schools and districts.
- **General selection criteria** (55 points). These require a state to make education funding a priority, ensure successful conditions for high-performing charter schools and other innovative schools, and demonstrate other significant reform conditions.
- An **optional science, technology, engineering, math (STEM) emphasis**

(15 points) requires a state to have a plan to offer a rigorous STEM course of study, cooperate with community-based STEM partners, and prepare students for STEM advanced study and careers.

A successful state must allocate at least 50 percent of its RTTT grant to districts

Federal reviewers review and rate each state's application. A successful state applicant must allocate at least 50 percent of the grant to local school districts, based on their relative share of federal Title I funding provided to districts for at-risk students living at or near poverty. A district must use the grant funds it receives in a manner that is consistent with the state's RTTT reform plan and any applicable district agreements. The remainder of the state grant must be used to support the state's RTTT reform plan.

Only school districts that sign a memorandum of understanding (MOU) are eligible to receive funds. Even districts that do not sign an MOU must comply with some statewide elements of the RTTT plan. For example, all districts must adopt common core standards.

Minnesota's first round application included proposals for a number of policy changes in the K-12 education system

Minnesota's RTTT application, among other things, proposed to:

- adopt a common set of nationwide core K-12 standards in English-language arts and math that build toward college and career readiness and to participate in a consortium working to develop high-quality assessments aligned with these standards;
- have the state Board of Teaching and the state Board of School Administrators amend their rules to support alternative licensure programs consistent with RTTT guidelines and adopt a three-tiered licensure structure;
- implement a teacher and principal evaluation system premised on using student growth data as a "significant" factor in making employment-related decisions;
- implement an enhanced and more uniform Q-Comp plan for districts that would, among other things, include principals, require peer assistance and review, grant tenure to effective teachers based on evaluation outcomes, use individual, class, and school-level student growth data to evaluate teachers, and use school-level student growth data to evaluate teachers and principals;
- use financial and nonfinancial incentives to provide greater flexibility in placing and retaining highly effective teachers and principals in high-need schools and subject areas throughout the state;
- have the state Board of Teaching amend its rules to require that all approved teacher preparation programs with 20 or more program graduates provide the state with student proficiency and growth data and other data related to program graduates; and
- use an Office of Turnaround Schools that is separate from the Minnesota Department of Education and the newly enacted site-governed schools model to intervene in the persistently lowest-achieving schools and in districts in improvement or corrective action status.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Jim Cleary

Updated: August 2010

Military Pay under Minnesota's Individual Income Tax

Several factors affect Minnesota individual income taxation of active service military pay

Minnesota income tax treatment of active service military pay depends on several factors:

- Where the service was provided (in Minnesota or outside Minnesota)
- If the individual had nonmilitary income above the filing requirement for the tax year
- If the individual is a Minnesota resident
- If the individual is in the regular full-time military or in the National Guard or reserves

Service outside Minnesota by Minnesota residents, with nonmilitary income below the filing requirement

Minnesota residents who serve outside Minnesota and have nonmilitary income less than the filing requirement for the tax year ($9,350 for tax year 2010) are not subject to state income tax withholding and do not have to file a Minnesota income tax return. This generally applies to members of the full-time military who are in active service outside Minnesota throughout the entire tax year, as members of either the full-time military or the National Guard or reserves.

Service outside Minnesota by Minnesota residents with nonmilitary income above the filing requirement

Minnesota residents who serve outside Minnesota and have nonmilitary income above the filing requirement for the tax year must file a Minnesota return, but may subtract all types of military pay earned outside Minnesota. Some common situations include the following:

- Members of the full-time military in active service whose spouses are employed and live in Minnesota
- Members of the National Guard and reserves in active service outside Minnesota for the entire tax year who have employed spouses living in Minnesota, or whose civilian employer provides a salary differential
- Members of the National Guard and reserves in active service outside of Minnesota for part or all of the year who have interest, dividend, or business income
- Members of the National Guard and reserves called to active service outside Minnesota for a portion of the tax year, who have civilian income in Minnesota during the remainder of the tax year

Service in Minnesota by a resident of another state

Individuals who serve in Minnesota and are residents of another state must file a Minnesota income tax return but may claim a subtraction for active service military pay earned in Minnesota. Federal law prohibits states from taxing active service military pay earned by nonresidents. This treatment typically applies to residents of other states who are stationed in Minnesota. Federal law also prohibits states from considering spouses of residents of other states to be Minnesota residents for tax purposes.

Service in Minnesota by a Minnesota resident who is a member of the full-time military

Individuals who serve in Minnesota and are Minnesota residents may claim a subtraction for regular active service military pay. This treatment typically applies to Minnesota residents who are full-time military and are stationed in Minnesota, such as members of the Coast Guard and recruitment officers. This subtraction does not apply to Active Guard/Reserve (AGR) personnel and to certain other limited categories of state service.

Service in Minnesota by a Minnesota resident who is a member of the National Guard or reserves

Minnesota residents who are members of the National Guard and reserves are allowed a subtraction for pay received for qualifying active service within Minnesota. "Qualifying active service" includes:

- certain *state active service*, such as assistance in natural disasters and searches for lost persons (Minn. Stat. § 190.05, subd. 5a, cl. (1));
- *federally funded state active service*, under U.S.C. Title 32 (National Guard), such as weekend drills and annual training (summer camp), special school attendance, airport security, or active duty for special work (ADSW) (Minn. Stat. § 190.05, subd. 5b); and
- *federal active service*, under U.S.C. Title 10 (Reserves), such as weekend drills, annual training (summer camp), special school attendance, pre- or postdeployment-related duty, and time on medical hold under Title 10 active duty orders while recuperating from an injury (Minn. Stat. § 190.05, subd. 5c).

"Qualifying active service" excludes service by AGR personnel and by former members of the National Guard ordered to active service by the adjutant general to perform administrative duties.

Minnesota follows federal tax treatment of other kinds of military income and benefits

Minnesota conforms to federal income tax treatment of various types of military income, whether received in-kind or as a reimbursement or allowance. Examples of excluded income include the following:

- Housing allowances
- Moving allowances
- Travel allowances and per diem
- Combat zone pay
- Death gratuity benefits

While Minnesota excludes combat pay from taxable income, it counts combat pay in determining an individual's eligibility for the working family tax credit. This credit for low-income taxpayers is calculated as a percentage of earned income. Counting combat pay as earned income results in some service members remaining eligible for the credit and qualifying for refunds.

For more information: The Department of Revenue maintains information on taxation of military pay online at taxes.state.mn.us/individ/pages/residency_and_filing_status_military_sub_active_duty_military.aspx; or contact legislative analyst Nina Manzi at 651-296-5204 or Jim Cleary at 651-296-5053.

Karen Baker and Steve Hinze

Updated: September 2010

Property Tax 101: Property Tax Administration

Who does what

Counties are responsible for property tax administration; the Department of Revenue provides assistance and oversight. The list below shows each county office's responsibilities for property tax administration. In some counties these offices are merged and one or two offices may perform the functions.

Assessor

- Values property
- Determines proper classification
- Sends valuation notices to taxpayers

Auditor

- Determines each taxing jurisdiction's total tax capacity (i.e., its tax base)
- Calculates proposed and final tax rates
- Prepares truth-in-taxation notices (based on proposed levies)

Treasurer

- Prepares and mails out property tax statements
- Collects property tax payments
- Distributes property tax receipts to each taxing jurisdiction

Property tax timeline

The process of calculating, imposing, and collecting Minnesota property taxes for a year actually spans two full calendar years. As shown on the reverse side, the two-year cycle begins with the January 2 statutory assessment date and extends all the way through the next calendar year until the property taxes have been paid. For example, for taxes payable in 2011, the cycle begins on January 2, 2010, and doesn't end until the final payments are made in October/November 2011.

Appeal process

If a property owner disagrees with the assessor's valuation (shown on the valuation notice), the taxpayer can seek relief directly from the assessor. This may resolve the matter, so that no further action is necessary. If it does not, there are two separate avenues of appeal:

1. A three-step appeal process, consisting of an appeal to:
   - the local board of review; if not satisfied, appeal to,
   - the county board of equalization; if not satisfied, appeal to,
   - the Minnesota tax court.
2. A single-step appeal to the Minnesota tax court. There are two divisions:
   - The regular division, which can be used for any property. Proceedings are formal (an attorney is recommended), and the decision may be appealed to the Minnesota Supreme Court; or
   - The small claims division, which can be used only for homesteads (regardless of value) and other property where the market value is under $300,000. Proceedings are less formal, and decisions are final.

Property Tax System Timeline			
		Assessment Year 2010 Taxes Payable 2011	**Assessment Year 2011 Taxes Payable 2012**
2010	January	Assessment date (2nd)	
	March	Valuation notices mailed	
	April	Local boards of appeal and equalization	
	June	County board of appeal and equalization; state board of equalization	
	July	Certification of state aid amounts	
	September	Truth-in-taxation levy certifications (15th, 30th)	
	November	Truth-in-taxation notices mailed	
	December	Final budget hearings; final levy certifications (27th)	
2011	January	County auditors compute tax rates	Assessment date (2nd)
	March	Property tax statements mailed	Valuation notices mailed
	April		Local boards of appeal and equalization
	May	1st half tax payments due (15th)	
	June		County board of appeal and equalization; state board of equalization
	July	1st half state aid payments made (20th)	Certification of state aid amounts
	September		Truth-in-taxation levy certifications (15th, 30th)
	October	2nd half tax payments due – except on agricultural property (15th)	
	November	2nd half tax payments due – on agricultural property (15th)	Truth-in-taxation notices mailed
	December	2nd half state aid payments made (26th)	Final budget hearings; final levy certifications (27th)
2012	January		County auditors compute tax rates
	March		Property tax statements mailed
	May		1st half tax payments due (15th)
	July		1st half state aid payments made (20th)
	October		2nd half tax payments due – except on agricultural property (15th)
	November		2nd half tax payments due – on agricultural property (15th)
	December		2nd half state aid payments made (26th)

For more information: Contact legislative analyst Karen Baker at karen.baker@house.mn or Steve Hinze at steve.hinze@house.mn.

HOUSE RESEARCH | Short Subjects

Steve Hinze and Karen Baker

Updated: September 2010

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 2011

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 $1,140,000	0.50	No	No
	Over $1,140,000	1.00	No	No
2a	Agricultural nonhomestead	1.00	No	No
2b	Nonhomestead rural vacant land	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?

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 2011)

Property Type	Class Rate(s)	Net Tax Capacity	Property Tax* Gross	Property Tax* Net	Effective Tax Rate
Agricultural homestead**	0.5/1.0%	$1,200	$1,272	$790	0.39%
Agricultural nonhomestead	1.0	2,000	2,000	2,000	1.00
Residential homestead	1.0	2,000	2,360	2,168	1.08
Seasonal recreational residential (i.e., cabin)	1.0	2,000	2,293	2,293	1.15
Residential nonhomestead (1 unit)	1.0	2,000	2,360	2,360	1.18
Residential nonhomestead (2-3 units)	1.25	2,500	2,860	2,860	1.43
Apartment	1.25	2,500	2,860	2,860	1.43
Low-income apartment	0.75	1,500	1,770	1,770	0.89
Commercial/Industrial	1.5/2.0	3,250	5,170	5,170	2.59
Commercial/Industrial @ $2,000,000***	1.5/2.0	39,250	61,690	61,690	3.08

* These examples assume a total local net tax capacity tax rate of 100 percent, a total market value tax rate of 0.18 percent, a state commercial-industrial tax rate of 46 percent, and a state seasonal recreational tax rate of 19 percent.

** The agricultural homestead is assumed to consist of a house valued at $40,000 and agricultural land and buildings valued at $160,000.

*** 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 steve.hinze@house.mn or Karen Baker at karen.baker@house.mn.

HOUSE RESEARCH | **Short Subjects**

Joel Michael

September 2010

Estate and Inheritance Taxation: An Overview of Taxes in the States

After Congress repealed the credit that allowed states to impose "pickup" estate taxes that were borne by the federal treasury, 41 states eliminated their taxes

From 1924 through 2001, the federal estate tax allowed a dollar-for-dollar credit for state death taxes paid (up to maximum limits). All states imposed estate taxes up to the amount of the federal credit; some states also imposed additional inheritance or estate taxes. The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA) repealed the federal credit for state death taxes (effective for deaths after December 31, 2004). Now that they can no longer impose taxes that do not increase the total tax burden on estates and heirs, most states (41 for 2010 deaths) no longer impose estate or inheritance taxes. Minnesota has opted to continue imposing an estate tax equal to the credit under pre-EGTRRA federal law.

This short subject summarizes the status of state inheritance and estate taxes in the states as of August 2010.

The two types of taxes differ in the base for computing them; one depends on the total size of the estate, the other on to whom bequests are made

Estate taxes generally apply a single tax rate schedule to the taxable value of the decedent's total estate (bequests to charities and surviving spouses are typically exempt).

Inheritance taxes apply varying tax rate schedules to bequests made to different classes of beneficiaries. Bequests to surviving spouses and lineal heirs typically enjoy lower rates or are totally exempt, while bequests to more distant or unrelated heirs (collateral heirs) are usually taxed at higher rates or have lower exemptions or both.

Eleven states and the District of Columbia impose only estate taxes

For decedents dying in calendar year 2010, 11 states (Connecticut, Delaware, Hawaii, Massachusetts, Minnesota, New York, Ohio, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia impose estate taxes. Two of these states (Delaware and Hawaii) had allowed their taxes to expire after EGTRRA repealed the federal credit for state death taxes, but reenacted the taxes in 2010 in response to the reductions in revenue resulting from the Great Recession (as the most recent economic recession has been called).

Exemption amounts under the state estate taxes vary. Three states have $3.5 million exemptions, two have $2 million, five, including Minnesota, have $1 million, and Ohio has a $338,333 exemption. Top rates range from 7 percent to 19 percent with most states, like Minnesota, imposing a top rate of 16 percent.

Six states impose only inheritance taxes

Six states (Indiana, Iowa, Kentucky, Nebraska, Pennsylvania, and Tennessee) impose only inheritance taxes.

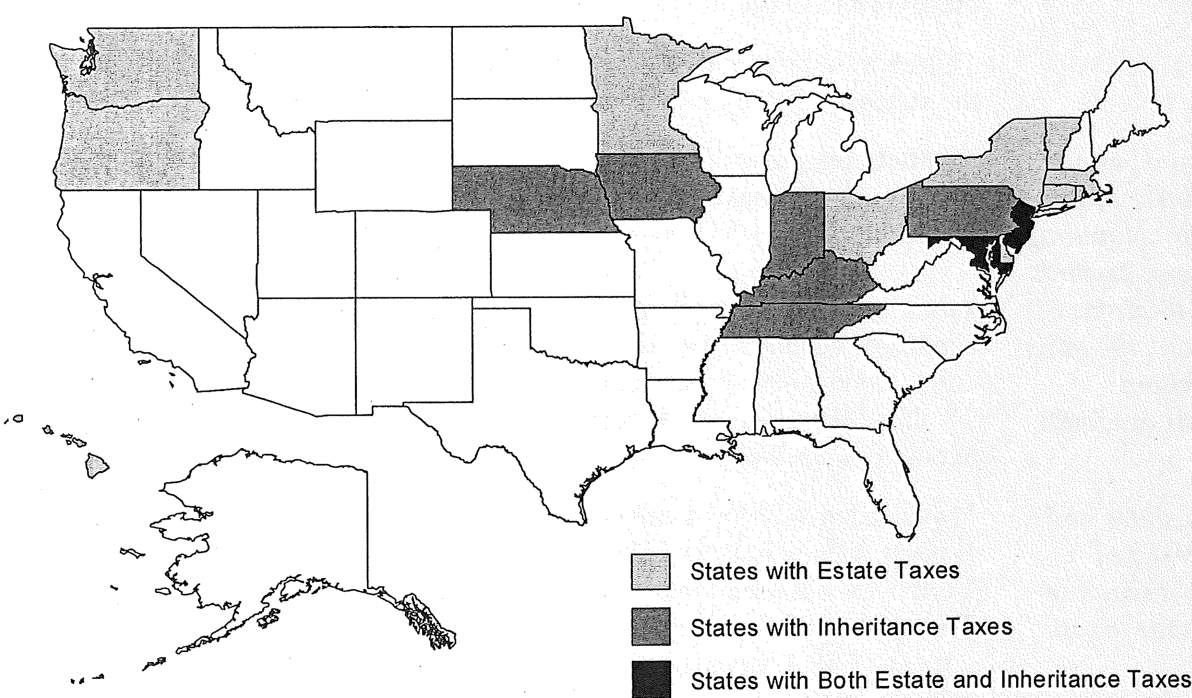
The exemptions under these taxes vary greatly, ranging from $100 (Indiana) for bequests to unrelated individuals to unlimited exemptions (Iowa and Kentucky) for bequests to lineal heirs, such as children or parents of the decedent. (Most states do not tax bequests to surviving spouses under either estate or inheritance taxes.) Top tax rates range from 4.5 percent (Pennsylvania on lineal heirs) to 20 percent (Indiana on collateral heirs).

Two states impose both taxes

Maryland and New Jersey impose both types of taxes, but the estate tax paid is a credit against the inheritance tax, so the total tax liability is not the sum of the two, but the greater of the two taxes. Maryland's estate tax has a $1 million exemption, and New Jersey's tax, a $675,000 exemption.

The map shows the states with estates and inheritance taxes.

State Estate and Inheritance Taxes



For more information: See the information brief *Survey of State Estate, Inheritance, and Gift Taxes*, September 2010.

HOUSE RESEARCH | Short Subjects

Danyell Punelli September 2010

Electronic Benefits Transfer (EBT)

What is electronic benefits transfer?

Since October 1998, cash and Food Support benefits have been issued by Minnesota counties to all recipients in an electronic debit card format known as EBT, or electronic benefits transfer. An EBT card looks and works like any other bank debit card. Benefits are issued directly to families receiving Minnesota Family Investment Program (MFIP) and Food Support benefits. As part of the 1996 federal welfare reform, all states were required to move to EBT systems by October 1, 2001.

How do the assistance programs work?

MFIP benefits are based on family size, with the MFIP grant composed of a cash portion and a food portion. Counties issue both the cash and the food portion of an MFIP family's grant in EBT form. MFIP families receive the food portion of assistance as a part of the MFIP grant, instead of receiving a separate benefit payment through the federal Supplemental Nutrition Assistance Program (SNAP). The MFIP food portion uses the same EBT mechanism to deliver the MFIP food benefits as the stand-alone Food Support program does. However, the two kinds of MFIP benefits (cash and food) are electronically segregated on the family's EBT card. This ensures that the family can only use the food portion of their MFIP benefit to purchase food items that are approved under the federal SNAP program, from a retailer that has been approved under that program.

Food Support assists households composed of eligible single individuals and families. Generally speaking, the basic Food Support household consists of individuals living together who purchase and prepare meals in common. A household qualifies for the Food Support program if it satisfies certain eligibility requirements or if its income and assets are below the program's established limits.

The Food Support program benefits, and MFIP food portion, are adjusted as needed to reflect cost-of-living adjustments to the federal SNAP. The MFIP cash portion is not automatically adjusted.

MFIP benefits are vendor-paid for the first six months a family is on the program. A county pays the family's shelter costs, up to the amount of the cash portion of the family's MFIP grant, directly to the landlord or mortgage holder.

Are there restrictions on what EBT can be used to purchase?

Food Support may only be used to purchase federally approved food and food products, excluding alcohol, tobacco, and pet food, in approved stores. Approved stores include grocery stores and convenience stores that sell a variety of foods and have been authorized to accept Minnesota EBT cards. Individuals over 60 (and their spouses), blind and disabled persons, and homeless individuals can also use Food Support to purchase meals in authorized restaurants. In addition, Food

Support can be used to purchase hot foods or hot food products through nonprofit meal delivery services, at communal dining facilities, and at institutions serving meals to drug addicts, alcoholics, and battered women and children.

There are no such restrictions on the cash portion of the MFIP benefit; the family accesses these benefits through point-of-sale terminals or automatic teller machines (ATMs).

How often do benefits get issued?

Each month, a family's EBT account is credited with their cash and Food Support benefits. During the month, the family uses the EBT card to purchase items or withdraw cash. The family swipes their EBT card through a point-of-sale terminal or ATM, and the purchases or withdrawn cash are deducted from their account balance. Cash may only be withdrawn from the cash portion of the MFIP benefit.

In federal fiscal year 2010, a family of three with no earnings would receive an MFIP cash benefit of $532 and food benefit of $473 per month. In July 2010, the average monthly Food Support amount issued per household was $258.75.

For more information: Contact legislative analyst Danyell Punelli at 651-296-5058. Also see the House Research publication *Minnesota Family Assistance*, December 2009.

HOUSE RESEARCH | Short Subjects

Matt Burress

Updated: September 2010

County State-Aid Highway System

Overview

The county state-aid highway system is a network of key highways under the jurisdiction of Minnesota's counties. It covers roughly 30,500 miles, comprises just over two-thirds of all county highway miles, and includes roadways within all 87 counties. Counties receive money from the state's county state-aid highway (CSAH) fund for the construction, improvement, and maintenance of their highways included in the state-aid system. Under a 2008 change, two formulas determine how much aid is allocated to each county.

Sources of revenue

State aid is provided through the CSAH fund, which is established by the Minnesota Constitution. Revenue mainly comes from taxes on motor fuels, motor vehicle registration, and motor vehicle sales. Available revenue consisted of $423.1 million in calendar year 2010. (This briefing does not discuss a CSAH fund "set-aside" that goes into town road, town bridge, and flexible highway accounts, some of which may also be provided to counties.)

Limitations on aid

Among the requirements accompanying the aid, counties must typically expend 60 percent of their allocation on construction projects and 40 percent on maintenance efforts. Minn. Rules part 8820.1400. Counties are also required to expend a share of their aid on stretches of county state-aid highways located within small cities having a population under 5,000. Minn. Stat. § 162.08, subd. 1. In general, the amount expended must at least be proportional, based on the construction needs for county state-aid highway segments located in a county's small cities compared to the total construction needs in that county's state-aid highway system.

Distribution of funds

Money in the CSAH fund is allocated on a calendar-year basis (using actual tax receipts as well as estimates). A portion is set aside as deductions for county highway-related purposes, including: (1) MnDOT administrative costs, (2) a disaster account, (3) a research account, and (4) a state park roads account. The calendar year 2010 deductions amounted to $16.1 million, or about 5 percent of the total in the fund.

Direct aid, at about $407 million in calendar year 2010, is divided into two categories. The first is the **apportionment sum** and the second is the **excess sum**. Each category reflects a distinct revenue stream and each contains a statutory formula to calculate the aid distribution among the counties. Minn. Stat. § 162.07.

Apportionment sum revenue and distribution formula

The apportionment sum revenue consists of available CSAH fund dollars that are not identified as part of the excess sum (described below). The funds are distributed to counties following a statutory formula, so that:

- 10 percent of the apportionment sum is divided equally among all counties;
- 10 percent is proportional, based on motor vehicle registration in each county (compared to the total for all counties);

- 30 percent is proportional, based on county state-aid highway lane-miles (compared to the total for all counties); and
- 50 percent is proportional, based on county construction needs to bring the system up to county engineering standards. Minn. Stat. § 162.07, subd. 1b.

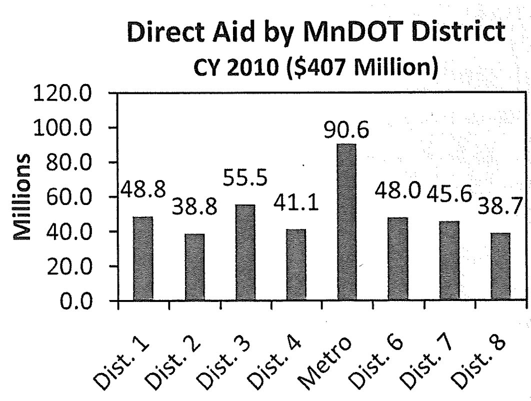
Excess sum revenue Excess sum revenue consists of the total from three sources:

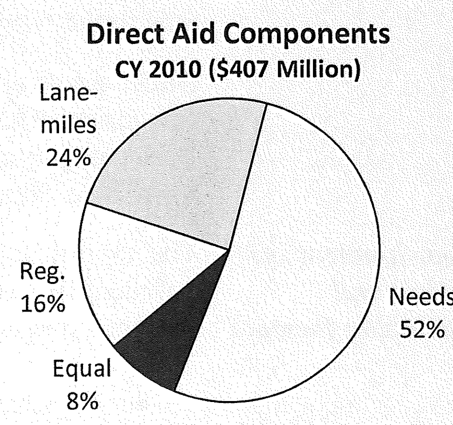
- revenue from motor fuels tax above the amount collected at a rate of 20 cents per gallon (which is composed of new revenue from a motor fuels tax increase established in 2008 transportation finance legislation);
- revenue from the registration tax above the inflation-adjusted amount collected in fiscal year 2008 (which is designed to identify increased revenue resulting from registration tax changes also made 2008); and
- revenue from the motor vehicle sales tax above the percentage allocated to the CSAH fund in fiscal year 2007 (which is designed to reflect additional motor vehicle sales tax revenue currently being phased in for transportation purposes). Minn. Stat. § 162.07, subd. 1a.

Excess sum distribution formula The formula for distributing the excess sum is 40 percent proportional, based on motor vehicle registration in each county, and 60 percent proportional, based on each county's construction needs. Minn. Stat. § 162.07, subd. 1c.

Analysis of formulas The apportionment and excess sum categories were introduced in 2008 as part of legislation that increased funding for transportation purposes. Laws 2008, ch. 152. The creation of two aid formulas was designed to address equity concerns in the statewide distribution of the aid.

For 2010, the excess sum consisted of $81.5 million or 20 percent of the formula-based direct aid allocated to counties (that is, excluding deductions). However, the share of aid distributed under the excess sum formula—as opposed to the apportionment sum formula—is expected to increase. This is because in the next few years additional revenue is projected for transportation purposes due to recent legislation, and the increased revenue will mainly be distributed under the excess sum formula. The effect of the predicted revenue growth will likely be to de-emphasize the county lane-miles formula component and more heavily weight vehicle registration as well as construction needs.





Lisa Larson

Revised: September 2010

Voluntary School Integration: 2007 U.S. Supreme Court Decision

The U.S. Supreme Court ruled that two districts with voluntary integration plans could not use race in assigning students to public schools

The most recent voluntary school integration case decided by the U.S. Supreme Court, *Parents Involved in Community Schools v. Seattle School District No. 1*, 551 U.S. 701 (2007), and a companion case, *Meredith v. Jefferson County Board of Education*, challenged school districts' race-conscious attendance policies under the Equal Protection Clause of the Fourteenth Amendment. In a decision where five different justices filed opinions and Justice Kennedy's fifth vote, in effect, decided the case, a Court majority struck down the voluntary integration plans of these two districts under a strict-scrutiny analysis, ruling that the district plans were not narrowly tailored to the districts' interest in maintaining racially diverse schools. Although the Court ruled the districts' plans impermissible because they involved racial classifications that violated the Equal Protection Clause of the Fourteenth Amendment, it did not foreclose school districts' ability to use nuanced, racial-conscious alternatives to constitutionally pursue racial diversity in schools.

The Fourteenth Amendment serves to prevent and remedy segregation and eliminate the inequitable separation of races. It also gives equal opportunity to every person regardless of race and protects against denying a person an opportunity because of race.

The Court uses strict scrutiny to review cases where government action "distributes burdens or benefits on the basis of individual racial classifications." To survive strict scrutiny, the government must show that it had a compelling interest in using racial classifications and that its classifications were narrowly tailored to meet that interest.

The two districts used racial balancing to decide school admissions and reflect the racial composition of the district

In Seattle, the school district's open choice policy allowed incoming ninth graders to choose which high school they wanted to attend. The district used two tiebreakers to decide which students to admit to an oversubscribed high school: whether a sibling already attended the high school; and whether a student would disrupt the school's racial balance. In Louisville, after a court removed a decree ordering the Jefferson County schools to desegregate, the county adopted a voluntary student assignment plan, assigning kindergarteners, first graders, and transfer students based on available space and racial guidelines and denying admission to middle school and high school students who disrupted those racial guidelines.

The Court rejected the two school admission plans based on a strict-scrutiny analysis

The Court rejected the two school desegregation plans based on a strict-scrutiny analysis that requires government actions to be narrowly tailored to achieve a compelling government interest. In these cases, the Court considered whether the student assignment plans were narrowly tailored and whether the goal of racial diversity among students was a compelling government interest.

The Court allows public schools to use race-based assignments to remedy past discrimination

According to the Court, school officials may use race to assign students to public schools to: remedy past intentional segregation; or create educational diversity in higher education, consistent with *Grutter v. Bollinger*, a case about whether a law school may use race-conscious admissions criteria. The Seattle school district had no history of forced segregation and Jefferson County was not required to desegregate schools after its desegregation decree was removed. In *Grutter*, however, the Court allowed the University of Michigan to consider an applicant's race among other factors when deciding who would benefit its law school by contributing to a more diverse experience. The university could include race as a basis for admission to its law school because it evaluated student applicants as individuals and not as members of a racial group.

A Court majority said that racial diversity is a compelling educational goal

A Court majority said that racial diversity, depending on its meaning and definition, is a compelling educational goal. However, the Court was not persuaded by the Seattle district's argument that its admissions plan served a compelling government interest both in undoing the school segregation caused by the city's housing patterns and in providing a superior, racially diverse learning environment. The Court rejected the district argument, finding that the schools' admissions plans were tied to "specific racial demographics, rather than to any pedagogical concept of the level of diversity needed to obtain the asserted educational benefits."

The two districts' race-based admissions plans were not narrowly tailored and therefore impermissible

The court found that the two districts' race-based admissions plans were not narrowly tailored and that the districts had failed to consider race-neutral alternatives as a way to achieve racial diversity in schools. Unlike *Grutter,* where race had been one of a number of factors for determining admission, these districts had used race as a primary or the sole factor in assigning students. Justice Kennedy, whose concurrence serves as the controlling opinion, wrote that race-conscious policies that are not discriminatory are permissible and do not demand strict scrutiny.

Justice Kennedy stated that schools may use race-conscious alternatives to achieve racial diversity without discrimination

Justice Kennedy also stated in his concurrence that diversity for the purpose of offering all students equal educational opportunity is a compelling interest. To that end, schools with voluntary plans may use race-conscious measures to make school assignments if the measures address the problem of limited diversity and do not treat students differently solely based on race. For example, schools may achieve diversity through alternatives such as strategically placed new schools, demographically sensitive attendance zones, targeted recruitment of students and faculty, tracking student enrollment, performance, and other race data, and the allocation of resources for special programs. According to Justice Kennedy, these race-conscious alternatives, which can achieve racial diversity in schools without racial discrimination, would be constitutionally permissible.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

Matt Burress Updated: October 2010

Municipal State-Aid Street System

The municipal state-aid street system is a collection of about 3,500 miles of key streets located in 144 Minnesota cities. The system constitutes less than 16 percent of all miles of city streets. Cities receive financial assistance from the state for the construction and maintenance of those streets included in the system. Assistance comes from a portion of constitutionally dedicated, transportation-related taxes. Based on a statutory formula, the aid is distributed through a state-aid program administered by the Minnesota Department of Transportation (MnDOT). Minn. Stat. § 162.13. The aid can only be expended on streets that constitute part of the municipal state-aid street system. Total available funds for calendar year 2010 amounted to $130.7 million.

Constitutional and statutory framework for state aid

The Minnesota Constitution establishes a basic framework for state highway finance. It (1) dedicates funding to be "used solely for highway purposes" through taxes on motor fuels, motor vehicle registration, and motor vehicle sales; (2) establishes various accounting funds, including a municipal state-aid street (MSAS) fund for financial assistance to cities; (3) allocates tax revenues among state, county, and municipal roads, so that the MSAS fund receives 9 percent of 95 percent of those tax revenues constitutionally dedicated to streets and highways (after some special allocations and transfers); and (4) establishes certain requirements related to use of the funds and characteristics each highway system. Minn. Const. art. XIV. State statutes further specify finance and policy elements such as aid allocation formulas and requirements for cities to receive aid.

Eligibility and requirements

Within each city, the municipal state-aid street system is restricted to up to 20 percent of the total miles of (1) the city's streets, plus (2) county highways located within the jurisdiction of that city. City streets that were previously part of a state trunk highway or a county highway system and were "turned back" to a city are also included in the municipal state-aid street system and do not count against the 20 percent limit. Minn. Stat. § 162.09.

Among the qualifications under the Minnesota Constitution for inclusion in the system, a city must have a population over 5,000. Minn. Const. art. XIV. (Chisholm fell below the population cutoff but is grandfathered in.) Smaller cities having a population under 5,000 do not receive aid from the MSAS fund. However, such cities are indirectly assisted through a separate program that funds certain county highways: a portion of state funds for the county state-aid highway system provided to each county must be allocated to a municipal account for county state-aid highways located in smaller cities. Minn. Stat. § 162.08.

Distribution of funds

State-aid funding is distributed on a calendar-year basis. MnDOT determines the amount annually based on both tax receipts to date and estimates of receipts for the remainder of that fiscal year. Apportionment amounts are released each January. For calendar year 2010, total available MSAS funding was $130.7 million.

Funds were distributed as follows based on formulas and caps set in state law:

- $127.3 million apportioned by formula as direct aid to cities;
- $2.6 million to an administrative account for MnDOT expenses in administering the state-aid program;
- $167,000 to a disaster account for unforeseen events resulting in undue financial hardship; and
- $609,000 to a research account. Minn. Stat. §§ 162.12, 162.13.

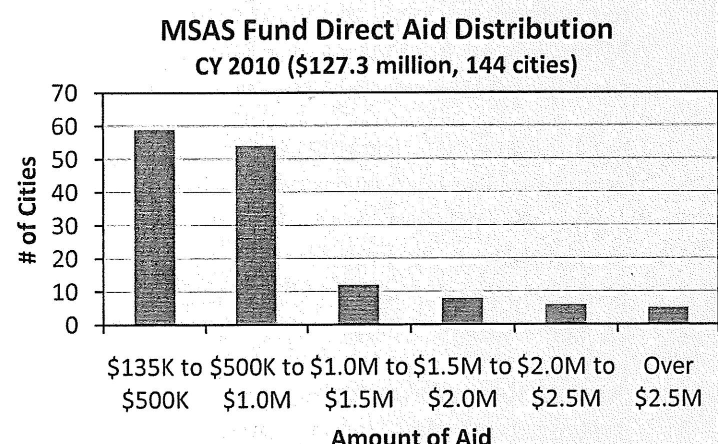
Direct aid allocation formula

Money in the MSAS fund apportioned to cities via direct aid follows a formula provided in statute, so that:

- **50 percent** is divided proportionally based on the population of each city (compared to the total for all cities); and
- **50 percent** is divided proportionally based on the construction needs of each city, which is the amount the city needs to bring all its municipal state-aid streets up to state standards. Minn. Stat. § 162.13.

Analysis of aid apportionment

Owing to the variety of cities having streets in the state-aid system, MSAS fund distributions vary. Calendar year 2010 direct aid apportionments to cities ranged from about $137,000 to over $11 million. The average allocation was $880,000, with 31 cities receiving over $1 million a piece and 11 cities receiving over $2 million. Obviously, because population is a key element of aid allocation, larger cities tend to receive relatively greater amounts of funding. The following chart groups cities based on amount of aid distributed.



Comparing 2009 to 2010 direct aid apportionments, all cities had an increase in apportionment based on the population component of the funding allocation formula, while 42 cities saw a decrease under the construction-needs component. The net result was an aid decrease for ten cities and an increase for the remaining 134 cities. The largest net decrease was relatively modest, at about $28,000.

For more information: Contact legislative analyst Matt Burress at 651-296-5045. Also see the House Research publication *Highway Finance Overview*, November 2009.

Randall Chun

Revised: September 2010

General Assistance Medical Care: An Overview

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. 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). Significant changes were made to the program during the 2010 session, in part as a response to Gov. Tim Pawlenty's line-item veto, following the 2009 session, of the fiscal year 2011 appropriation for the program.

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 (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*
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)
Other eligible persons	75 percent of federal poverty guidelines (FPG)	$1,000 per household

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

Eligibility changes made by the 2010 Legislature include eliminating: (1) eligibility for certain subgroups; (2) hospital-only coverage for persons with incomes greater than 75 percent but not exceeding 175 percent of FPG; and (3) the requirement that certain groups of GAMC enrollees without a qualifying condition (such as disability) enroll in the MinnesotaCare program.

Service Delivery

GAMC recipients can receive GAMC services from hospitals that have contracted with DHS to provide those services through a **coordinated care delivery system** (CCDS). A recipient is allowed to enroll in any available CCDS statewide, subject to enrollment limits specific to each CCDS. Recipients must receive all nonemergency services through the CCDS.

The following four hospitals currently operate a CCDS: Hennepin County Medical Center, North Memorial Medical Center, Regions Hospital, and University of Minnesota Medical Center, Fairview. As of September 13, 2010, Hennepin County Medical Center is the only CCDS that has not reached its enrollment limit and continues to accept new enrollees.

Hospitals that are not part of a CCDS can receive payment for inpatient and outpatient hospital services provided to GAMC enrollees who are not enrolled in a CCDS from a **temporary uncompensated care pool** (operational from June 1, 2010, through February 28, 2011).

Outpatient prescription drugs for all GAMC enrollees, whether or not they are enrolled in a CCDS, are funded through a **prescription drug pool** on a fee-for-service basis. A CCDS is required to pay DHS 20 percent of the cost of drugs provided to its enrollees.

Covered services

GAMC recipients enrolled in a CCDS receive coverage for an alternative benefit set. (CCDSs also have the option to provide the regular GAMC benefit set, slightly modified; no CCDS has chosen this option.) The alternative benefit set must include, but is not limited to: emergency care, medical transportation services, inpatient hospital and physician services, outpatient health services, preventive health services, mental health services, and prescription drugs administered in a clinic or other outpatient setting.

GAMC recipients who are not enrolled in a CCDS receive GAMC coverage only for outpatient prescription drugs funded through prescription drug pool. These recipients can also seek services from non-CCDS hospitals that obtain payments from the temporary uncompensated care pool.

Cost-sharing

Recipients are subject to the following copayments: (1) $25 for nonemergency visits to an emergency room; and (2) $3 per brand-name prescription and $1 per generic, subject to a $7 per-month limit. Antipsychotic drugs are exempt from copayments.

CCDS Payments

Each CCDS is paid quarterly from the available appropriation, in proportion to its share of calendar year 2008 GAMC fee-for-service payments. DHS can reallocate payments twice a year to reflect actual CCDS enrollment and chose to do this effective September 1, 2010.

Funding and expenditures

GAMC is completely state-funded; there is no federal funding. Unlike the old GAMC program, the modified GAMC program is not an entitlement. Enrollment in a CCDS is subject to enrollment limits and funding for the CCDS system, temporary uncompensated care pool, and prescription drug pool is fixed. Absent legislative action, funding will not increase with additional enrollment or the provision of additional services. For fiscal year 2011, the legislature appropriated $127.2 million for the GAMC program; the annual appropriation is reduced to $98.7 million for fiscal year 2012 and subsequent fiscal years to reflect the elimination of the temporary uncompensated care pool.

Recipients

The average monthly number of GAMC recipients for the calendar quarter ending June 30, 2010, was 31,630. As of September 3, 2010, 12,359 GAMC recipients were enrolled in a CCDS and the cumulative enrollment limit for all four CCDSs was 14,990.

For more information: See the House Research information brief *General Assistance Medical Care*, September 2010.

HOUSE RESEARCH | Short Subjects

Randall Chun

Revised: September 2010

MinnesotaCare: An Overview

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 ($60,672 for a household of four), and 250 percent of FPG for adults without children ($27,084 for a household of one and $36,444 for a household of two). Parents with annual gross incomes over $50,000 (to increase to $57,500 upon federal approval) 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 (to increase to 200 percent of FPG upon federal approval) 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 (to increase to 200 percent of FPG upon federal approval), and certain other children are exempt from this requirement if they are considered to be "underinsured."
- 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.

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 adults without children are covered for most, but not all MA services. Parents with household incomes greater than 215 percent of FPG and all adults without children are subject to an annual inpatient hospital benefit limit of $10,000. Services not covered include personal care attendant services, private duty nursing, nursing home care, ICF/DD (intermediate care facility for persons with developmental disabilities), and special transportation 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. Effective upon federal approval, children with family incomes not exceeding 200 percent of FPG will not be charged premiums. Adult enrollees who are not pregnant are subject to coinsurance and copayments for specified services.

Provider reimbursement

Nearly 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 2009, the MinnesotaCare program paid $526 million for medical services provided to enrollees. Sixty-five percent of this cost was paid for by the state, 29 percent by the federal government, and 6 percent by enrollees through premium payments (this last category also includes enrollee cost-sharing).

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 Children's Health Insurance Program) for children under age 21 with incomes equal to or greater than 133 percent, but not exceeding 275 percent of FPG.

Recipients

As of May 2010, 141,070 individuals were enrolled in the MinnesotaCare program. Just over one-half of these enrollees were 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: See the House Research information brief *MinnesotaCare*, September 2010.

Kathy Novak **Updated: September 2010**

Governing Higher Education in Minnesota: Public Postsecondary Systems and Agencies

Minnesota has two public postsecondary systems and one state agency dealing with postsecondary education

Minnesota has two public postsecondary systems:

- The **Minnesota State Colleges and Universities (MnSCU)** system has seven four-year universities and 25 two-year colleges located throughout Minnesota. MnSCU institutions provide occupational, general, baccalaureate, and graduate education, including certain applied doctoral degrees. The MnSCU system office—the office of the chancellor—is in St. Paul.
- The **University of Minnesota** is a major research institution with five campuses providing undergraduate, graduate, and professional education and research and outreach centers throughout Minnesota. The main campus and central administration are in the Twin Cities.

The **Minnesota Office of Higher Education** is a state agency responsible for postsecondary financial aid and other assistance programs, data and information, and registration and licensing of private postsecondary institutions. The Minnesota Office of Higher Education is the successor to the Higher Education Services Office.

MnSCU is governed by state law and a board of trustees

Minnesota Law. MnSCU is established in Minnesota Statutes, chapter 136F. In 1991, the legislature created MnSCU through the merger of the state universities, community colleges, and technical colleges. Minnesota Statutes:

- establish a 15-member board of trustees to govern MnSCU;
- specify the board's powers to manage MnSCU, its assets, and its institutions;
- designate the specific colleges and universities in the MnSCU system;
- require legislation to create any new MnSCU institution or location;
- authorize the colleges and universities to operate specific enterprises; and
- require the board to recognize statewide student associations.

Board of Trustees. Under state law, the governor appoints 15 trustees with the advice and consent of the Senate. Eight members of the board must reside in the state's eight congressional districts, one in each district. Three members must be MnSCU students and one member must represent labor. Student trustees serve two-year terms; other trustees serve staggered six-year terms. Except for the student and labor trustees, trustee candidates are recruited and screened by the Trustee Advisory Council, established in state law. All recommendations on trustee appointments are made to the governor.

Minnesota Statutes give the board of trustees all the power necessary to govern MnSCU, unless otherwise directed or prohibited in law. The board is responsible for appointing a chancellor with the authority to perform duties the board delegates. Minnesota law can put conditions on state appropriations for MnSCU.

The University of Minnesota is governed by the state constitution, state laws, and a board of regents

University Charter, Minnesota Constitution. The territorial legislature established the University of Minnesota in 1851, governed by a 12-member board of regents. The Minnesota Constitution incorporates the university charter by continuing all of the "rights, immunities, franchises and endowments" previously conferred to the university.

Board of Regents. The constitution requires the legislature to elect 12 regents to staggered six-year terms. The governor may appoint a regent to fill a vacancy who serves until the legislature elects a replacement. Regent candidates are recruited and screened by the Regent Advisory Council established in state law. The council makes its recommendations to a joint legislative committee, also established in law, consisting of members of legislative committees with jurisdiction over higher education. The regents have the power to manage the university and all its campuses and facilities. Under the university charter, the board has responsibility for selecting the university president.

Minnesota Law. Minnesota Statutes, chapter 137, requires eight of the elected regents to reside in the state's eight congressional districts, one in each district. One at-large regent must be a student when elected. This chapter specifically provides authority for the regents to exercise eminent domain, accept federal money, control the permanent university fund, and establish a branch campus in Rochester. State law prohibits the regents from allowing expenditures for a purpose beyond the amount appropriated. State law also may put conditions on the university appropriations, if the conditions don't violate the university's constitutional autonomy.

The Minnesota Office of Higher Education is created by state law and advised by a council

Minnesota Law. The Minnesota Office of Higher Education (MOHE) is established in chapter 136A of Minnesota Statutes. Since 2004, the office has been under the administrative control of a director appointed by the governor with the advice and consent of the Senate.

Advisory Councils. The statutes establish two advisory councils that do not expire. The Higher Education Advisory Council (HEAC) consists of a representative of public and private higher education, the Department of Education, and a member appointed by the governor. HEAC brings higher education matters to the attention of MOHE. The Student Advisory Council (SAC) is made up of student representatives of public and private postsecondary student associations. SAC reports quarterly to MOHE and may make recommendations, as appropriate.

Director. The director of MOHE serves at the pleasure of the governor and has administrative control over the office.

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

Karen Baker and Nina Manzi

Updated: October 2010

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. In determining eligibility, the previous year's tax amount is the net amount paid by the homeowner after deduction of any targeting refund received in that year.

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 after deduction of targeting or (2) $100. The maximum refund is $1,000. The following example shows how the refund is calculated.

Payable 2010 Property Tax after Targeting Payable 2011 Property Tax	$1,400 2,000
2011 tax increase (over 2010) Taxpayer pays first 12% of increase compared to previous year's tax, which must be at least $100 (12% x 1,400)	$600 168
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 2011 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 2011 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 over 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 decreased substantially from $13.6 million in 2006 to nearly $6.1 million in 2009, with much of the decrease 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, Filed 2006 – 2009 (dollars in thousands)

	Filed 2006	Filed 2007	Filed 2008	Filed 2009
Total Metro	$10,224	$4,940	$4,330	$3,750
Total Nonmetro	$3,390	$2,655	$3,046	$2,338
State	$13,614	$7,595	$7,376	$6,088

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 if all eligible taxpayers had filed.

How many homeowners claim the refund?

In 2009, nearly 42,000 homeowners claimed refunds based on their property tax increase from payable 2008 to 2009. The average refund amount was $146.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) 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, 2011, will be paid beginning in late September 2011. The deadline for filing claims based on taxes payable in 2011 is August 15, 2012; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's web site, under "Forms and Instructions" (www.taxes.state.mn.us).

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.taxes.state.mn.us. Also see the House Research Short Subject *Homeowner's Property Tax Refund Program*, December 2009, and the Information Brief *Targeting*, December 2008.

HOUSE RESEARCH | Short Subjects

Karen Baker and Steve Hinze

Updated: October 2010

Senior Citizens Property Tax Deferral Program

What is the Senior Citizens Property Tax Deferral Program?

The Senior Citizens Property Tax Deferral Program allows property taxpayers who are 65 years or older, and whose total household income is $60,000 or less, to defer a portion of their homestead property taxes until some later time. It allows senior citizens whose property taxes are high relative to their incomes, but who wish to stay in their homes, an option for paying their property taxes.

How does it work?

Regardless of how high the tax is on the homestead, the taxpayer initially pays an amount equal to only 3 percent of the total preceding year's household income. The state pays any amount over 3 percent, called the "deferred tax," to the county in which the home is located. A lien attaches to the property. The deferred tax is a loan. Interest on the loan is calculated at the same rate as unpaid state taxes (a floating rate), but cannot exceed 5 percent. Before the owner can transfer the title of the property, the deferred tax plus interest must be repaid.

For example, John and Mary Jones own a home; its total property tax is $1,400. They have a total household income of $30,000. Under this program, they must pay $900 in tax (3 percent of $30,000); the remaining $500 ($1,400 minus $900) is deferred.

Who qualifies?

In order to qualify for the program, **all** of the following criteria must be met:

- The property must be owned and occupied as a homestead by a person at least 65 years old (If married, one spouse must be at least 65 years old and the other must be at least 62 years old)
- Total household income must be $60,000 or less for the calendar year preceding the year of the initial application
- The home must have been owned and occupied as the homestead of at least one of the homeowners for at least 15 years before the initial application
- There must be no state or federal tax liens or judgment liens on the property
- The total unpaid balances of debts secured by mortgages and other liens on the property, including deferred tax and interest amounts under the program, unpaid and delinquent special assessments and property taxes, penalties and interest (but excluding the current year's property taxes), do not exceed 75 percent of the assessor's estimated market value for the current year

Does the taxpayer need to annually reapply?

No, once a taxpayer is enrolled in the program, annual applications are not required. However, if household income exceeds $60,000 in any calendar year, the owner must notify the Department of Revenue. No *further* property taxes may be deferred until income falls below the $60,000 threshold. However, the owners will remain enrolled in the program until their income falls below the $60,000 threshold, at which point they must notify the state and request that the deferral be resumed.

Can the taxpayer still file for refunds?

Yes, a taxpayer is still allowed to file for the property tax refund and any other property rebates that the state may offer. However, no direct cash payments will be made to the taxpayer. Rather, the amount of the refund will be applied to the total amount of the deferred property tax on the taxpayer's home. The property tax refund is calculated on the full tax amount.

When does it terminate?

The deferral terminates when **any one** of the following events occurs:

- the property is sold or transferred
- all qualifying homeowners die
- the homeowner notifies the Commissioner of Revenue, in writing, of intent to withdraw from the program
- the property no longer qualifies as a homestead

How does this program differ from a reverse mortgage?

A reverse mortgage loan is a loan arrangement with a lender, secured by a mortgage (lien), where the homeowner **receives** a monthly payment from the lender. The total dollar amount is established at the beginning of the arrangement. The full amount, plus interest, is due when the home is sold. The lender charges closing costs, which can be substantial.

The senior citizen deferral program also constitutes a lien on the property, but the homeowner does not need to guess "up front" how many dollars are needed. Rather any tax amount over 3 percent of income is automatically deferred. Interest, not to exceed 5 percent, is charged on the deferred tax as it is accumulated.

How many taxpayers are participating in the program?

For property taxes payable in 2010, qualifying taxpayers are using the program to defer taxes on 271 homes. The Department of Revenue reimbursed the counties $838,315 for the deferred tax in 2010.

Where does a taxpayer apply for the program?

Applications are available in the county auditor's office or may be obtained from the Department of Revenue's web site at www.taxes.state.mn.us/forms/documents/crscd.pdf.

For more information: Contact legislative analyst Karen Baker at karen.baker@house.mn or Steve Hinze at steve.hinze@house.mn.

HOUSE RESEARCH | Short Subjects

Joel Michael and Nina Manzi

Updated: September 2010

Revenue Recapture Program

Revenue recapture allows state and some local governments to collect debts by intercepting tax refunds

Revenue recapture authorizes the Department of Revenue (DOR) to intercept or offset part or all of a state tax refund or other payment to collect a debt that the taxpayer owes to a government agency or other authorized creditor.

The following agencies may use the Revenue Recapture Program:

- State agencies
- University of Minnesota
- Minnesota district courts
- Counties
- Cities for public ambulance service and public library debts
- Governmentally owned hospitals and Regions Hospital
- Agencies responsible for child support enforcement
- Agencies that administer low-income housing programs

A variety of debts qualify for collection using recapture

The debt (minimum amount of $25) must be owed to or collectable by one of the qualifying governmental agencies. The debtor must be an individual; the law does not apply to corporations. The creditor does not need to obtain a court judgment or order to enforce the debt. Qualifying debts include the following:

- Contractual or statutory obligations
- Criminal fines and fines for petty misdemeanors
- Court-ordered restitution for a crime
- Child support obligations
- Overpayment of public assistance
- Unpaid MinnesotaCare insurance premiums

Obligations of low-income individuals (incomes between $11,380 and $21,510 in 2009, depending upon family size) to repay debts for medical care, including hospitalization, cannot be recaptured. Debts barred by the statute of limitations also cannot be recaptured.

Amounts available to offset qualifying debts are applied first to unpaid taxes, interest, and penalties before revenue recapture takes effect.

Some types of refunds are subject to recapture

Revenue recapture applies to the following:

- Individual income tax refunds
- Property tax refunds
- Sustainable forest tax payments
- Lottery prizes

The claimant must notify debtor about revenue recapture

Under revenue recapture, a claimant (creditor) agency submits the claim (debt) to DOR for offset. Within five days after doing so, it must notify the debtor-taxpayer in writing of the debt(s) that will be subject to revenue recapture. The taxpayer then has 45 days to request a hearing, which the claimant agency initiates; the hearing is conducted as a contested case under the Administrative Procedures Act.

Child support has first priority for collection

When more than one debt is submitted, the debts are applied in the following order of priority:

- Child support obligations
- Restitution obligations
- Claims submitted for a hospital or ambulance service
- Other debts based on the order in which DOR received the claims

DOR accounts receivable (e.g., unpaid taxes, interest, and penalties) are offset before claims under revenue recapture.

A $15 administrative fee applies

A fee of $15 per claim is first deducted from the refund, and the claimant agency receives the balance of the refund or the claim amount, whichever is less. Of this $15, $4 is set aside in a dedicated, revolving fund to pay DOR's cost of operating the program; the rest goes to the state's general fund.

More than $72 million was recaptured in 2009

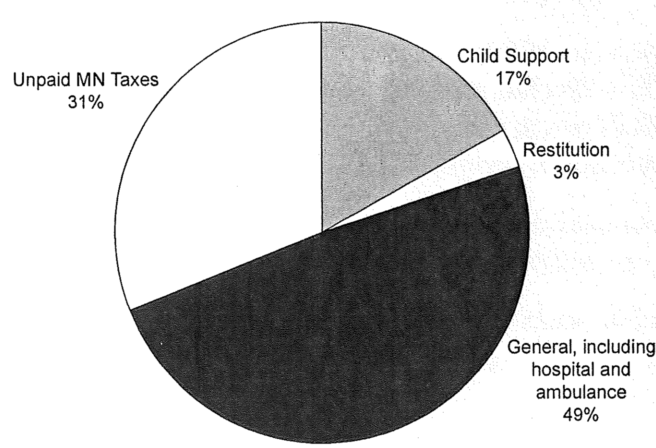
The table to the right shows the number of revenue recapture offsets and amount of refunds offset for calendar years 2005 to 2009.

The graph below shows the percentage of revenue recapture amounts and tax debts offset for calendar years 2005 to 2009 by four of the major types of debts for which the law sets priorities.

Revenue Recapture Amounts CY2005-2009

	Number of Offsets	Amount of Recapture
2005	210,655	$59,247,902
2006	179,754	$59,945,770
2007	211,636	$68,275,418
2008	230,911	$87,756,822
2009	216,623	$72,845,049

Excludes amounts offset on behalf of the IRS to satisfy debts for taxes owed to the federal government.
Source: DOR



For more information: See www.taxes.state.mn.us/collection/pages/rr_index.aspx for more information for claimant agencies, or call 651-556-4758 or email mdor.recapture@state.mn.us.

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

Joel Michael

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Tax Increment Financing

What is TIF?

Tax increment financing (TIF) uses the increased property taxes that a new real estate development generates to finance costs of the development. In Minnesota, TIF is used for two basic purposes:

- To induce or cause a development or redevelopment that otherwise would not occur—e.g., to convince a developer to build an office building, retail, industrial, or housing development that otherwise would not be constructed. To do so, the increased property taxes are used to pay for costs (e.g., land acquisition or site preparation) that the developer would normally pay.
- To finance public infrastructure (streets, sewer, water, or parking facilities) that are related to the development. In some cases, the developer would be required to pay for this infrastructure through special assessments or other charges. In other cases, all taxpayers would pay through general city taxes.

How does TIF work?

When a new TIF district is created, the county auditor certifies (1) the current net tax capacity (i.e., property tax base) of the TIF district and (2) the local property tax rates. As the net tax capacity of the district increases, the property taxes (i.e., the "tax increment") paid by this increase in value is dedicated and paid to the development authority. The tax increment is limited to the tax derived from the certified tax rate. Increases in value that generate increment may be caused by construction of the development or by general inflation in property values. The authority uses the increment to pay qualifying costs (e.g., land acquisition, site preparation, and public infrastructure) that it has incurred for the TIF project.

How is TIF used to pay "upfront" development costs?

There is a mismatch between when most TIF costs must be paid—at the beginning of a development—and when increments are received—after the development is built and begins paying higher property taxes. Three basic financing techniques are used to finance these upfront costs:

- **Bonds.** The authority or municipality (city or county) may issue its bonds to pay these upfront costs and use increment to pay the bonds back. Often, extra bonds are issued to pay interest on the bonds ("capitalizing" interest) until increments begin to be received.
- **Interfund loans.** In some cases, the authority or city may advance money from its own funds (e.g., a development fund or sewer and water fund) and use the increments to reimburse the fund.
- **Pay-as-you-go financing.** The developer may pay the costs with its own funds. The increments, then, are used to reimburse the developer for these costs. This type of developer financing is often called "pay-as-you-go" or "pay-go" financing.

What governmental units can use TIF?

Minnesota authorizes development authorities to use TIF. These authorities are primarily housing and redevelopment authorities (HRAs), economic development authorities (EDAs), port authorities, and cities. In addition, the "municipality" (usually the city) in which the district is located must approve the TIF plan and some key TIF decisions. TIF uses the property taxes imposed by all types of local governments. But the school district and county, the two other major entities imposing property taxes, are generally limited to providing comments to the development authority and city on proposed uses of TIF. The state-imposed tax on commercial-industrial and seasonal-recreational properties is not captured by TIF.

What is the but-for test?

Before an authority may create a TIF district, it and the city must make "but-for" findings that (1) the development would not occur without TIF assistance and (2) that the market value of the TIF development will be higher (after subtracting the value of the TIF assistance) than what would occur on the site, if TIF were not used.

What types of TIF districts may be created?

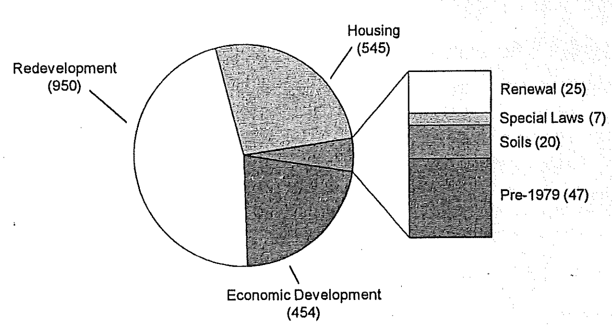
Minnesota allows several different types of TIF districts. The legal restrictions on how long increments may be collected, the sites that qualify, and the purposes for which increments may be used vary with the type of district.

District type	Use of Increment	Maximum duration
Redevelopment	Redevelop blighted areas	25 years
Renewal and renovation	Redevelop areas with obsolete uses, not meeting blight test	15 years
Economic development	Encourage manufacturing and other footloose industries	8 years
Housing	Assist low- and moderate-income housing	25 years
Soils	Clean up contaminated sites	20 years
Compact development	Redevelop commercial areas with more dense developments	25 years

How many TIF districts exist?

According to the 2010 report of the Office of State Auditor (OSA), there were 2,048 active TIF districts in 2008. The graph shows the relative shares by type of district.

TIF Districts by Type in 2008
(2,048 districts)



Source: 2010 Report of the State Auditor

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research web site for more information on TIF at www.house.mn/hrd/issinfo/tifmain.htm.

Nina Manzi and Joel Michael

Updated: October 2010

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 2010, businesses can claim up to $500,000 of property expenditures under section 179. If a business places more than $2 million 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 $2.5 million in qualifying property are not eligible for section 179 expensing. For tax years 2010 and 2011 only, businesses may claim up to $250,000 of expenditures for qualified real property as 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 2010, and does not allow expenditures for qualified real property to be claimed as expensing. 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 2010, 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 $200,000, so that a business that places in service more than $225,000 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 2010 and 16 percent per year in tax years 2011 through 2015.

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

Over the last eight 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 $200,000 to $225,000. From 2003 to 2010, Congress has eight times enacted legislation that provides temporary increases in the maximum section 179 deductions and the "phaseout" limit; the legislation also indexes the temporarily increased amounts for inflation. This legislation is summarized in the following table.

Summary of Federal Section 179 Legislation 2003-2010

Year	Maximum deduction	Phaseout	Indexing	Expiration
2003	$25,000, increased to $100,0000	$200,000, 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
2008 and 2009	$250,000	$800,000	No	2010
2010 and 2011	$500,000	$2 million	No	2012

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, 2006, and 2008 legislative sessions, the legislature elected not to conform to the higher federal section 179 allowances.

Instead of conforming Minnesota's tax to the increased federal amounts, the 2005, 2006, and 2008 omnibus tax laws require 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	$24,000	$200,000	$24,000	$200,000
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	200,000
2007	125,000	500,000	25,000	200,000
2008-2009	250,000	800,000	25,000	200,000
2010-2011	500,000	2,000,000	25,000	200,000

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

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

Randall Chun

Revised: October 2010

Medical Assistance: An Overview

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). Federal Medicaid law 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.

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

Medicaid Expansion

The federal Affordable Care Act (ACA) requires states, effective January 1, 2014, to expand Medicaid to adults without dependent children with incomes not exceeding 133 percent of FPG who meet specified criteria. The ACA allows states to expand or phase in coverage to this group before this date. The 2010 Legislature authorized the current governor and the succeeding governor until January 15, 2011, to implement by executive order early Medicaid expansion for adults without dependent children with incomes not exceeding 75 percent of FPG.

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 developmental disabilities (ICF/DD) 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/DD.

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, county-based purchasing initiatives, and programs for the elderly and persons with disabilities). 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.

Funding and expenditures

In fiscal year 2009, total state and federal MA expenditures for services were $6.755 billion. The federal share of MA costs is determined by a formula based on state per capita income. In recent fiscal years, the federal government has paid 50 percent of the cost of MA services, with Minnesota responsible for the remaining 50 percent. For the period October 1, 2008, through December 31, 2010, the federal stimulus bill is providing Minnesota with a higher federal match that will result in the state receiving an additional $1.8 billion dollars. From January 1, 2011, to June 30, 2011, the federal Education, Jobs, and Medicaid Assistance Act will provide a higher federal match that will result in the state receiving an additional $238 million dollars.

Recipients

During fiscal year 2009, an average of 557,337 individuals were eligible for MA services each month. As of August 2010, 396,044 MA recipients received services under PMAP, a county-based purchasing initiative, or managed care programs for the elderly or persons with disabilities.

Application procedure

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

For more information: See the House Research information brief *Medical Assistance*, October 2010.

Deborah A. Dyson

Updated: October 2010

State-Local Relations

All local governmental units are creatures of the state and subject to the will of the state legislature, within any constitutional restrictions.

"Local Government"

"Local government" is a general term for those governmental entities or political subdivisions of the state that provide functions and services at the local level. In Minnesota, the term usually refers to counties, towns (townships), and cities. Single- or multipurpose (special) districts are frequently included in the term "political subdivision" but are less often defined as local governments.

Creatures of the State

The U.S. Constitution is silent on local government. Control of local government is not one of the enumerated federal powers of the Constitution, nor is it expressly prohibited to the states. It is, therefore, a residual power left to the states and people by the Tenth Amendment. Furthermore, local units of government do not have recourse to the federal constitution in order to resist state legislative interference or control. *Williams v. Mayor and City Council of Baltimore*, 289 U.S. 36, 40, 53 S.Ct. 431, 432 (1933) ("A municipal corporation, created by a state for the better ordering of government, has no privileges or immunities under the Federal Constitution which it may invoke in opposition to the will of its creator.").

Under the Minnesota Constitution, "The legislature may provide by law for the creation, organization, administration, consolidation, division and dissolution of local government units and their functions, for the change of boundaries thereof, for their elective and appointive officers including qualifications for office and for the transfer of county seats. A county boundary may not be changed or county seat transferred until approved in each county affected by a majority of the voters voting on the question." Minn. Const. art. XII, § 3. Several chapters of Minnesota Statutes are devoted to just these purposes.

Powers of a Municipal Corporation: Dillon's Rule

Local governments "possess only those powers that are conferred by statute or implied as necessary to carry out legislatively conferred powers." *Breza v. City of Minnetrista*, 725 N.W.2d 106, 110 (Minn. 2006). This basic principle of what powers a local government has follows the principle first stated in 1872 in a treatise on municipal corporations, written by Iowa Supreme Court Judge John F. Dillon; it is known as Dillon's Rule. The two major modifications the legislature has made to the rule are the authority for cities to adopt home rule charters and the broad grant of authority to legislate for the general welfare.

Modification of Dillon's Rule: Home Rule Charters

The legislature has granted cities the authority to adopt home rule charters; this action is the first significant mechanism in diminishing the practical effect of Dillon's Rule. A home rule charter, a local constitution, not only provides for the particular governmental organization of a municipality but also provides for substantive authority to be exercised by the governing body for the community. A charter must be consistent with the state constitution, and state law can overrule a charter provision.

The Minnesota Constitution authorizes any local government unit, when authorized by law, to adopt a home rule charter for its government. Minn. Const. art. XII, § 4. A charter must be approved by the voters of the local government unit as prescribed by general law.

A city may adopt a home rule charter following the procedures in Minnesota Statutes, chapter 410. Of the 854 cities in the state, 107 are home rule charter cities and the others are known as statutory cities. There is no general law enabling other local units of government to adopt home rule charters. A 1987 special law allowed Ramsey County to establish a commission to study the need or desirability of a home rule charter for the county, and if necessary to prepare and present a charter to the voters of the county. The voters approved a charter in 1990.

Modification of Dillon's Rule: General Welfare

The statutory authority to legislate for the general welfare also mitigates the severity of Dillon's Rule. It is a broad grant of authority for a local government to exercise any power not enumerated specifically that contributes to the protection of the health, morals, peace, and good order of the community; promotes its welfare in trade, commerce, and manufacture; or aids in carrying out all appropriate objects contemplated in the creation of a city.

All statutory cities in Minnesota have authority to legislate for the general welfare. Minn. Stat. § 412.221, subd. 32. Home rule charter cities simply include a general welfare clause or "all powers clause" within the provisions of their charters. Towns have the same authority in statute. Minn. Stat. §§ 365.10, subd. 17; 368.01, subd. 19.

Counties do not have "general welfare" authority, although Minnesota Statutes, section 145A.05, is sometimes viewed as providing a relatively broad grant of authority by authorizing ordinances protecting the public health.

For more information: Contact legislative analyst Deborah Dyson at deborah.dyson@house.mn.

Joel Michael and Nina Manzi

Updated: November 2010

Revenue Recapture Program

Revenue recapture allows state and some local governments to collect debts by intercepting tax refunds

Revenue recapture authorizes the Department of Revenue (DOR) to intercept or offset part or all of a state tax refund or other payment to collect a debt that the taxpayer owes to a government agency or other authorized creditor.

The following agencies may use the Revenue Recapture Program:

- State agencies
- University of Minnesota
- Minnesota district courts
- Counties
- Cities, including for public ambulance service and public library debts
- Governmentally owned hospitals and Regions Hospital
- Agencies responsible for child support enforcement
- Agencies that administer low-income housing programs

A variety of debts qualify for collection using recapture

The debt (minimum amount of $25) must be owed to or collectable by one of the qualifying governmental agencies. The debtor must be an individual; the law does not apply to corporations. The creditor does not need to obtain a court judgment or order to enforce the debt. Qualifying debts include the following:

- Contractual or statutory obligations
- Criminal fines and fines for petty misdemeanors
- Court-ordered restitution for a crime
- Child support obligations
- Overpayment of public assistance
- Unpaid MinnesotaCare insurance premiums

Obligations of low-income individuals (incomes between $11,380 and $21,510 in 2009, depending upon family size) to repay debts for medical care, including hospitalization, cannot be recaptured. Debts barred by the statute of limitations also cannot be recaptured.

Amounts available to offset qualifying debts are applied first to unpaid taxes, interest, and penalties before revenue recapture takes effect.

Some types of refunds are subject to recapture

Revenue recapture applies to the following:

- Individual income tax refunds
- Property tax refunds
- Sustainable forest tax payments
- Lottery prizes

The claimant must notify debtor about revenue recapture

Under revenue recapture, a claimant (creditor) agency submits the claim (debt) to DOR for offset. Within five days after doing so, it must notify the debtor-taxpayer in writing of the debt(s) that will be subject to revenue recapture. The taxpayer then has 45 days to request a hearing, which the claimant agency initiates; the hearing is conducted as a contested case under the Administrative Procedures Act.

Child support has first priority for collection

When more than one debt is submitted, the debts are applied in the following order of priority:

- Child support obligations
- Restitution obligations
- Claims submitted for a hospital or ambulance service
- Other debts based on the order in which DOR received the claims

DOR accounts receivable (e.g., unpaid taxes, interest, and penalties) are offset before claims under revenue recapture.

A $15 administrative fee applies

A fee of $15 per claim is first deducted from the refund, and the claimant agency receives the balance of the refund or the claim amount, whichever is less. Of this $15, $4 is set aside in a dedicated, revolving fund to pay DOR's cost of operating the program; the rest goes to the state's general fund.

More than $72 million was recaptured in 2009

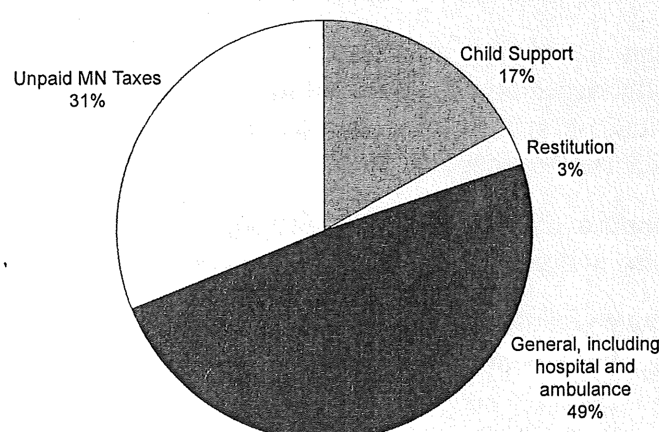
The table to the right shows the number of revenue recapture offsets and amount of refunds offset for calendar years 2005 to 2009.

The graph below shows the percentage of revenue recapture amounts and tax debts offset for calendar years 2005 to 2009 by four of the major types of debts for which the law sets priorities.

Revenue Recapture Amounts CY2005-2009

	Number of Offsets	Amount of Recapture
2005	210,655	$59,247,902
2006	179,754	$59,945,770
2007	211,636	$68,275,418
2008	230,911	$87,756,822
2009	216,623	$72,845,049

Excludes amounts offset on behalf of the IRS to satisfy debts for taxes owed to the federal government.
Source: DOR



For more information: See www.taxes.state.mn.us/collection/pages/rr_index.aspx for more information for claimant agencies, or call 651-556-4758 or email mdor.recapture@state.mn.us.

HOUSE RESEARCH | Short Subjects

Mark Shepard

Updated: November 2010

Gift Ban Law and Rules for House Members and Employees

What does the gift ban law prohibit?

Legislators and legislative employees must not request or accept a gift from a lobbyist or principal, and lobbyists and principals must not give a gift to a legislator or legislative employee or ask someone else to do so. Family members are not subject to the ban.

Who are lobbyists and principals?

A "lobbyist" is an individual registered with the Campaign Finance and Public Disclosure Board to lobby Minnesota state government. A "principal" is an entity that hires lobbyists and is registered with the board. Registered lobbyists and principals are listed on the board's website at www.cfboard.state.mn.us. If an individual or entity is not listed on the website, a member may call the board at 651-296-5148 or 800-657-3889 to see if the website is current. Members and staff may rely on the information provided by board staff on the issue of who is a lobbyist or principal. Examples of people who are not lobbyists include members of the media, local government elected officials, state employees, and representatives of foreign governments touring the Capitol.

What is the penalty for a violation?

There is no criminal penalty or civil fine. The board, which administers the law, takes the position that if possible, it will make a recipient return or pay for an improper gift. This has happened at least once.

What is a gift?

A gift is something received without giving equal or greater value in return. If the House pays to send a member or employee to a conference sponsored by a principal, the conference is not a gift from the principal. The event was paid for. By express terms or board advisory opinions "gift" includes the following:

- a job offer made as a bribe
- discounts, loans, privileges, or access made available to legislators but not to the general public
- paying off a debt for a legislator
- honoraria
- travel expenses or lodging for a meeting
- donations to a legal defense fund to benefit public officials generally
- donations to a retirement party held for a public official who is in office or has taken a new office

Some of the advisory opinions involved legislators, but the reasoning would also apply to legislative staff.

The following are excluded from the gift ban by the statute or by board opinions:

- campaign contributions
- services to assist in performing official duties
- services of insignificant monetary value
- plaques with a resale value of $5 or less
- trinkets or mementos costing $5 or less
- informational material with a resale value of $5 or less
- food and drink when asked to speak or answer questions at a program (eating lunch free when speaking at a legislative update program sponsored by a principal; not eating lunch free when touring a business that hires lobbyists). An advisory opinion lets a covered individual attend a party paid for by a principal if the individual (1) reimburses the principal for his or her fair share of the cost of the party; or (2) contributes to the party an item or items that equal or exceed the individual's share of the cost of the party.
- a gift received because of membership in a group, a majority of whom are not officials, and everyone in the group gets a similar gift (a member may accept a gift from his or her spouse's employer that is a principal if the employer gives all spouses a similar gift and a majority of those spouses are not public officials)
- a gift from a lobbyist or principal who is a relative, unless the gift is given on behalf of someone outside the family
- referral of legal matters between attorneys
- a job offer in the normal course of career changes

What House rules apply to gifts?

House Rule 9.20 prohibits a member from accepting an honorarium (other than expense reimbursement) for services performed for an individual or organization with a direct interest in the business of the House, including, but not limited to, lobbyists and principals. The rule specifies that violations must be referred to the Ethics Committee. The rule does not mention employees. House Rule 9.21 prohibits members and employees from accepting travel or lodging from a for-profit business, union, lobbyist, association of lobbyists, or a foreign government. Both rules are stricter than the statute in restricting the sources from which members and employees may accept things.

For more information: Contact legislative analyst Mark Shepard at 651-296-5051 or Jeffrey Diebel at 651-296-5041.

HOUSE RESEARCH | Short Subjects

Lisa Larson

November 2010

State Laws on Teacher Quality and Effectiveness

At least five areas of teacher quality and effectiveness are currently prescribed in state statute or rule. They deal with teacher education and preparation, licensure, compensation, and certification.

The Minnesota Board of Teaching approves teacher preparation programs and institutions

The Minnesota Board of Teaching approves Minnesota colleges and universities and their teacher preparation programs. Individuals who complete board-approved teacher preparation programs can be recommended for a teaching licensure. The board evaluates and approves teacher preparation institutions and programs at least once every seven years. The board may grant approval of an institution, grant conditional approval pending the institution meeting stated conditions, and revoke or suspend an institution or preparation program that does not meet the requirements in rule. The board also may grant five-year approval of experimental teacher preparation programs that meet certain criteria.

The standards the board uses to evaluate teacher preparation institutions and programs are similar to the standards that the National Association for Colleges of Teacher Education (NCATE) uses to accredit teacher preparation institutions and programs. The board also approves individual licensure programs, such as elementary or math education.

Teachers must satisfy teacher preparation and continuing education requirements

A traditional teacher candidate must complete a board-approved teacher preparation program (including student teaching), pass basic skills exams in reading, writing, and math, and pass exams of general pedagogical knowledge and licensure-specific teaching skills before the board may issue the candidate a teaching license. A candidate who completes a teacher preparation program in another state may be eligible for a teaching license. The board issues licenses for specific circumstances, including a nonrenewable license, a temporary limited license, and a short-call (or short-term) substitute teacher license.

A teacher must complete 125 clock hours of continuing education in order to renew a five-year professional license for another five-year period. Continuing education must include preparation in the key warning signs of early-onset mental illness in children and adolescents, further reading preparation, use of positive behavior interventions, use of technology, and evidence of work that demonstrates professional reflection and growth in best teaching practices. The board may grant variances to its licensure rules.

New teachers must complete a probationary period

Two statutes govern conditions of continuing employment for licensed teachers: Minnesota Statutes section 122A.40 applies to teachers in public schools generally; and Minnesota Statues section 122A.41 applies to teachers in the Minneapolis, St. Paul, and Duluth school districts. A newly licensed probationary teacher must successfully complete three years of continuous employment before becoming a continuing contract or tenured teacher. During the probationary period, a school board must formally evaluate probationary teachers, but the standards for the evaluations are not specified and the school board has considerable discretion in deciding whether to renew the probationary teacher's employment contract.

Continuing contract and tenured teachers are entitled to employment-related protections

Once a teacher receives a continuing contract or tenure, the teacher is entitled to employment-related protections, including bumping rights and just cause and due process guarantees. The terms "continuing contract rights" and "tenure rights" mean that a district may not dismiss a teacher without cause. These terms offer equivalent procedural protections and are often used interchangeably. The laws require mentoring for probationary teachers and peer coaching for continuing contract teachers but do not specify the standards or frequency for these activities. The continuing contracts of teachers in nonfirst-class city school districts remain in full force and effect unless a circumstance leads the school board to terminate the teacher. Tenured teachers in first-class city school districts may be discharged or demoted under specified circumstances.

Q-Comp is a voluntary teacher advancement and compensation program

The 2005 Minnesota Legislature adopted a voluntary alternative teacher professional pay system called Q-Comp that expanded alternative compensation programs and funding. Q-Comp allows interested districts, school sites, and charter schools and their teachers to develop and implement a professional teacher development and compensation plan specific to local needs. All Q-Comp plans contain five components: career advancement options; job-embedded professional development; an objective teacher evaluation plan aligned with the local staff development plan; performance pay that bases at least 60 percent of compensation increases for teacher performance on schoolwide student achievement gains and individual teacher evaluations; and an alternative salary schedule that is reflected in the local collective bargaining agreement and requires a "reformed" steps-and-lanes salary schedule. Receipt of Q-Comp funds is contingent upon state Department of Education (MDE) approval of a Q-Comp plan and the availability of Q-Comp funds. As of the 2009-2010 school year, MDE had approved 44 districts and 31 charter schools to implement Q-Comp.

National board certification is a voluntary process by which classroom teachers can be nationally certified

The National Board for Professional Teaching Standards has developed professional standards for what K-12 classroom teachers should know and be able to do. The board devised an assessment system and a voluntary certification process by which teachers can be certified in 24 fields and developmental levels of instruction. Research shows that the influence of certification on teacher practice and morale, professional development, and areas of school improvement such as leadership development, teacher mentoring, monitoring of student performance, team-building, and curriculum development is positive. The research is more mixed in terms of the impact of certification on student achievement as measured by standardized tests. National board certification impacts several teacher licensure rules related to issuing licenses and fulfilling clock hour requirements.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

Lisa Larson

November 2010

High School Graduation Assessments

Reading and math MCAs meet federal testing requirements and measure student progress toward meeting state academic standards

Minnesota and local school districts use the reading and math Minnesota Comprehensive Assessments (MCAs) to meet the requirements of the federal No Child Left Behind (NCLB) Act and to measure student progress toward achieving state academic standards. Students' scores on the reading and math MCAs determine whether schools and districts are making sufficient adequate yearly progress (AYP) toward having all students proficient in reading and math by the 2013-2014 school year. NCLB also requires states and school districts to administer a science exam to students in the 3-5, 6-9, and 10-12 grade spans but students' scores on the science exams are not included in AYP calculations.

Minnesota students annually take MCA exams in reading in grades 3-8 and 10, math in grades 3-8 and 11, and science in grades 5 and 8 and once in high school depending on when the students complete their life sciences curriculum. The science exams are not required for high school graduation.

Students must pass writing, reading, and math tests to graduate from high school

To graduate from high school, a student must either:

- achieve at or above "proficiency" on the reading MCA-II that is first administered in 10^{th} grade and on the math MCA-III that is first administered in 11^{th} grade;
- achieve a passing score on the embedded GRAD portion of the reading and math MCAs that measure state requirements for high school graduation; or
- for an eligible student with disabilities, pass the individual passing standard set for that student by the student's individualized education program team or 504 team. (Section 504 of the Rehabilitation Act of 1973 prohibits discrimination based on disability.)

Students identified as limited English proficient (LEP) students under the Minnesota Automated Reporting Student System must pass the GRAD tests if they have been enrolled in any Minnesota school for at least four consecutive school years. LEP students who first enroll in a Minnesota school in grade 9 or above and who complete all other state and local high school graduation requirements within four years are not required to pass the GRAD tests. Students identified as LEP students in grades 3 through 12 also take the Test of Emerging Academic English (TEAE).

Students must passs either the MCAs and GRAD tests in reading and math

Students who enter high school (grade 8) in the 2005-2006 school year and later fulfill Minnesota's graduation requirement by passing either the math and reading MCAs or the math and reading GRAD tests, and a written composition GRAD test first administered in grade 9. A high school student who does not achieve at or above proficiency on the MCAs or pass the GRAD portion of the exams when it is first administered has multiple chances to retake the GRAD tests (the MCAs are administered only annually).

A 2009 law allows students enrolled in grade 8 in any school year from the 2005-2006 to 2009-2010 who do not pass the 11th grade math GRAD test to receive a high school diploma if they: receive a passing score or grade on all state and local coursework required for graduation; participate in academic remediation in math; and take two math GRAD retests or pass one math GRAD retest, whichever comes first. Schools, districts, and charter schools must place students' highest assessment scores in reading, math, and writing on their high school transcripts.

State-level MCA/GRAD Results						
	Percent of Students Who Passed				Number Who Did Not Pass	
	11th Grade Math		10th Grade Reading		Math	Reading
School Year	MCA	GRAD	MCA	GRAD		
2009-10	43	57.8	75	78.1	26,157	13,865
2008-09	42	57.3	74	77.6	26,592	14,436
2007-08	34	NA	71	75.1	NA	16,249
Source: Minnesota Department of Education						

Categorizing students by ethnicity reveals significant differences in test results

If student MCA/GRAD results are categorized by student ethnicity, significant differences in performance appear.

State-level MCA/GRAD Results by Ethnicity					
	Percent of Students Who Passed Either MCA or GRAD				
	11th Grade Math		10th Grade Reading		
Ethnicity	2008-09	2009-10	2007-08	2008-09	2009-10
American Indian	30	27	55	57	58
Asian/Pacific Islander	52	54	63	62	64
Black	21	23	41	48	50
Hispanic	31	29	48	52	54
White	63	64	82	84	84
Source: Minnesota Department of Education					

These test scores reflect a disparity in academic achievement between white and minority students in Minnesota. For example, in the 2009-10 school year, 64 percent of white students passed the 11th grade math assessment while only 23 percent of black students passed that assessment. This trend persists over time.

Students with a passing score on the MCAs or GRAD tests do not necessarily meet the preparation requirements for two- or four-year colleges and universities.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036. Also see the House Research publication *Minnesota's High School Graduation Requirements*, July 2010.

Karen Baker and Deborah A. Dyson Revised: November 2010

Housing Improvement Areas

What are housing improvement areas?

A housing improvement area (HIA) is a defined area in a city in which housing improvements in condominium or townhome complexes may be financed with the assistance of the city, or the city's economic development authority (EDA) or housing and redevelopment authority (HRA).

Prior to 1996, cities needed special legislation to establish an HIA. In 1996, cities were granted the authority under general law. The general law, codified in Minnesota Statutes, sections 428A.11 to 428A.21, sunsets June 30, 2013.

What improvements can be made in an HIA?

The improvements that may be made under this law include improvements to the common elements in a condominium complex or townhome development. Examples include roofing, siding, landscaping, roadways, and walkways.

How is an HIA established?

At property owner's request. An HIA can only be established at the request (petition) of at least 50 percent of the owners of the housing units in the proposed area. If the petition is filed, then the city prepares an ordinance that:

- describes the area specifically;
- states the basis for imposing fees and the number of years the fees will be imposed;
- makes a finding that without the HIA, the proposed improvements could not be made; and
- specifies if the city, the EDA, or HRA will implement the ordinance.

In addition, the city must fully disclose the public expenditures and financing for the projects, and determine whether the association or the implementing agency will contract for the work.

Notice, public hearing, ordinance. Before adopting the ordinance, the city must hold a public hearing at which the proposed improvements, affected housing units, and the exempt units are listed. Fees can be imposed on the basis of the tax capacity (value) of the housing unit, total square footage of the housing unit, or a method determined by the city and specified in the resolution. Before a city uses an alternative method to set fees, it must make a finding that the alternative basis is more fair and reasonable. Potentially affected property owners may testify at the hearing. Those property owners may object in writing, and if the city agrees, may be excluded from the area or fee imposed.

The ordinance may be adopted within six months after the conclusion of the public hearing. If 45 percent or more of the affected residents file an objection, the HIA is not established.

How are the improvements financed?

The city may finance the housing improvements by:

(1) advancing funds available to the city and then recovering the costs by charging the property owners fees; or

(2) issuing bonds and then imposing fees or assessments to repay the bonds. The bonds are not included in the city's net debt and no election is required for their issuance.

Before imposing fees, the city must provide public notice and hold a public hearing. Within six months of the conclusion of the public hearing, the city may adopt a resolution to impose the fees.

What plans or reports are required?

Before the city imposes and collects the fee, the condominium or townhome association must develop a long-term plan to maintain the complex. The plan must address operations, maintenance, and necessary capital improvements of the common elements. It must identify financing for the projects. The association must also submit its audited financial report to the city annually.

How many cities have established HIAs?

It is difficult to determine how many cities have established HIAs. Although each city with an HIA is required to submit the HIA ordinance to the Commissioner of Revenue, the commissioner is not required to do anything with the ordinances, and there is no penalty for not filing. Also, it is impossible to know how much money is collected for HIA purposes statewide because the fees imposed are reported as special assessments by the cities and not identified separately.

The table below provides information on seven cities known to have established HIA districts. The data is from the ordinances, city information on the Internet, or phone interviews with city staff.

City	Year first HIA established	Year most recent HIA established	# of Districts	# of units in a district (range)	Approx cost per unit (range)[1]	City bonds or city funds advanced
Columbia Heights	2008	-	1	65	$42,000	bonds
Coon Rapids	1998	2008	10	8-39	$5,488 - $24,599	funds advanced
Hopkins	1995	1998	4[2]	206-536	$3,632 - $19,880	bonds
New Hope	1997	2001	2	12-36	$15,756	bonds
Plymouth	1999	-	1	219	$7,630	bonds
Roseville	2009	-	1	47	$33,178	bonds
St. Louis Park	2002	2009	5	20-280	$4,879 - $16,625	bonds

[1] Provided directly by each city except for Coon Rapids (calculated by dividing the total cost of each HIA district by the number of units within the district) and Hopkins (calculated by multiplying annual payments per unit for each HIA district by number of payment years for that district).

[2] The city of Hopkins website (http://www.hopkinsmn.com/home/taxes/special/index.php) lists four HIA districts, but two are multiple phases within the same condo complex (requiring two separate resolutions).

For more information: Contact legislative analyst Karen Baker at 651-296-8959 or Deborah Dyson at 651-296-8291.

Deborah A. Dyson **Updated: November 2010**

State General Obligation Bonding

One of the ways the state pays for projects is to borrow money by issuing bonds—which are promises to repay the money borrowed at a specified time and interest rate. There are two main types of bonds: general obligation (G.O.), backed by the full faith, credit, and taxing powers of the state, and revenue bonds, backed by revenues other than a tax of statewide application. The state constitution limits the purposes for which G.O. bonds may be issued and requires certain procedures.

All State G.O. Bonds

All state G.O. bonds have certain common requirements. They must be for a public purpose, specified in law, and mature in not more than 20 years.

Public purpose. Under the state constitution, all expenditures of state funds, including bond proceeds, must be for a public purpose. There is a public purpose if the expenditure can reasonably be expected to achieve a legitimate public goal or benefit, even if some benefit may result for nonpublic interests. In determining whether the purpose is "public," one must look at both historical and contemporary standards. The legislature is given deference in determining a purpose to be "public." *Visina v. Freeman*, 252 Minn. 177, 89 N.W.2d 635 (1958).

Specified in law. "Each law authorizing the issuance of bonds shall distinctly specify the purposes thereof and the maximum amount of the proceeds authorized to be expended for each purpose." Minn. Const. art. XI, § 7. This may be done by describing the project in some detail or by reference to a governmental program established in statute.

Mature in no more than 20 years. Minn. Const. art. XI, § 7.

Bonds to Acquire and Better Public Land and Buildings

The principal purpose for which state G.O. bonds are issued is to acquire and to better public land and buildings and to make other public capital improvements. Minn. Const. art. XI, § 5, para. (a).

Capital project. A capital project, in general, is for the acquisition or improvement of fixed assets, such as land or buildings. The fixed asset must be long-lived; bond counsel has suggested that the useful life be at least ten years. The improvements must be substantial, extend the useful life or substantially increase the value of the fixed asset and not be predictable or recurring (as repairs would be). For example, a study or planning are not capital in nature, but design work for a site-specific capital project is. An option to buy real property is an intangible asset and not eligible for bond funding.

Publicly owned. Bonds issued under the capital improvements provision may only be for publicly owned projects, whether state or local. "Publicly owned" has been determined to include projects of the Minnesota Historical Society, but not public radio, TV, or Indian tribe projects, or private sewage systems even if they will serve the public.

Three-fifths vote. A law to authorize the issuance of state G.O. bonds for capital improvements must be enacted with at least a three-fifths vote of the House and the Senate. Minn. Const. art. XI, § 5, para. (a). A law to repeal an authorization requires only a simple majority vote.

Other Constitutionally Authorized Uses

Under other provisions of the state constitution, state G.O. bond proceeds may also be used:

- to repel invasion or suppress insurrection;
- to borrow temporarily through certificates of indebtedness;
- to refund outstanding bonds of the state or its agencies;
- to establish and maintain highways subject to constitutional limitations on highway bonds;
- to promote forestation and prevent and abate forest fires;
- to construct, improve, and operate airports and other air navigation facilities;
- to develop the state's agricultural resources by extending credit on real estate;
- to improve and rehabilitate public or private railroad rights-of-way and other rail facilities up to $200 million par value; and
- as otherwise authorized in the constitution. Minn. Const. art. XI, § 5, paras. (b) to (j).

Not all of these purposes are capital in nature, and the constitution does not require a three-fifths vote to authorize issuance of bonds for these purposes.

Trunk highway bonds. Bonds issued for trunk highways are G.O. bonds, but payable from the trunk highway fund (with a statewide property tax as backup). Trunk highway projects may not be paid for with G.O. bonds that are payable in the first instance from the general fund. Minn. Const. art. XIV, § 11; art. XI, § 5, para. (e).

No Reimbursement. Under federal tax law governing tax-exempt state and local bonding, bond proceeds cannot be used for reimbursement (with very limited exceptions).

Revenue Bonds

The constitution neither specifically authorizes nor prohibits issuance of revenue bonds. As with any expenditure of public funds, revenue bond proceeds must be used for a public purpose. A significant limitation on the issuance of revenue bonds is whether the revenue to repay the bonds is sufficient to make the bonds marketable. Various state agencies have authority to issue revenue bonds. For example, the Minnesota Housing Finance Agency, may issue mortgage revenue bonds, and the Minnesota Public Facilities Authority may issue revenue bonds to finance municipal wastewater treatment and other public infrastructure projects.

Capital Investment Guidelines

There is no constitutional or statutory limitation on how much debt the state may incur (with the exception of debt for railroads), but Minnesota Management and Budget has guidelines intended to maintain the state's good credit rating.

- Total tax-supported principal outstanding shall be 3.25 percent or less of total state personal income.
- Total principal (both issued and authorized but unissued) for state general obligations, moral obligations, equipment capital leases, and real estate capital leases must not exceed 6 percent of state personal income.
- 40 percent of G.O. debt must be due within five years and 70 percent within ten years, if consistent with the useful life of the financed assets and market conditions.

Role of Bond Counsel

While there is some guidance from the courts on the constitutional requirements for and limitations on state bonding, bond questions rarely reach the courts. In order for bonds to be sold, attorneys for the state—bond counsel—are asked to render an unqualified legal opinion approving the issuance of the bonds. Without a good opinion, no one will buy the bonds. Thus, the primary guidance the legislature has on what is "bondable" and how the law must be written comes from bond counsel.

For more information: Contact legislative analyst Deborah Dyson at 651-296-8291.

HOUSE RESEARCH | Short Subjects

Jim Cleary and Jeff Diebel Updated: November 2010

Minnesota Firearms Law for Minors

General Requirements

Minors 13 years old and younger must be supervised when handling a firearm. At age 14 and 15, a minor may possess a shotgun or rifle without supervision if the minor has a firearms safety certificate. At age 16 and 17, a minor may possess a shotgun or rifle without supervision or a certificate. (Minn. Stat. § 97B.021, subd. 1)

A person under age 18 generally may not possess a *pistol or assault weapon* unless supervised (see below for exceptions). (Minn. Stat. § 624.713, subd. 1(1)) A person under the age of 21 may not obtain a permit to carry a pistol and may not use in Minnesota any concealed-carry permit issued by another state. (Minn. Stat. § 624.714, subd. 16)

Hunting Requirements

Minors 13 years old and younger must be accompanied by a parent or guardian when hunting. Youth are permitted to hunt alone beginning at age 14, provided the person possesses a firearms safety certificate. (Minn. Stat. § 97B.021)

Possession of Firearms

Shotguns and Rifles. Except when hunting, a minor under age 16 generally may not possess a shotgun or rifle without being accompanied by a parent or guardian. The primary exception is again for a 14- or 15-year-old who has a firearms safety certificate. Other exceptions include: when the minor is on a parent or guardian's residential property; when participating in supervised target shooting; and when participating in a firearms safety program. (Minn. Stat. § 97B.021)

Pistols and Assault Weapons. A minor under age 18 generally may not possess a pistol or assault weapon, except under the supervision of a parent or guardian. Other exceptions include: while engaged in an official military drill; during supervised practice at an approved shooting range; and while participating in a state-approved marksmanship or safety program. (Minn. Stat. § 624.713, subd. 1)

Penalties for Juvenile Firearms Offenses

Certification for Adult Court. A juvenile court may order that a juvenile 14 years old or older be certified for trial in adult court, if the juvenile has committed any offense that would be a felony if committed by an adult. Furthermore, there is a presumption that a juvenile 16 or 17 years old will be certified to be tried as an adult if there is probable cause to believe that the juvenile used a firearm to commit the offense. A juvenile may rebut the presumption by clearly and convincingly demonstrating that retaining juvenile court jurisdiction serves public safety. (Minn. Stat. § 260B.125, subd. 3)

Possession During a Crime. If a juvenile is adjudicated delinquent and is found to have possessed a firearm when committing the offense, the court must order seizure of the firearm, and must also order the child to perform 100 hours of community service unless the court places the juvenile in a residential treatment program or a juvenile correctional facility. If a juvenile possesses a dangerous weapon, including a firearm, when committing an offense on school property or in a school bus, the juvenile loses driving privileges until age 18. (Minn. Stat. § 260B.198, subd. 2)

Illegal Possession. If a juvenile under age 16 illegally possesses a firearm (e.g., a 14- or 15-year-old without a firearms safety certificate), the firearm will be seized by law enforcement and is subject to forfeiture. However, the juvenile may reclaim a seized rifle or shotgun by obtaining a firearms safety certificate within 90 days of the start of the next available firearms safety course in the county. (Minn. Stat. § 97B.021, subds. 2 and 3)

Crimes Relating to Minors and the Storage, Furnishing, and Display of Firearms

Negligent Storage. It is generally a crime of child endangerment to negligently store or leave a loaded firearm in a location where the owner of the firearm should reasonably know that a child is likely to have access to it. (Minn. Stat. §§ 609.666, subd. 2; 609.378, subd. 1(c); and 624.7162, subd. 2)

Furnishing. It is a misdemeanor for a person to furnish a child under age 14 with a firearm or ammunition *outside of a municipality* without consent of a parent or guardian. The sentence is enhanced to a gross misdemeanor if the act occurs at or near a school, a park, or public housing property. *Within a municipality*, it is a felony to furnish a minor under the age of 18 with a firearm or ammunition without the consent of a parent, guardian, or the local police. (Minn. Stat. § 609.66, subd. 1(a)(6) and (b), and subd. 1b)

Display of Handgun Ammunition. Ammunition retailers may not display handgun ammunition in a manner that is directly accessible to minors under age 18. Violation is a petty misdemeanor. Ammunition in an enclosed display case or behind a counter is deemed inaccessible. There are exceptions for ammunition accessible to juvenile employees, ammunition under observation by employees, and ammunition displayed in an area where the store takes reasonable steps to exclude minors, as well as ammunition suitable for big game hunting. (Minn. Stat. § 609.663)

Schools

Firearms Possession at School. A pupil who brings a firearm to school must be expelled for at least one year. A school board can modify this expulsion requirement on a case-by-case basis. School boards must have policies to notify law enforcement officials when a pupil unlawfully brings a firearm to school. A pupil who brings a firearm to school will also generally be subject to a juvenile delinquency petition or adult criminal charges, depending on the circumstances. (Minn. Stat. § 121A.44)

Notifying Schools. A law enforcement agency must notify a juvenile's school when the agency has probable cause to believe the juvenile committed an offense involving a dangerous weapon, including a firearm. A juvenile's probation officer must give a copy of the juvenile's disposition order to the school if the juvenile is adjudicated delinquent for an act involving a dangerous weapon (including a firearm). (Minn. Stat. §§ 260B.171, subds. 3(a)(3) and 5(e); 609.02, subd. 6)

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HOUSE RESEARCH | Short Subjects

Kathy Novak

Updated: November 2010

Election of University of Minnesota Regents

Regents are elected by the legislature to govern the University of Minnesota. Over the past five years, the legislature has changed the process for nominating regent candidates. The first change included a role for the governor and established a joint committee of the legislature to consider nominations. The governor's role was subsequently eliminated, and the composition and responsibilities of the joint committee were modified. This short subject describes the current requirements for recruiting, reviewing, recommending, nominating, and electing regents and highlights recent changes to the process.

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 represents specific areas and includes one student

Minnesota law specifies that eight of the 12 regents must reside in Minnesota's congressional districts, one in each district. 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. §§ 137.023 and 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 two student members, appointed by the House of Representatives and the Senate to staggered terms. Student members serve two-year terms. All others serve six-year terms with a two-term limit. The council screens and recommends regent candidates to a joint committee of the legislature. Minn. Stat. § 137.0245, subd. 2.

The council must develop selection criteria for recruiting regent candidates. Beginning in 2005, diversity became an explicit part of the criteria, including geography, gender, race, occupation, and experience. The council must identify the membership needs of the board, including the skills and characteristics necessary to govern the university and must develop criteria to ensure membership diversity. The council's selection criteria must not include a limit on the number of terms served by an individual regent. Minn. Stat. § 137.0245, subd. 3.

The advisory council recommends regent candidates to a joint legislative committee

The regent candidate advisory council must make recommendations to the joint legislative committee by January 15 of each odd-numbered year. The council must recommend two to four candidates for each regent to be elected and must submit, with the recommendations, a report that identifies the membership needs of the board.

Changes made in 2007 reversed an earlier requirement that the council recommend candidates to the governor, who then submitted a slate of candidates to the joint committee. Minn. Stat. § 137.0245, subd. 4.

The joint legislative committee receives the council recommendations and may nominate other candidates

The joint committee was first established in law in 2005 to consider the governor's slate of regent candidates. Previously, legislative rules governed the makeup and duties of a joint committee for the regent election process. Under current law, the joint committee consists of the members of the higher education budget and policy divisions of the Senate and the House. The Senate and House committee chairs serve as cochairs of the joint committee.

The joint committee must meet by February 28 of each odd-numbered year, or on a date set by concurrent resolution, to consider the regent nominees. 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 2009 Legislature repealed a requirement that the committee meet more than once.

The joint committee may nominate and consider a candidate who is not recommended by the advisory council. To be considered, the nominee must be supported by at least five members of the joint committee—two from the Senate and three from the House. Minn. Stat. § 137.0246.

The joint committee recommends candidates to the joint convention

For each vacancy on the Board of Regents, the joint committee may recommend only one candidate to the joint convention of the Senate and the House. A majority of the House members and a majority of the Senate members on the joint committee must support a candidate for that candidate to be recommended to the joint convention. In making recommendations, the law requires the committee to consider the needs of the board, and the gender, racial, and ethnic balance of the board. Minn. Stat. § 137.0246. Joint rules of the Senate and House provide for the operation of the joint committee, including how nominations are made and votes are taken. Joint Rules of the Senate and House of Representatives, 4.01.

A joint convention of the Senate and the House elects regents

The joint rules also provide for the election of the regents at a joint convention of the legislative bodies, as required in the constitution. Under the joint rules, the joint committee must report the names of persons recommended for each vacant regent seat. The person named is considered to be nominated for a regent position. Members of the legislature may submit additional nominations, and the joint rules govern voting on all nominations. The candidate for a regent vacancy who receives a majority of the votes cast is declared the winner. Joint Rules of the Senate and House of Representatives, 4.02.

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HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Jim Cleary **Updated: November 2010**

Minnesota Income Tax Credit for Past Military Service

What is the income tax credit for past military service?

The 2008 omnibus tax bill (Laws 2008, ch. 366) provided for a new income tax credit for past military service. The credit equals $750 for qualifying individuals. It is nonrefundable and is subject to an income limitation. The credit took effect in tax year 2009 and was first claimed on tax year 2009 returns filed in 2010.

Who qualifies for the credit for past military service?

To qualify for the credit, a veteran must:

- have served in the military (including the National Guard and reserves) for at least 20 years; or
- have a service-connected disability rated by the U.S. Department of Veterans' Affairs as being 100 percent total and permanent.

Individuals currently serving in the military do not qualify for the credit.

What is a nonrefundable credit?

A nonrefundable credit may be used only to offset Minnesota income tax liability. A veteran must have at least $750 of income tax liability to receive the full credit amount. A qualified veteran with less than $750 of state income tax liability is eligible for a credit only up to the amount of tax. A qualified veteran with no state income tax liability is not eligible for a credit.

In tax year 2009, when the credit was first allowed, a single veteran with no dependents who claimed the standard deduction would have needed to have $23,369 of federal adjusted gross income to receive the full $750 credit.

How does a nonrefundable credit compare with an income tax subtraction?

A nonrefundable credit has an effect on final liability similar to that of an income tax subtraction. A credit is a dollar-for-dollar reduction in tax liability, while a subtraction reduces taxable income, which results in lower tax liability. The benefit from a subtraction depends upon the taxpayer's tax bracket or rate. Because of the income limits, veterans who qualify for the credit will be in the bottom or lowest tax bracket with a rate of 5.35 percent. The $750 nonrefundable military service credit is equivalent to a $14,020 income tax subtraction ($14,020 times 5.35 percent, the state income tax rate for the first bracket of taxable income, equals $750).

Only individuals with tax liability will benefit from either a nonrefundable credit or a subtraction, and the amount of the benefit is limited to their tax liability.

How is the military service credit income limited?

The military service credit is phased out for individuals with federal adjusted gross income (FAGI) of $30,000 or more. The credit is reduced by 10 percent of FAGI in excess of $30,000, so that individuals with FAGI over $37,500 are not eligible for any portion of the credit.

FAGI is calculated on the federal tax forms (Form 1040, 1040A, or 1040EZ). It includes most kinds of income, such as:

- wages, salaries, and tips;
- taxable interest;
- dividends and capital gains or losses;
- business income or loss, including income from partnerships and S corporations;
- taxable IRA, pension, and annuity distributions;
- farm income or loss;
- unemployment compensation; and
- taxable Social Security benefits (the amount of Social Security benefits that are taxable depends on the individual's income level; at most, 85 percent of benefits are included in federal adjusted gross income).

Some of the major items excluded from FAGI are:

- deductible retirement plan contributions;
- nontaxable employee fringe benefits;
- student loan interest payments;
- one-half of self-employment tax;
- health insurance premiums (for self-employed taxpayers only);
- tax-exempt bond interest; and
- veterans disability payments.

What are some examples of individuals who will and will not receive the new military service credit?

Qualifying veterans with less than $30,000 in taxable military retirement income and no other income other than Social Security would qualify for part or all of the credit, depending on the individual's tax liability. Since Social Security benefits are not included in FAGI for low-income filers, receipt of Social Security will not subject an individual to the income-based phaseout.

Qualifying veterans who are 100 percent totally and permanently disabled may or may not receive the credit, depending on their amount of taxable income (military disability pay itself is nontaxable). With no taxable income or with more than $37,500 of adjusted gross income, such disabled veterans do not receive the credit. Conversely, with any amount of taxable income greater than zero and less than $37,500, the disabled veteran would receive a full or partial credit.

How many individuals claimed the credit in 2009, and how much did they claim?

Through October 15, 2010, 1,499 returns (for tax year 2009) claimed about $970,000 in credits, for an average credit of $646. This represents about 99 percent of all 2009 returns that will be filed. Usage of the credit in its first year in effect was substantially lower than the estimate prepared when the credit was enacted in 2008, which projected that about 14,000 veterans would claim $10.3 million in credits.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Jim Cleary at 651-296-5053.

HOUSE RESEARCH | Short Subjects

Nina Manzi & Randall Chun

Updated: November 2010

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 of 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 him or herself 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.

How many Minnesotans claim the credit?

For tax year 2008, 61,034 Minnesota returns claimed the credit. These claims represent about 2 percent of all state returns filed by Minnesotans.

Filers claim the credit on their Minnesota income tax return using Schedule M1LTI.

How much is paid out in credits?

In tax year 2008, Minnesotans claimed $8.48 million of long-term care insurance credits. The average long-term care tax credit was $139 in tax year 2008. The average credit exceeds the maximum credit of $100 per qualified beneficiary because married couples filing joint returns may claim the maximum credit for both spouses (up to a total of $200).

How does Minnesota compare with other states?

This table includes all states that offered a long-term care insurance tax credit in 2008, but not those states that offer a long-term care insurance tax deduction. Data on the number of claimants and cost by state is for 2008.

In addition to the states listed, Louisiana has enacted but not funded a 10 percent credit, Maine provides a credit to employers who provide coverage to employees, and New Mexico allows a refundable credit of $2,800 for individuals age 65 or older with over $28,000 in medical expenses, including long-term care premiums. North Dakota's credit will be increased to 100 percent of premiums, up to a maximum of $250 in tax year 2009, when the state's long form is eliminated and the credit is made available to all filers.

	Maximum credit	**Credit rate***	**Number of returns claiming the credit**	**Cost to the state for the credit**
Colorado	$150	25%	Not available	Not available
Maryland[1]	Varies by age: $280-$500	100%	5,491	$3.07 million
Minnesota	$100	25%	61,034	$8.48 million
Mississippi	$500	25%	1,843	$0.77 million
Montana[2]	$5,000	Varies by income: 20% to 30%	46	$50,534
New York	None	20%	124,000	$64 million
North Carolina	$350	15%	29,255	$6.05 million
North Dakota	$100	25%	Not available	Not available
Oregon	$500	15%	32,691	$7.6 million
Virginia[3]	None	15%	4,070	$1.1 million

* The credit rate is the percentage of premiums allowed as a credit.
1 Maryland's credit can be claimed only once per person.
2 Montana's tax credit is a credit for expenses related to care of elderly family members. Long-term care insurance premiums are a qualifying expense. Data for Montana includes credits for all qualifying expenses, including long-term care insurance premiums.
3 Virginia's credit applies only to the first 12 months of premiums paid.

For more information: Contact legislative analysts Nina Manzi at 651-296-5204, Joel Michael at 651-296-5057, or Randall Chun at 651-296-8639.

HOUSE RESEARCH | Short Subjects

Emily Cleveland and Colbey Sullivan December 2010

Food Safety System: An Overview

This short subject describes state laws and activities intended to protect Minnesota's food supply from accidental or intentional contamination by filth, vermin, disease-causing bacteria or viruses, or other adulterants. The state food safety system includes activities that identify foods and beverages responsible for foodborne illness outbreaks.

What is the state's role?

State law requires licensing and periodic inspection of many participants in the commercial food industry. This includes most food manufacturers, processors, distributors, transporters, and retailers. Licensing requirements, food-handling and facility-sanitation standards, and inspection frequency vary based on the type of food operation and the perceived level of risk posed to public health. The state also has a role in monitoring, detecting, and investigating foodborne illness.

Which state agencies are involved?

The Departments of Agriculture and Health share primary responsibility for administering the state's food safety laws. Each agency's jurisdiction is established in law and summarized in the table below. Together these agencies work to ensure the safety of food and beverages "from farm to table."

Agencies Responsible for Food Safety

Agency	Role	Regulated Entities
Minnesota Department of Agriculture (MDA)	MDA licenses and inspects food manufacturers, wholesalers, transporters, and retailers. Inspectors enforce state standards relating to food quality, condition, labeling, and advertising as well as the sanitation of premises, equipment, and vehicles used in the sale, storage, or distribution of foods and beverages. MDA also investigates complaints regarding questionable food products or sales practices, participates in foodborne illness investigations involving MDA-regulated facilities, and educates regulated entities and citizens about safe food-handling practices.	Grocery stores; bakeries; convenience stores; meat or poultry processors; egg handlers; dairy farms, processing plants, and haulers; food manufacturers; vending machines; food delivery vehicles; fair stands; mobile food units; wholesale food distributors; and feed mills
Minnesota Department of Health (MDH)	MDH licenses and inspects food service entities; enforces the food code (Minn. Rules, ch. 4626); and provides food safety information to the public and industry via its website, an interactive education program, and professional development courses. MDH also tracks and monitors foodborne illness through disease outbreak detection activities, including active lab surveillance for reportable diseases, utilization of the Minnesota Foodborne Illness Hotline, and inspection of identified facilities to ensure safe food handling.	Cafes; restaurants; bars and lounges; bed and breakfasts; hotels; motels; resorts; delis; caterers; cafeterias; coffee shops; clubs; and conference centers

What role do other levels of government play?

Many Minnesota food safety laws are based on federal food safety laws, model codes, and national facility, equipment, and sanitation standards. In fact, several federal laws and interstate standards are explicitly incorporated in state law. Federal regulators also have a physical presence in the state. As required by federal law, inspectors with the U.S. Department of Agriculture (USDA) examine all meat, poultry, and related products produced in Minnesota that may be sold in other states. In addition, state employees inspect small meat and poultry processors and other food businesses under agreements with the USDA or the Food and Drug Administration (FDA) within the U.S. Department of Health and Human Services. Additionally, the Centers for Disease Control and Prevention (CDC) coordinate the national foodborne illness surveillance network and provide funding to ensure state participation.

Both MDA and MDH exercise statutory authority to delegate certain retail facility licensing and inspection activities to eligible, participating local units of government. For example, some larger cities carry out their own restaurant licensing and inspection programs under an agreement with MDH.

How are food safety activities funded?

Activities at both MDA and MDH are funded by a combination of fees paid by regulated entities, federal funds, and state general fund appropriations. The relative importance of each source varies significantly by program.

How frequently are food establishments inspected?

The frequency of inspection depends upon the type of operation as well as the food-handling methods employed at the site. For example, federal law and USDA cooperative agreements require MDA inspectors to be present whenever small, intrastate operations are slaughtering livestock or producing meat or poultry products for sale. MDA and MDH—or a local entity under a delegation agreement—inspect other regulated entities once a year, once every 18 months, or once every 24 months, depending on the operation's risk to public health.

Are there any constraints on state food safety policy?

Yes. Federal laws, delegation agreements, and interstate food safety ordinances that provide for a degree of uniformity across the nation effectively limit state food safety policymaking in certain areas.

How are foodborne illness outbreaks detected in Minnesota?

MDH detects foodborne illness outbreaks by utilizing mandatory reporting of communicable diseases and the Minnesota Foodborne Illness Hotline. Reported cases confirmed by MDH are quickly investigated to identify potential sources of illness. Once a source is identified, the regulatory divisions of MDA and MDH are notified in order to address the food item of concern and to identify and correct food-handling practices that led to contamination.

For more information: For licensing questions, food-handling guidance, foodborne illness concerns, or other related matters, contact the Minnesota Department of Agriculture at 1-800-967-AGRI or the Minnesota Department of Health at 651-201-4500. For legislative matters, contact legislative analyst Emily Cleveland (public health) at 651-296-5808 or Colbey Sullivan (agriculture) at 651-296-5047.

Nina Manzi & Joel Michael

Updated: November 2010

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, the military service combat zone 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 5 percent for 2009 and 3 percent for 2010 and 2011.

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?

In certain circumstances, failing to file and underreporting tax liability are criminal offenses. 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

Lisa Larson

Updated: December 2010

Minnesota's Public School Fee Law

Minnesota's constitution guarantees a free public education to all eligible students

Minnesota Statutes, sections 123B.34 to 123B.39, compose Minnesota's public school fee law. The public school fee law regulates the fees that school districts may and may not charge to students. Underlying the law is Article XIII, section 1, of the Minnesota Constitution, which directs the legislature to establish a general and uniform system of public schools, using taxes or other means, that will provide "a thorough and efficient system of public schools throughout the state." This provision is construed to mean that a public school education is free to all eligible students.

Public school fee law defines prohibited and authorized fees

School districts may charge only those fees authorized in statute and must hold a hearing before imposing fees that are neither authorized nor prohibited by statute. Under the public school fee law, school districts cannot deny students an education based on students' inability to furnish books or other educational supplies needed to complete high school graduation or other related educational requirements. School districts may not suspend or exclude students or withhold students' grades or diplomas for failing to pay school fees.

School districts may accept voluntary contributions and may charge fees for extracurricular and noncurricular activities, or activities that supplement a class or educational program. School districts deposit the proceeds from extracurricular and noncurricular fees in the "undesignated-unreserved" portion of the district's general fund. Minnesota Rules, part 3500.1050 defines curricular, cocurricular, noncurricular, extracurricular, and supplementary activities for purposes of the public school fee law.

Schools are prohibited from charging fees for necessary goods and services

Minnesota's constitutional guarantee of a free public school education for all eligible students means schools are prohibited from charging fees for necessary goods and services. State statutes define necessary goods and services to include instructional materials and supplies, required library books, required school activities, lockers, graduation caps and gowns, and bus fees to students who live more than two miles from school. However, schools may charge bus fees to students who live within two miles of school and wish to ride the school bus.

School districts may not withhold the grades or diplomas of students who fail to pay fees but may seek court action to collect unpaid fees. It is unclear whether remedial instruction constitutes supplemental education, where a fee is permitted, or core curricula, where a fee is prohibited.

Schools may charge students for certain school-related costs

School districts may require students to pay for certain specified school-related costs including fees for school uniforms, extracurricular activities, security deposits, personal athletic equipment, supplementary field trips, voluntary student insurance, musical instruments, student publications, graduation announcements, class rings, postsecondary instructional programs (e.g., vocational technical training, veteran farmer cooperative training, community education programs, and continuing education and evening school programs) excluding adult basic education programs, and personal stationery supplies.

School districts may charge fees for lost or destroyed textbooks, workbooks, and library books if the school district annually informs parents and students about its fee policy regarding lost and destroyed books. School districts must hold a public hearing before imposing a fee that is neither authorized nor prohibited by statute. School districts may waive fees for economically disadvantaged students and for students whose parents serve in or recently served in active military service.

Student user fees can generate revenues, concerns

Student user fees generate revenue for school districts. They also can present concerns for school officials and state policymakers regarding equity in generating and allocating funds, accountability, and taxpayer support of school funding.

User fee supporters argue that fees are more acceptable than general tax increases because people who use fee-subsidized programs and services help pay for them. The absence of fees, they say, would force school officials to eliminate entire extracurricular or enrichment programs that are important but cannot be funded with current levels of state aid or local tax revenues. Student participation fees for extracurricular activities, for example, allow a district to generate additional revenue to help offset a budget shortfall in an extracurricular activity or to help pay for new extracurricular activities not funded by the district.

User fee opponents argue that fees undermine the notion of a free public education by diminishing students' equal access to education, students' self worth, and equity among taxpayers. They say that fiscal inequities can arise when: parent-teacher associations in neighboring schools are not equally successful in using fees to raise funds to supplement classroom resources; affluent school districts are able to charge fees and thus spend at above-average levels; and fee-generated revenues, which produce relatively small amounts of money as compared to other funding sources, affect public support for tax levies and bond issues. They also say that fee waivers may separate students based on economic status.

For more information: Contact legislative analyst Lisa Larson at 651-296-8036. Also see the House Research publication *Minnesota's Public School Fee Law and Education Tax Credit and Deduction*, November 2008.

HOUSE RESEARCH | **Short Subjects**

Matt Burress **Updated: December 2010**

Highway Funding Sources

Funding framework

The Minnesota Constitution establishes a basic framework for state highway finance. It dedicates certain funding to be "used solely for highway purposes," through three main transportation-related taxes on: motor fuels, motor vehicle registration, and motor vehicle sales. Minn. Const. art. XIV. State statutes further specify policies, such as tax rates, allocation formulas, and local aid requirements.

Motor fuels tax

The motor fuels tax is imposed at a per-gallon rate and collected from petroleum distributors. The tax rate varies across fuel classifications in state law. The rate for regular gasoline is the same for diesel and certain gasoline blends. Minn. Stat. § 296A.07, subd. 3. The tax rate for other fuel types, such as E85 and compressed natural gas, is proportional to that of gasoline based on energy content of each fuel.

Legislation passed in 2008 phases in an 8.5-cent tax increase, so that starting in fiscal year 2013, the rate for gas and diesel will be 28.5 cents per gallon (and proportional for other fuel types). Laws 2008, ch. 152.

Gasoline Tax Phase-In

Period	Rate per gallon (cents)
FY 2007	20.0
FY 2008-09	20.0 - 25.5 (varies)
FY 2010	27.1
FY 2011	27.5
FY 2012	28.0
FY 2013 & After	28.5

Based on constitutional language dedicating motor fuel tax revenue "used for propelling vehicles on the public highways of this state," revenue is handled in a couple of ways when the motor fuel is not used for transportation on public roads. Minn. Const. art. XIV, § 10.

- Taxes paid on fuel used in nonhighway commercial operations, principally farming, are refunded.
- A portion of tax revenue is attributed to fuel use in nonhighway recreation, such as in motorboats and ATVs, and transferred into Department of Natural Resources (DNR) accounts supporting those activities. Minn. Stat. § 296A.18.

Motor vehicle registration tax

The state imposes a registration tax (also known as tab fees) on motor vehicles domiciled in Minnesota. The annual tax applies to passenger vehicles as well as trucks and other vehicles that use public streets and highways. A major exception is vehicles owned by government agencies (including school buses).

For passenger vehicles, the tax depends on the vehicle's original value as well as its age. Vehicles are taxed at 1.25 percent of the *base value* multiplied by a *depreciation factor*, plus $10. The base value is the manufacturer's list price (without options) for a particular make and model when the vehicle was new. The depreciation factor is a yearly reduction following a statutory schedule. In the vehicle's first year of life there is no depreciation. The depreciation is 90 percent in its second year, and it drops by 10 percentage points a year until its eleventh year (when the formula changes from a percentage to a flat $25). Minn. Stat. §

168.013, subd. 1a. Legislation in 2008 modified the schedule for depreciating the base value and eliminated caps on the amount of tax due. Laws 2008, ch. 152.

Trucks are taxed on the basis of weight and age. The tax on trucks and truck-tractors depends on weight, but entails a 25 percent reduction after eight years of life. Farm trucks pay a weight-based tax that is reduced after eight years of life. Buses are also taxed on weight, with depreciation beginning in the third year of life. Motorcycles have a flat tax of $10 annually. Minn. Stat. § 168.013.

Motor vehicle sales tax

The motor vehicle sales tax, or MVST, is a 6.5 percent tax applied to the sale of new and used motor vehicles based on the purchase price of the vehicle. Minn. Stat. § 297B.02. It is imposed instead of the general sales tax. 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.

Historically, MVST revenue has gone to both transportation and the general fund. Voters in 2006 approved a constitutional amendment that dedicates all MVST revenue to transportation purposes, phased in over fiscal years 2008 to 2012. The Constitution also requires that "no more than 60 percent" of the revenue go to highways and "not less than 40 percent" go to public transit assistance. Minn. Const. art. XIV, § 13. An MVST phase-in schedule established in statute specifies the actual division between highways and transit. 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.

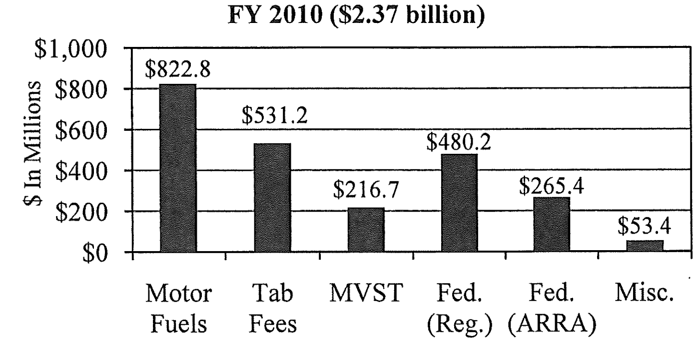
Other sources

Federal aid is another signficant highway funding source. In fiscal year 2010, it amounted to $536.53 million for trunk highways and $209.1 million for local roads. Federal aid can also be divided between regular program aid and onetime stimulus funding from the American Reinvestment and Recovery Act of 2009 (ARRA). Additional funding for the state's trunk highway system comes from (1) debt financing, in the form of trunk highway bonds; and (2) various sources such as fees, fines, and sales of excess land and property.

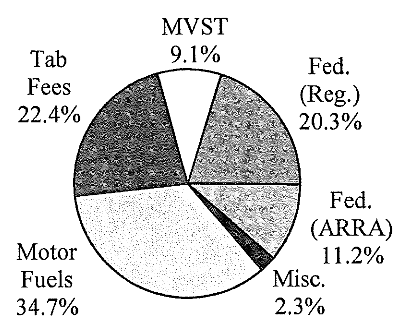
Funding amounts

The charts below summarize amounts of highway funding from state and federal sources (for the trunk highway system as well as for aid to local government).

State and Federal Highway Funding
FY 2010 ($2.37 billion)



Distribution of Funding Sources
FY 2010 ($2.37 billion)



Notes: (1) "Motor fuels" category includes DNR transfers; (2) "MVST" category only contains highway fundng; (3) "Misc." category is primarily various forms of revenue for the trunk highway system; and (4) funding excludes bond proceeds.

HOUSE RESEARCH | Short Subjects

Anita Neumann December 2010

Minnesota Building Code

The building code is a collection of state laws and rules that apply to building construction and modification activities in the state.

What is the state building code?

Under Minnesota Statutes, section 326B.121, the Minnesota Building Code, or the code, is the "standard that applies statewide for the construction, reconstruction, alteration and repair of buildings and other structures." Agricultural buildings—those used only for agricultural purposes and situated on agricultural land—generally are not covered by the code. For more detailed information on exempt agricultural buildings see Minnesota Statutes sections 326B.103, subdivision 3, and 273.13, subdivision 23.

Who administers and enforces the building code?

The code is administered by the state Department of Labor and Industry's (DOLI) Construction Codes and Licensing Division (CCLD) in conjunction with cities, townships, and counties throughout the state.

In some areas of the state the code is enforced by state officials, and in other areas the code is formally adopted and enforced by local officials.

For more information on building code enforcement see: http://www.dli.mn.gov/ccld/Codes.asp

What national and international standards are included in the state building code?

The International Building Code, the International Residential Code, the International Mechanical Code, the National Building Code, the National Electric Code, and the Guidelines for the Rehabilitation of Existing Buildings are examples of codes and standards incorporated in whole or in part in the Minnesota Building Code. The inclusion of these elements in the state code is generally done by adopting references in the state's rules regarding the building code.

How is the code changed?

The code is modified regularly in conjunction with updates to model and specialty codes and amended by the legislature. Members of the public may also propose changes by submitting a proposal in writing to DOLI on a form provided by the department.

What are examples of legislatively directed code elements?

The legislature often directs that specific items or standards be included within the building code. A partial list of items included as part of the code by way of specific statutory language includes: smoke detection, automatic garage door openers, decks, patios and balconies, radon control, and window fall prevention. State law also directs that the code cover several broad areas including: elevators, electricity, plumbing, accessibility, manufactured homes, prefabricated homes, and industrialized and modular buildings.

Does the state building code include the state fire code?	The State Fire Code is a separate set of standards. The state Department of Public Safety and the State Fire Marshal administer the State Fire Code. For additional information about the state fire code see: http://www.dps.state.mn.us/fmarshal/fmarshal.html
Where can I find a copy of the building code?	Information on obtaining the state building code and other reference materials is available from the Department of Labor and Industry website: http://www.dli.mn.gov/ccld/PDF/sbc_availability.pdf

For more information: Contact legislative analyst Anita Neumann at anita.neumann@house.mn.

Jeff Diebel

Updated: December 2010

Minnesota's Civil Commitment System for Sexually Dangerous Persons

When is a sex offender subject to civil commitment?

Any person who has been determined by a court to be a "sexually dangerous person" may be involuntarily committed as a patient in a secure hospital. Minn. Stat. § 253B.185. There are three elements to the definition of "sexually dangerous person."

- First, the person must have engaged in a course of "harmful sexual conduct" in the past. Sexual conduct is "harmful" if it creates a substantial likelihood of causing serious physical or emotional harm to another person.
- Second, the person must manifest a sexual, personality, or other mental disorder or dysfunction.
- Third, as a result of this mental disorder or dysfunction, the person must be likely to engage in future acts of harmful sexual conduct.

The law does not require proof that the person is **unable** to control his or her sexual impulses; it is sufficient that the person faces difficulty in controlling behavior, and there is a likelihood of future harmful sexual conduct due to the person's mental disorder or dysfunction. Minn. Stat. § 253B.02, subds. 7a and 18c.

Must there be a prior criminal offense?

No. Prior criminal convictions are not required in order to civilly commit a person under this law, but the person almost always has prior convictions. Minn. Stat. §§ 253B.02, subd. 18c; 253B.18, subd. 1; and 253B.185.

How does the state ensure appropriate persons are referred for commitment?

Minnesota law requires courts sentencing offenders who have committed felony-level criminal sexual conduct crimes to make a preliminary determination as to whether civil commitment of the person as a sexually dangerous person would be appropriate. Minn. Stat. § 609.1351.

Similarly, the Commissioner of Corrections must make a preliminary determination concerning the appropriateness of civil commitment before releasing certain predatory offenders from state prison. The commissioner must forward the preliminary determination to the county attorney in the county where the offender was convicted. This information must be forwarded no later than 12 months before the inmate's release date or as soon as is practicable if the inmate is incarcerated for fewer than 12 months. The law then directs the county attorney to proceed to assess the case and determine whether civil commitment proceedings should be initiated. Minn. Stat. §§ 244.05, subd. 7; and 253B.185, subd. 8.

Where are persons held pending resolution of a civil commitment petition?

A person subject to a civil commitment petition shall be held in a state-run secure treatment facility unless the person elects to be held in a Department of Corrections facility or a county jail. Regardless of where the person is held, the precommitment cost of housing the offender is shared 50/50 between the state and the county seeking commitment. The state only pays its share if the legislature appropriates funds for the purpose. Minn. Stat. §§ 253B.045, subd. 1a; and 253B.185, subd. 5.

Where are civil commitment proceedings heard?

The county attorney initiates a civil commitment proceeding under this law in the county where the proposed patient resides or is present. If the proposed patient is an inmate of a state prison, the petition may be filed in the county where the proposed patient was convicted. Minn. Stat. § 253B.185.

What rights and procedures govern commitment hearings?

The hearing on the petition is a civil proceeding and is governed by the same procedures and rules as a proceeding to commit a person as "mentally ill and dangerous." These procedures, among other things, guarantee the proposed patient's right to be represented by counsel at public expense, if necessary, and require the need for commitment to be proven by clear and convincing evidence. Minn. Stat. §§ 253B.18; and 253B.185.

Where are those civilly committed housed?

Sexually dangerous persons are committed to the custody of the Commissioner of Human Services and are placed in a secure treatment facility in Moose Lake, Minnesota. Minn. Stat. §§ 246B.02; and 253B.185, subd. 1.

For how long is a person committed?

During the 60-day period following the initial commitment decision by the court, the treatment facility prepares a treatment report and the court holds another hearing to decide whether the commitment decision should be made final. If the court finalizes its commitment decision at the review hearing, the person is committed to the Commissioner of Human Services' custody for an indeterminate period of time. Minn. Stat. § 253B.18.

How can the terms of the civil commitment be altered?

The decision to transfer the person to a more or less secure treatment facility or to discharge a sexually dangerous person from civil commitment is made by a three-judge panel with input from a special review board panel appointed by the Commissioner of Human Services. The review board consists of three members who are experienced in the field of mental illness and must include a psychiatrist and an attorney. A patient may file a petition for transfer, discharge, or provisional discharge with the special review board panel after six months have elapsed since the person was first committed (and all appeals are exhausted) and may not file additional petitions with the board unless six months have elapsed since the last petition is finally resolved, including appeals. Following the hearing and based on factors outlined in statute and evidence presented at the hearing, the panel makes written findings and recommendations on the petition and submits them to a judicial review panel, and everyone entitled to receive notice of the petition. The final decision on transfer or discharge rests with the judicial panel. Minn. Stat. §§ 253B.18, subd. 4c; 253B.185, subd. 9; and 253B19.

For more information: Contact legislative analyst Jeff Diebel at 651-296-5041.

HOUSE RESEARCH | Short Subjects

Nina Manzi & Joel Michael

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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 AMT requires taxpayers to pay tax under an "alternative" tax with a broader base and lower tax rates, if that results in higher tax liability than the regular tax.

What is the history of the AMT?

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. Minnesota first enacted an 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 three major differences.

- The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not.
- The Minnesota AMT has one flat rate, while the federal tax has two rates.
- The Minnesota AMT has a higher exemption amount than the federal AMT and the Minnesota exemption is indexed for inflation, while the federal exemption is not.

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 2011 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 Incentive stock options Depletion Intangible drilling costs Tax-exempt interest from private activity bonds
Standard deduction	$9,650 (married joint) $5,800 (single) $8,500 (head of household)	$67,590 for married joint (phased out for income from $150,000 to $420,360) $50,700 for single and head of household (phased out for income from $112,500 to $315,300)
Personal exemptions	$3,700 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	Credit for taxes paid to other states	Allowed
	Transit passes	Not Allowed
	Other nonrefundable credits (Long-term care insurance, marriage credit, past military service, health insurance premiums)	Allowed
	Refundable credits (working family, dependent care, K-12 education, combat zone service, bovine tuberculosis, angel investment, historic structure rehabilitation)	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 $32.1 million in tax year 2011, from about 15,400 taxpayers. The amount of revenue and the number of taxpayers paying the AMT are expected to increase in future years. Although the exemption is indexed annually for inflation, the AMT will tend to increase as real income increases and as AMT preference items, such as home mortgage interest and property taxes, increase more rapidly than inflation.

Joel Michael and Nina Manzi

December 2010

Minnesota Angel Investment Credit

What is the angel investment credit?

The Minnesota Small Business Investment Credit (commonly referred to as the angel investment credit) provides qualified investors in certified small businesses with a refundable income tax credit equal to 25 percent of their investments up to a maximum of $125,000 ($250,000 for married joint filers). The angel investment credit was enacted by the 2010 Legislature to encourage investment in emerging Minnesota small businesses. It took effect for tax year 2010 and is scheduled to expire for investments made after tax year 2014.

Three key sets of requirements apply under the credit:

- Rules that govern which investors qualify to make investments
- Rules specifying the types of businesses that qualify to receive investments
- Limits on which investments qualify

What investors qualify for the credit?

The angel credit allows two different types of investors to qualify for the credit:

- **Individual investors** qualify either by being accredited investors under Securities and Exchange Commission (SEC) Regulation D or by certifying that they will only invest in an offering that is exempt from registration under state law. Accredited investors generally must have net worths of $1 million (excluding the value of their homes) or annual income of $200,000 ($300,000 for married couples).
- **Qualified funds** are pass-through tax entities, such as LLCs or S corporations, that invest in qualifying small businesses and have three or more investors who each meet the requirements for individual investors. These funds pass through the credit to their individual owners, who claim it on their own tax returns.

Investors must apply to and be certified by the Department of Employment and Economic Development (DEED) before making the investment for which they are claiming the credit. However, individuals who are not accredited investors but who qualify because the offering is an exempt small corporation registration may apply up to 30 days after making the investment. Investors (either investing directly or through a fund) or members of their immediate families may not derive more than 50 percent of their gross annual incomes from the small business.

What small businesses qualify under the credit?

A qualifying small business (i.e., one in which an investment qualifies for the credit) must:

- Have its headquarters and 51 percent of its employees and payroll in Minnesota;
- Be engaged in:
  - Using proprietary technology to add value to a product, process, or service in a high-technology field;
  - Researching or developing a proprietary product, process, or service in

high-technology field; or
    - Researching, developing, or producing a new proprietary technology for agriculture, tourism, forestry, manufacturing, mining, or transportation;
- Have fewer than 25 employees;
- Pay its employees wages equal to at least 175 percent of the federal poverty guideline for a family of four on a full-time equivalent basis (executives, officers, and owners are excluded from this requirement);
- Have not been in operation for more than ten years;
- Have not received more than $2 million in private equity investment; and
- Be certified by DEED as meeting these requirements.

What types of investments qualify for the credit?

To qualify for the credit, an investment must:

- Receive DEED credit certification from the annual credit cap;
- Be made in cash (other types of property or providing services to the business do not qualify);
- Satisfy minimums of either $10,000 (individual investor) or $30,000 (fund); and
- Receive in return an equity-type interest (e.g., common stock, partnership interest, preferred stock, or debt with a mandatory conversion to equity).

What is the maximum credit for a business?

The law prohibits DEED for certifying more than $1 million in credit allocations to any one business. Thus, a business that attracts $4 million of qualifying investments could receive the maximum credit. No lifetime maximum credit applies to investors beyond the annual limits of $125,000 ($250,000 for married joint filers).

How much will the credit reduce state tax revenues?

The law imposes an annual dollar limit or cap on the total amount of credits. The Department of Revenue has estimated that credits will be claimed up to the full amount of the limits. Some of these credits may be paid as refunds (rather than reducing tax liability), since the credit is refundable. The total limit over the life of the credit is $58.9 million:

- $11 million for tax year 2010
- $12 million per year for tax years 2011 through 2014, except the 2013 amount is reduced by $100,000 to fund a program evaluation

DEED administers the limits by certifying dollar amounts of credits to applicant investors on a first-come, first-served basis.

Do clawback provisions apply?

The law provides for revocation and repayment of the credit if the small business does not maintain at least 51 percent of its employees and payroll in Minnesota for five years starting the year after the investment was made. The required repayment declines by 20 percentage points per year (100 percent in year one, 80 percent in year two, etc.). The business, not the investors, must make the repayment.

What reporting requirements apply?

Investors, funds, and small businesses must annually report to DEED on their compliance with the law. DEED must annually report to the legislature starting in March 2011. In addition, the law provides for an independent program evaluation to be completed by January 2014.

For more information: See the DEED website: http://www.positivelyminnesota.com/Business/Financing_a_Business/DEED_Business_Finance_Programs/Angel_Tax_Credit.aspx.

HOUSE RESEARCH | Short Subjects

Karen Baker & Nina Manzi **December 2010**

Major State Aids and Taxes: An Overview of the 2008 Update

This provides a brief overview of the report *Major State Aids and Taxes: A Comparative Analysis, 2008 Update*, which highlights major aids provided to the local governments and people in Minnesota and lists the major taxes collected. The per capita amounts were calculated using 2008 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 *Aid paid to school districts for all K-12 educational expenses*	2007/2008 (school year)	**$6,732.2 State** $3,706.6 Metro $3,025.6 Nonmetro	**$1,273 State** $1,291 Metro $1,251 Nonmetro
Human services aid *State's share of human services aid for various income and medical assistance programs*	2008	**$4,196.0 State** $2,280.9 Metro $1,915.1 Nonmetro	**$793 State** $795 Metro $792 Nonmetro
Highway aid *Distributed to counties, cities, and towns for highway purposes*	2008	**$531.6 State** $152.0 Metro $379.6 Nonmetro	**$101 State** $53 Metro $157 Nonmetro
Local government aid *Provides property tax relief by providing general purpose financial support to cities*	2008	**$430.6 State** $139.0 Metro $291.7 Nonmetro	**$81 State** $48 Metro $121 Nonmetro
Disparity reduction aid *Provides aid to jurisdictions (counties, towns, and school districts) that had inordinately high tax rates in 1988*	2008	**$18.0 State** $1.4 Metro $16.7 Nonmetro	**$3 State** – Metro $7 Nonmetro
County program aid *County general purpose aids: includes former homestead and agricultural credit, county criminal justice aid, family preservation aid, and attached machinery aid*	2008	**$161.0 State** $63.6 Metro $97.4 Nonmetro	**$30 State** $22 Metro $40 Nonmetro
Community corrections funding *Aid that provides a portion of counties' costs for community correctional services*	2008	**$85.9 State** $43.0 Metro $42.9 Nonmetro	**$16 State** $15 Metro $18 Nonmetro
Property tax refund (excludes targeting) *Reimburses homeowners and renters for a portion of property taxes if those taxes exceed a household income threshold*	2007 (filed in 2008)	**$398.6 State** $272.0 Metro $126.6 Nonmetro	**$75 State** $95 Metro $52 Nonmetro
Targeting *Additional homeowner property tax refund if property taxes increased a certain percentage threshold over previous year (no income limits)*	2008	**$7.4 State** $4.0 Metro $3.3 Nonmetro	**$1 State** $1 Metro $1 Nonmetro

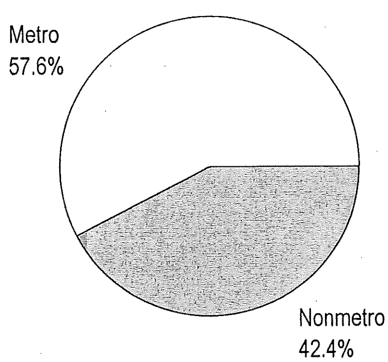
MAJOR TAXES

	Year	Amount (millions)	Per capita
Individual income tax *Imposed on income of state residents and income derived from state sources of nonresidents*	2007 (filed in 2008)	**$7,191.0 Total** **$6,918.6 Residents** $4,694.7 Metro $2,223.9 Nonmetro	**$1,308 State** $1,636 Metro $920 Nonmetro
Sales and use tax *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)*	2008	**$4,430.7 (After refunds)** **$3,704.9 Residents** $2,401.5 Metro $1,303.0 Nonmetro	**$701 State** $837 Metro $539 Nonmetro
Motor vehicle sales tax *Imposed on new and used motor vehicles at the time of sale at the same rate of state sales tax*	2008	**$480.7 State** $250.0 Metro $230.7 Nonmetro	**$91 State** $87 Metro $95 Nonmetro
Motor vehicle registration tax *Imposed annually on vehicles licensed in the state*	2008	**$485.5 State** $261.2 Metro $224.3 Nonmetro	**$92 State** $91 Metro $93 Nonmetro
Motor vehicle fuels tax (gas tax) *Imposed on gasoline, diesel fuel, and other motor fuels used by vehicles and on aviation fuels*	2008	**$681.4 State** $322.7 Metro $358.7 Nonmetro	**$129 State** $112 Metro $148 Nonmetro
Corporate franchise (income) tax *Imposed at a rate of 9.8 percent on the net income of corporations (or alternative minimum tax)*	2007	**$985.2 State** $712.3 Metro $272.9 Nonmetro	**$186 State** $248 Metro $113 Nonmetro
State general property tax *Imposed on commercial/industrial/public utility property and seasonal recreational property*	2008	**$731.6 State** $500.0 Metro $231.5 Nonmetro	**$138 State** $174 Metro $96 Nonmetro

PROPERTY TAX DATA

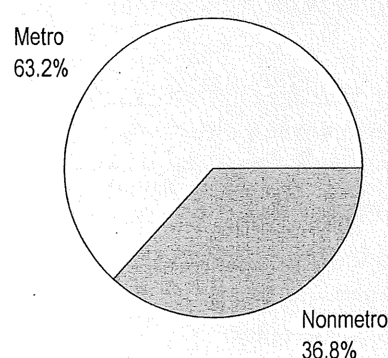
Market Value

Total statewide: $561.6 billion



Net Property Tax

Total statewide: $7.6 billion



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, 2008 Update* (December 2010) 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.

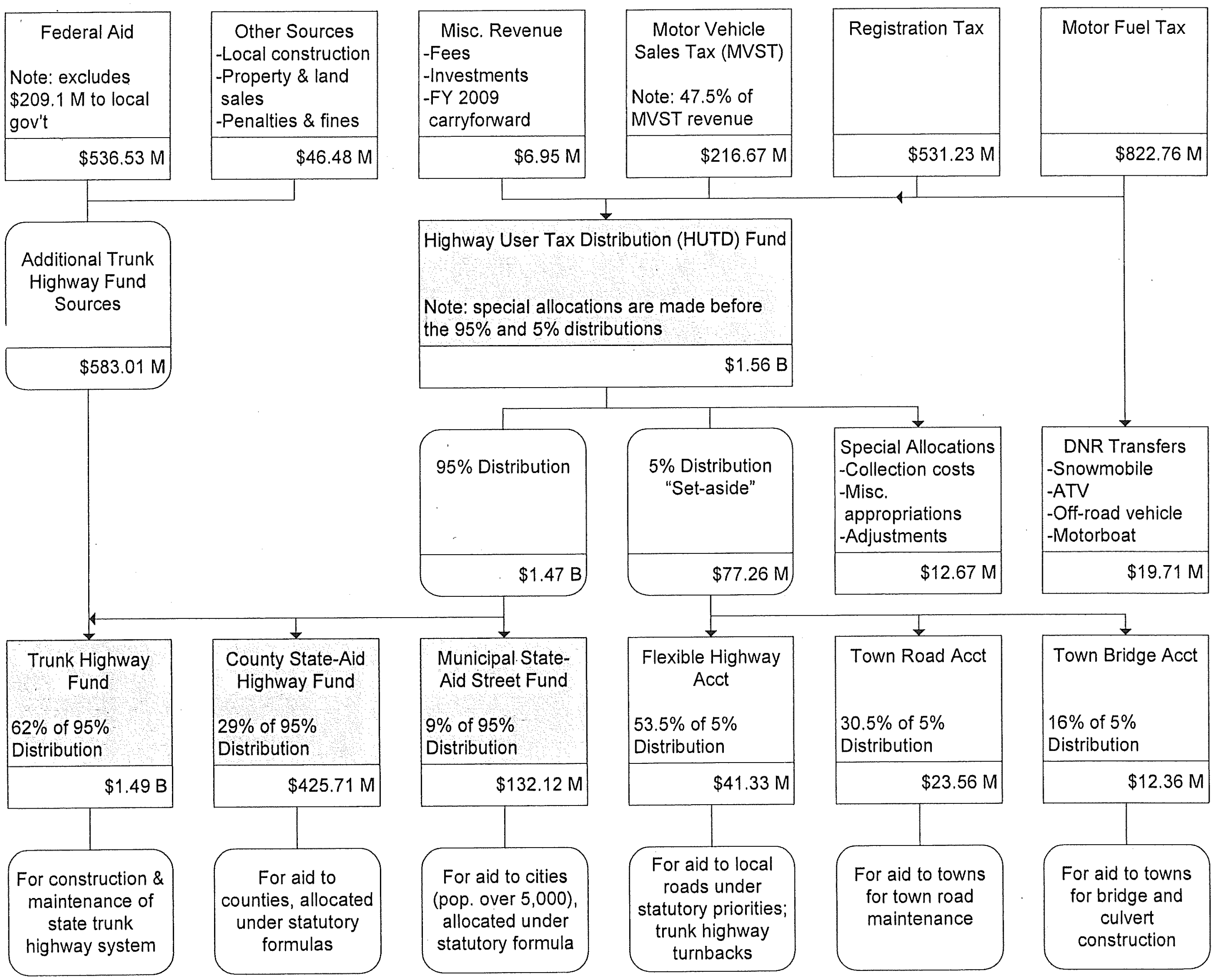
HOUSE RESEARCH | Short Subjects

Matt Burress

Updated: December 2010

Highway Finance Overview

The finance structure for Minnesota's transportation system follows a constitutional framework, and almost all highway funding is handled outside of the state's general fund. State funding primarily comes from three transportation-related taxes and is allocated to the state trunk highway system as well as local streets and highways following various constitutional and statutory formulas. The chart below summarizes the flow of highway funding from state and federal funds, using fiscal year 2010 amounts.



Constitutional and statutory framework

The Minnesota Constitution establishes a basic framework for state highway finance. It (1) dedicates certain funding to be "used solely for highway purposes," through taxes on motor fuels, motor vehicle registration, and motor vehicle sales;

(2) establishes various accounting funds for transportation finance; (3) allocates tax revenues among state, county, and municipal roads; and (4) establishes requirements related to use of the funds and characteristics of each road system. Minn. Const. art. XIV. State statutes further specify policies such as taxation rates, allocation formulas, and local aid program requirements.

State sources of highway funding

The first of three main state funding sources is a tax on motor fuels, imposed at a per-gallon rate. For special fuels such as E-85, rates are based on the energy content of the fuel. Legislation passed in 2008 phases in an 8.5-cent tax increase, so that starting in fiscal year 2013 the rate for gas and diesel fuel will be 28.5 cents per gallon. A portion of the revenue from the gasoline tax is attributed to nonhighway use and transferred to various accounts managed by the Department of Natural Resources. Minn. Stat. §§ 296A.07; 296A.08; 296A.18.

The second source is a registration tax (also known as tab fees) imposed on motor vehicles using the highway system. The registration tax for passenger vehicles is mainly a percentage of the vehicle's original value, which is reduced as the vehicle gets older until reaching a minimum flat amount. Taxes on trucks, buses, and recreational vehicles are based on a vehicle's weight and age. Minn. Stat. § 168.013.

Third, a motor vehicle sales tax (MVST) applies to the sale of motor vehicles, imposed at the same rate but in lieu of the 6.5-percent general sales tax. Following a constitutional amendment adopted in the 2006 election, MVST revenue is phasing in from the state general fund to be dedicated solely to highways 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.

Distribution of state revenue

State revenue is distributed in two parts following certain transfers and special allocations. First, a constitutional formula distributes 95 percent of funds.

- 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 various other sources.
- 29 percent goes to the county state-aid highway (CSAH) fund to support county state-aid highways. Most of the funds are allocated among counties via statutory formulas. Minn. Stat. § 162.07.
- 9 percent is for the municipal state-aid street (MSAS) fund for city streets in the state-aid system, allocated by statutory formula. Minn. Stat. § 162.13.

Second, a 5 percent "set-aside" is distributed by statute. Under the Constitution, money must go to one of the three foregoing funds and the distribution cannot be changed more than once every six years. Following a change that went into effect July 1, 2009, the set-aside goes into the CSAH fund and is allocated as follows.

- 53.5 percent goes to a flexible highway account for (1) metropolitan county highways, (2) trunk highways being turned over to cities or counties, (3) safety improvements on local roads, and (4) routes of regional significance.
- 30.5 percent goes to an account for town road construction and repair.
- 16 percent goes to an account for town bridges. Minn. Stat. § 161.081.

HOUSE RESEARCH | **Short Subjects**

Karen Baker and Nina Manzi

Updated: December 2010

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.

What are recent changes to the program?

The 2008 tax law expanded the homeowner's property tax refund program, effective for refunds based on property taxes payable in 2009. The changes lowered the maximum threshold percentage for determining eligibility from 4.0 percent of income to 3.5 percent of income and increased the maximum refund allowed from $1,800 to $2,310.

What are the maximums?

For refund claims filed in 2011, based on property taxes payable in 2011 and 2010 household income, the maximum refund is $2,370. Homeowners whose income exceeds $99,239 are not eligible for a refund.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR. Schedule M1PR is filed separately from the individual income tax form. Claims filed before August 15, 2011, will be paid beginning in late September 2011. The deadline for filing claims based on taxes payable in 2011 is August 15, 2012; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's website, under "Forms and Instructions" (www.taxes.state.mn.us).

What is the average refund and total amount paid?

Statewide Homeowner Property Tax Refunds Filed in 2009
(based on 2008 incomes and payable 2009 taxes, most recent data available)

	Number of returns	Total refund amount	Average per return
Under 65 years old	221,393	$164,232,346	$742
Senior/disabled	139,426	$105,082,861	$754
Total: all homeowners	360,819	$269,315,207	$746

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 2011 property taxes of $3,325, a typical amount for the metro. The family in greater Minnesota has payable 2011 property taxes of $1,600, a typical amount 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
Example refunds for claims to be filed in 2011,
based on taxes payable in 2011 and 2010 income

		Metro area		Greater Minnesota	
		Taxpayer #1	Taxpayer #2	Taxpayer #3	Taxpayer #4
1	Estimated typical market value of home	$246,000	$246,000	$159,000	$159,000
2	Gross income	$35,000	$75,000	$35,000	$75,000
3	Deduction for dependents	$9,855	$9,855	$9,855	$9,855
4	Household income (2 – 3 = 4)	$25,145	$65,145	$25,145	$65,145
5	Property tax	$3,325	$3,325	$1,600	$1,600
6	Statutory threshold percentage	2.4%	3.2%	2.4%	3.2%
7	Threshold % x income (4 x 6 = 7)	$603	$2,085	$603	$2,085
8	Property tax over threshold (5 – 7 = 8)	$2,722	$1,240	$997	$0
9	Statutory copay percentage	35%	45%	35%	45%
10	Taxpayer copay amount (8 x 9 = 10)	$953	$558	$349	NA
11	Remaining tax over threshold (8 – 10 = 11)	$1,769	$682	$648	NA
12	Maximum refund allowed	$1,820	$1,420	$1,820	$1,420
13	Net property tax refund	$1,769	$682	$648	$0

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online at www.taxes.state.mn.us.

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

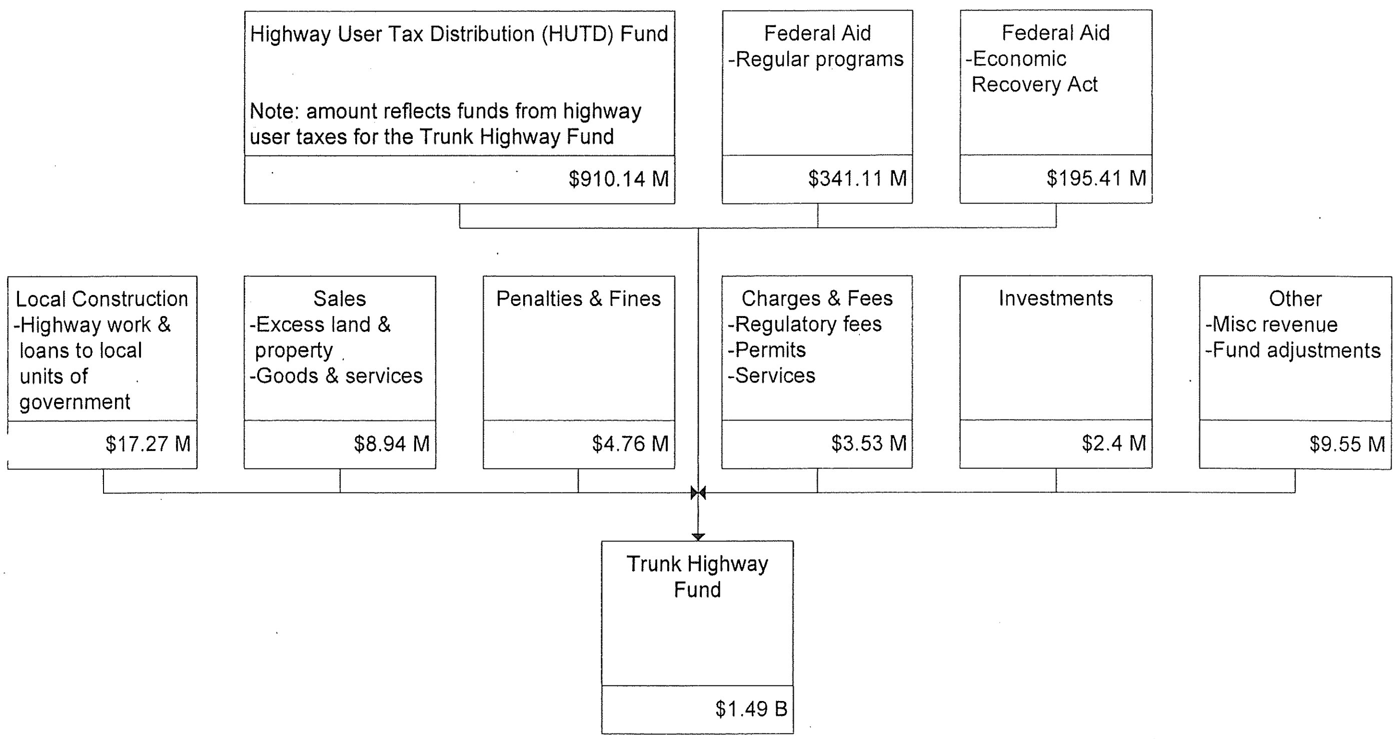
House Research Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

HOUSE RESEARCH | Short Subjects

Matt Burress **Updated: December 2010**

Trunk Highway System

The trunk highway system is a roughly 12,000-mile network of key roads connecting communities throughout the state, maintained by the Minnesota Department of Transportation (MnDOT). It includes the interstate and U.S. highway systems as well as other state highways. The bulk of funding for the system comes from transportation-related taxes and federal aid. Fiscal year 2010 funding for the trunk highway system, amounting to $1.49 billion (excluding trunk highway bond proceeds), is summarized below.



Funding framework Funding is based on a highway finance framework established by the Minnesota Constitution, which includes dedication of funding through three transportation-related taxes and allocation of the tax revenues. Minn. Const. art. XIV.

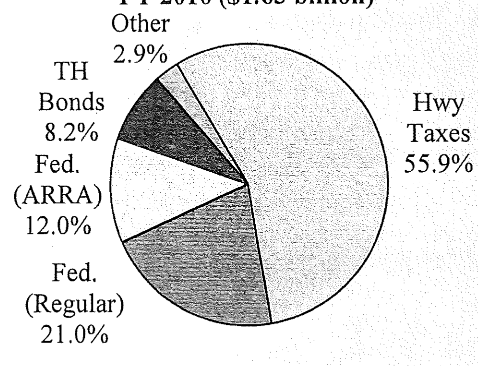
Primary sources The primary state sources of revenue for the trunk highway fund are three highway user taxes: a tax on motor fuels, a registration tax on motor vehicles, and a tax on the sale of motor vehicles. Federal aid constitutes another significant source; it can be divided between regular funds (under various federal aid programs) and one-time stimulus under the American Reinvestment and Recovery Act of 2009 (ARRA).

Trunk highway bonds Trunk highway bonds are a specialized form of general obligation bonding, issued by the state only for construction on the trunk highway system (following constitutional requirements). Minn. Const. arts. XI, § 5 (e); XIV, § 11. Since bonds carry an obligation for future repayment with interest, proceeds from bond issuances represent debt rather than "new" revenue. Nonetheless, proceeds from bonds sales can be viewed as a funding source.

In fiscal year 2010, $133.7 million in bond proceeds went to the trunk highway system. This amount only represents funds utilized in that fiscal year. Legislative bond *authorizations* for fiscal year 2010 are higher because much of the bond proceeds are committed to projects in which actual expenditures will not take place until future fiscal years. (Bonds are issued based on cash flow needs of authorized projects, in amounts needed to cover upcoming costs until a subsequent bond sale).

Distribution of funding

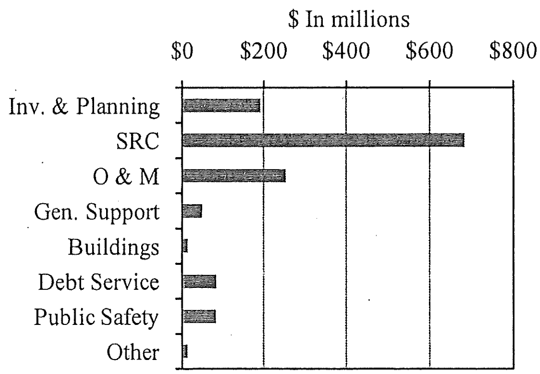
Distribution of Funding Sources
FY 2010 ($1.63 billion)



Expenditures

The following summarizes trunk highway fund expenditures by budget activity.

Trunk Highway System Expenditures
FY 2010 ($1.38 billion)



- **Investment and planning** includes three main elements: (1) project development to prepare a project for construction through tasks like scoping, design and engineering, and environmental analysis; (2) project management, which involves oversight of specific projects; and (3) general statewide system planning.
- **State road construction (SRC)** is the largest category, funding specific construction projects. Its main components are (1) contracts and consultant agreements for actual construction work, (2) materials purchasing, and (3) right-of-way acquisition.
- **Operations and maintenance (O & M)** provides for snow plowing and road clearance as well as ongoing items like roadway repairs, maintaining traffic safety infrastructure (such as guard rails and signs), and day-to-day preservation of MnDOT facilities.
- **General support** includes departmental leadership, finance, information technology, and human resources.
- **Buildings** is for larger facilities construction projects.
- **Debt service** is repayment of principal and interest on trunk highway bonds (issued in previous years).
- **Public safety** primarily funds the State Patrol.

For more information: Contact legislative analyst Matt Burress at 651-296-5045. Also see the House Research publication *Highway Finance Overview*, December 2010.

Nina Manzi and Lisa Larson

Updated: December 2010

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.

In tax year 2009 (fiscal year 2010) an estimated 176,000 returns claimed the deduction. The Department of Revenue estimates that the deduction will cost the state $14.4 million in tax year 2011 (fiscal year 2012).

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 2010, a typical married couple with two dependents would need to have $26,000 of gross income before owing any state income tax.

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.).

In tax year 2008, 54,031 Minnesotans claimed a total of $14.2 million in K-12 education credits. The average credit was $264. In tax year 2011 (fiscal year 2012), the Department of Revenue estimates that Minnesota will claim $13.2 million in K-12 education credits.

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 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, nine states in addition to Minnesota provide income tax benefits for education-related expenses: Arizona, Florida, Georgia, Illinois, Indiana, Iowa, Louisiana, Rhode Island, and Pennsylvania. Puerto Rico provides a credit similar to the one allowed in Florida and other states. **Arizona, Florida, Indiana, Iowa,** and **Rhode Island** all provide tax credits for contributions to nonprofit school tuition organizations that operate like charities. **Iowa** allows the credit for individual filers; the **Florida** and **Rhode Island** credits are for corporate taxpayers; and **Arizona, Georgia** and **Indiana** have credits 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, while **Louisiana** allows a tax deduction. Iowa's credit applies to tuition for children attending accredited not-for-profit K-12 schools, and Louisiana's deduction applies to public, private, and homeschool expenses. Courts in Arizona, Illinois, and Iowa have upheld the permissibility of these education credits; a challenge to Arizona's credit is pending.

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*, November 2008.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2010

The Minnesota and Federal Dependent Care Tax Credits: An Overview

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.

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). Maximum allowable qualifying expenses are reduced by amounts paid through dependent care pre-tax accounts.

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 maximum credit percentage, qualifying expenses, and phaseout threshold for the federal credit were scheduled to decrease to 30 percent, $2,400 for one child ($4,800 for two or more children), and $10,000 in tax year 2011. The federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the increased parameters to tax years 2011 and 2012.

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 tax year 2010, the state credit is tied to the federal credit actually in effect for tax year 2010. Unless Minnesota passes legislation to conform to the extension of the increased federal credit amounts to tax years 2011 and 2012, the state credit will be tied to the smaller federal credit that would have been in effect in the absence of the extension. If Minnesota does not conform, about 27,500 Minnesotans will qualify for smaller state credits, and the state will pay about $2.3 million less in credits.

The state credit is subject to an income phaseout. (By contrast, the federal credit phases down to a minimum amount but is never totally phased out.) In tax year 2011, the state phaseout begins when income exceeds $23,720, and the state credit is fully phased out when income exceeds $37,370. 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 2008, 147,491 Minnesotans claimed the federal dependent care credit and 36,106 claimed the state credit. These claims represent 5.7 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 2008 was only available to filers with incomes below $36,030, most of the state credits are claimed by low-income filers.

How much is paid out in credits?

In tax year 2008, Minnesotans claimed $67.1 million of federal dependent care credits. The average federal dependent care credit was $455.

In tax year 2008, Minnesotans claimed $14.2 million of state dependent care credits. The average state dependent care credit was $392.

How does Minnesota compare with other states?

Nationwide, 4.5 percent of all income tax returns claimed the federal dependent care credit, compared to 5.7 percent in Minnesota. South Dakota had the highest percentage of returns claiming the federal credit at 6.5 percent, and West Virginia had the lowest at 2.3 percent.

The average federal dependent care credit in 2008 was $536 nationwide and $455 in Minnesota. The District of Columbia had the highest average credit at $615, and Montana had the lowest at $432. Minnesota's average credit amount may be lower than the national averages because state residents have above average incomes, or because Minnesotans are more likely to receive child care assistance or use pre-tax dependent care accounts, reducing the amount of qualifying expenses.

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 2008.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2010

The Federal Child Tax Credit

What is the federal child tax credit?

Parents may claim a credit against federal income tax for each child under age 17. The credit was enacted in the Tax Relief Act of 1997 (TRA) and first allowed in 1998. It was expanded under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and later laws. It equaled $400 per child in 1998, increased to $500 in 1999, $600 in 2001 and 2002, and $1,000 for 2003 through 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA) extended the $1,000 per-child amount through 2012. Unless extended by Congress, the credit will decrease to $500 per child in 2013 and following years.

How much do Minnesotans claim?

In tax year 2008, 447,269 federal income tax returns filed by Minnesotans claimed $605.7 million in federal child credits. The average amount claimed was $1,354.

Are there income limitations?

The credit is reduced by $50 for every $1,000 of income over $110,000 of adjusted gross income for married joint filers and $75,000 for head of household filers. A married couple filing jointly with two children under age 17 will become ineligible for the credit when their income reaches $150,000; a single parent claiming the credit for one child will become ineligible when income reaches $95,000.

Is the credit refundable?

The child credit is partly refundable. In tax years 2009 through 2012, the refundable part is the greater of:

- 15 percent of earned income over $3,000, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit.

For example, a married couple with two children under age 17 and $30,000 of income is eligible for $2,000 in child tax credits, $1,000 for each child. If the couple claims the standard deduction, their federal income tax will equal $400 in 2010. They use $400 of their $2,000 credit to reduce their liability to $0. They may claim up to 15 percent of their earnings in excess of $3,000 as a refund. Assuming all $30,000 of their income is from wages, that means they would be eligible to claim up to $4,050 of the remaining credit as a refund (15 percent of $30,000 minus $3,000 equals $4,050). The result is that they claim $400 as an offset to their tax liability and are paid the remaining $1,600 as a refund.

When first enacted in TRA, the child credit was only refundable for taxpayers with three or more children, and only to the extent that their payroll taxes exceeded the federal earned income tax credit. The implicit rationale was that the refundable portion of the federal earned income tax credit was first used to offset payroll taxes for Social Security and Medicare, and then any payroll taxes left over after the federal earned income tax credit could be offset by the federal child credit. This refund mechanism was limited to families with three or more children because families with fewer children and no federal tax liability would typically have all of their payroll taxes offset by the federal earned income tax credit and none left over to be offset by the new child credit.

In 2001 the refundable portion was changed to be the greater of:

- a percentage of earned income over a minimum amount for all families regardless of the number of children, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit (the provision that was already in law).

The minimum amount was set at $8,500 in the 2001 law and decreased to $3,000 for 2009 through 2012. Unless Congress extends the expanded refundability of the credit, in 2013 only families with three or more children will be able to claim the credit as a refund, and the refund will be limited to payroll taxes in excess of the federal earned income tax credit.

What was the effect of the American Recovery and Reinvestment Act on the federal child credit?

The American Recovery and Reinvestment Act of 2009 (ARRA) temporarily expanded the refundable portion of the child credit, for tax years 2009 and 2010 only, to equal 15 percent of earnings in excess of $3,000. Under previous law, the refundable portion equaled 15 percent of earnings in excess of $8,500. As a result, about 65,000 Minnesota households will be eligible to claim more of the credit as a refund in tax year 2010, with the additional amount claimed equaling about $30 million.

TRUIRJCA extended the expanded refundability of the child credit through tax year 2012.

What was the effect of TRUIRJCA on the federal child credit?

TRUIRJCA extended many provisions of federal tax law that were set to expire after tax year 2010 for two years, through tax year 2012. Included among the provisions extended through 2012 are:

- the increase in the child tax credit from the $500 per child amount set in the late 1990s to $1,000, and
- allowing the credit to be claimed as a refund equal to a percentage of earned income over a threshold.

Unless Congress extends those provisions beyond 2012, in 2013 the per-child credit amount will decrease from $1,000 to $500 and the credit will be refundable only for households with three or more children, and only to the extent that their payroll taxes exceed the federal earned income tax credit.

The number of Minnesota households that claim the child tax credit is expected to fall by about 105,000 filers to 444,000 in tax year 2013 as a result of the TRUIRJCA sunset, and the total amount claimed by Minnesota filers is estimated to decrease by about $541 million to $363 million.

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

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2010

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 additions and subtractions.

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 for tax year 2011. These items are subject to Minnesota tax, but not federal tax.

- **State income or sales tax deduction.** Filers who claimed a federal itemized deduction for state income or sales taxes paid must add that amount to 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.**
- **Expenses relating to income not taxed by Minnesota.**
- **Capital gain part of lump-sum distributions from qualified retirement plans.**
- **Fines and penalties allowed as deductions from federal taxable income.**
- **80 percent of the difference between federal and state allowances for bonus depreciation and section 179 expensing.**

Minnesota may also require additions for federal deductions that were extended to tax year 2011 in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, such as the increased standard deduction for married joint filers, the educator expense deduction, and the higher education tuition deduction.

What subtractions does Minnesota allow from taxable income?

Minnesota allows the following *subtractions* from federal taxable income for tax year 2011. The estimated reductions in revenue shown below are taken from the Department of Revenue's *Tax Expenditure Budget for 2010-2013* and from estimates made during the 2010 session. Revenue estimates made during the 2011 legislative session will differ from the *Tax Expenditure Budget* because they will be based on a more recent economic forecast, and they may take into account behavioral changes likely to result from proposed changes in the law.

- **State income tax refund.** The federal income tax allows an itemized deduction for state income taxes. Minnesota requires itemizers 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 received by residents:
  - U.S. bond interest
  - Railroad retirement benefits
  - On-reservation earnings of enrolled tribal members
- **K-12 dependent education expenses** ($14.4 million in fiscal year 2012). 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, including training** ($4.6 million in fiscal year 2012).
- **Compensation for most military service in Minnesota** ($3.6 million in fiscal year 2012). Allowed for state active service, federally funded state active service (generally floods, other disasters, and airport security), active service in the full-time military by Minnesota residents, and training pay.
- **50 percent of charitable contributions in excess of $500** ($5.9 million in fiscal year 2012). 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** ($0.5 million in fiscal year 2012). 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** ($7.0 million in fiscal year 2012). 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** (less than $50,000 in fiscal year 2012). Allowed for up to $10,000 of expenses related to organ donation by the taxpayer or a dependent, including lost wages.
- **Gain on sale of farm property for insolvent taxpayers** (less than $50,000 in fiscal year 2012). 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** ($90,000 in fiscal year 2012). Allowed for taxes paid to a foreign governmental unit, to the extent the taxpayer did not claim the federal foreign tax credit for the subnational taxes.
- **National service education awards** ($100,000 in fiscal year 2012). Allowed for scholarships received for AmeriCorps service.
- **Bonus depreciation, section 179 expensing, and income from the discharge of indebtedness.** Allowed for amounts included in Minnesota taxable income, but not federal taxable income, in earlier tax years.

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*, August 2010; and *Minnesota's Elderly Exclusion* (web only) on the income tax page of the House Research web site: www.house.mn/hrd/hrd.htm.

Nina Manzi

Updated: December 2010

Minnesota's Individual Income Tax

How much are income tax revenues?

Minnesota's income tax revenues are projected to equal $7.3 billion in fiscal year 2011, about 42 percent of state tax collections and 35 percent of all state revenues.

What is the tax base used to calculate Minnesota's income tax?

Minnesota's income tax applies to a base of Minnesota taxable income (MTI). The starting point for calculating MTI is federal taxable income (FTI), which is the income measure used in determining federal income tax liability. In calculating MTI, taxpayers are required to add certain types of income to FTI and allowed to subtract other kinds of income. Some of the subtractions are required under federal law. For more detail on these adjustments, see the House Research publication *Minnesota Taxable Income,* December 2010.

What are the income tax rates and brackets?

Minnesota's income tax is a graduated tax, with three rates: 5.35 percent, 7.05 percent, and 7.85 percent. The rates are applied to income brackets that vary by filing status. Married couples filing joint returns are allowed the most generous (widest) brackets, followed by head of household filers (single parents), and then by unmarried single filers.

The table shows the income tax brackets in effect for each rate in tax year 2011 (brackets for married taxpayers, filing separately, are half the width of the married joint brackets):

	Married Joint	**Single**	**Head of Household**
5.35%	First $33,770	First $23,100	First $28,440
7.05%	$33,771 to $134,170	$23,101 to $75,890	$28,441 to $114,290
7.85%	All over $134,170	All over $75,890	All over $114,290

A married couple filing a joint return owes income tax equal to 5.35 percent of their first $33,770 of taxable income, 7.05 percent of income between $33,770 and $134,170, and 7.85 percent of taxable income over $134,170. The income tax brackets are adjusted each year for inflation.

What income tax credits does Minnesota allow?

Minnesota allows taxpayers to claim several credits against tax liability. Credits that may be used only to reduce liability, called nonrefundable credits, include the following:

- Credit for taxes paid to other states ($120.0 million in tax year 2008)
- Marriage credit ($65.5 million in fiscal year 2012)
- Credit for past military service ($1 million in fiscal year 2012)
- Long-term care insurance credit ($7.9 million in fiscal year 2012)
- Credit for new participants in section 125 employer health insurance plans ($0.7 million in fiscal year 2012)

In addition, Minnesota allows nine refundable credits, which are paid as refunds to taxpayers even if the credit amount is greater than their income tax liability:

- Working family (earned income) credit ($178.0 million in fiscal year 2012)
- Dependent care credit ($12.8 million in fiscal year 2012)
- K-12 education credit ($13.2 million in fiscal year 2012)
- Military combat zone credit ($1.8 million in fiscal year 2012)
- Job opportunity building zone (JOBZ) credit ($0.8 million in fiscal year 2012)
- Bovine tuberculosis testing credit ($0.1 million in fiscal year 2012)
- Enterprise zone credit (less than $50,000 in fiscal year 2012)
- Angel investment credit ($12.0 million in fiscal year 2012)
- Historic structure rehabilitation credit ($10.0 million in fiscal year 2012)

Credit amounts are from the Minnesota Department of Revenue's *Tax Expenditure Budget, Fiscal Years 2010-2013,* Department of Revenue estimates, and income tax return processing data.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publications, *Minnesota Taxable Income*, December 2010; *The Minnesota Income Tax Marriage Credit*, December 2008; *The Minnesota and Federal Dependent Care Tax Credits*, December 2008; *The Federal Earned Income Credit and the Minnesota Working Family Credit,* August 2010; *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, November 2008; and *Income Tax Terms: Deductions and Credits*, August 2010.

HOUSE RESEARCH | Short Subjects

Nina Manzi

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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 income (FAGI) 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?

FAGI 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?

FAGI 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 2011, $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 2008, the most recent year for which data is available, 58 percent of Minnesotans claimed the standard deduction and 42 percent itemized.

How much is the standard deduction?

In tax year 2011, the standard deduction is as follows:

- $11,600 for married couples filing joint returns
- $5,800 for married couples filing separate returns
- $8,500 for head of household filers
- $5,800 for single filers

What itemized deductions are allowed?

Itemized deductions are allowed for the following:

- Payments of state and local property taxes and either income or sales taxes
- Mortgage 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 2011, the personal and dependent exemptions are $3,700 each. A family of four qualifies for four exemptions, totaling $14,800.

Are there limits on deductions and exemptions?

The federal Revenue Reconciliation Act of 1990 (RRA 1990) limited itemized deductions for taxpayers with incomes over a threshold. This limit takes away some of the benefit of the deduction for higher income taxpayers. Taxpayers subject to the limit have their deductions reduced by 3 percent of their AGI over the applicable thresholds. But they are always guaranteed 20 percent of the deductions, no matter how high their AGIs are.

RRA 1990 also provided for personal and dependent exemptions to be phased out for taxpayers with incomes over a threshold. Affected taxpayers lose 2 percent of their total exemption amount for each $2,500 of income over the threshold.

The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 gradually phased out the limitation on itemized deductions and the phaseout of exemptions over five years, from 2006 to 2010, so that in tax year 2010, the limitation and the phaseout were not in effect. The federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the elimination of the deduction limitation and the exemption phaseout to tax years 2011 and 2012. In tax year 2013 the limitation of itemized deductions and the phaseout of exemptions will be reinstated.

The table shows the income thresholds for the itemized deduction limitation and the personal exemption phaseout in effect in tax year 2009. The income thresholds are adjusted annually for inflation, and the inflation adjustment will resume in 2013 if the limitation and phaseout are reinstated.

Tax year 2009	**Itemized deduction limit begins at**	**Exemption phaseout begins at**
Married joint filers	$166,800	$250,200
Married separate filers	$83,400	$125,100
Single filers	$166,800	$166,800
Head of household filers	$166,800	$208,500

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*, August 2010.

HOUSE RESEARCH | Short Subjects

Nina Manzi

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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 2011, individuals with more than $3,150 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 2011, 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	$464	$116	$7,590	$7,590	$13,660	$13,670
1 child	$3,094	$927	$16,690	$19,830	$36,052	$35,999
2 children	$5,112	$1,788	$16,690	$23,530	$40,964	$40,889
3 or more children	$5,112	$1,788	$16,690	$23,530	$40,964	$40,889
Married claimants						
No children	$464	$116	$12,670	$7,590	$18,740	$13,670
1 child	$3,094	$927	$21,770	$19,830	$41,132	$35,999
2 children	$5,112	$1,788	$21,770	$23,530	$46,044	$40,889
3 or more children	$5,112	$1,788	$21,770	$23,530	$49,078	$40,889

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 2008, 308,262 Minnesota returns claimed the EITC and 297,107 claimed the WFC. These claims represent 12.0 percent of all federal returns filed by Minnesotans and 11.4 percent of all state returns filed.

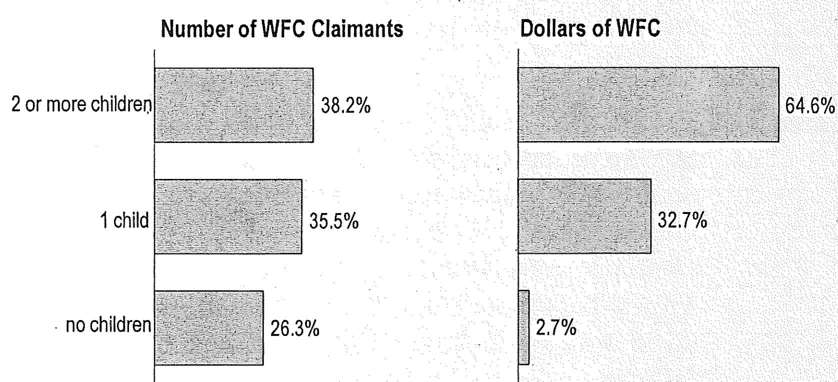
How much is paid out in credits?

In tax year 2008, Minnesotans claimed $548 million in EITC, of which $70 million offset tax liability, and the remaining $478 million was paid as a refund. The average EITC claimed by Minnesotans was $1,778.

Minnesotans claimed an additional $173 million in WFC, of which $32 million offset tax liability, and the remaining $141 million was paid as a refund. The average WFC was $581.

How are the credits distributed among different types of families?

Seventy-four percent of all working family credits went to families with one or more children. These families received about 97 percent of the total amount of credits paid in 2008. Individuals without children filed 26.3 percent of returns claiming credits, but received only 2.7 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. The distribution of earned income tax credits is similar.



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 52 percent of all returns filed. Put another way, in 2008 nonmetro filers were more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 17.3 percent of all income tax returns claimed the EITC, compared to 12.0 percent in Minnesota. The average EITC nationwide in 2008 was $1,979; it was $1,778 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*, August 2010.

Nina Manzi **December 2010**

Extension of Federal Individual Income Tax Provisions in 2010 and Effects on Minnesota's Income Tax

In December 2010, Congress enacted the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA), extending many tax reductions through tax year 2012. Most of the tax provisions in TRUIRJCA were originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), or the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and were scheduled to expire after tax year 2010.

What EGTRRA and JGTRRA provisions were extended to tax year 2012 in TRUIRJCA?

The principal individual income tax components of EGTRRA and JGTRRA that were extended to tax years 2011 and 2012 are the following:

- Marriage penalty relief through the standard deduction and rate brackets
- No income limit on itemized deductions
- No income phaseout of personal and dependent exemptions
- Lower individual income tax rates
- Lower tax rate for capital gains and dividend income
- Federal child credit maintained at $1,000 per child, rather than $500
- Increased qualifying expenses, credit rate, and phaseout floor for federal dependent care credit

Which of these provisions affect Minnesota's income tax?

Extension of the EGTRRA and JGTRRA provisions affects Minnesota's income tax in several ways:

- Because Minnesota's income tax calculation starts with federal taxable income, federal changes to the definition of federal taxable income affect Minnesota's income tax calculation. Providing an increased standard deduction for married joint filers, not having a limit on itemized deductions, and not having a phaseout of exemptions all result in smaller federal taxable income; if Minnesota conforms to these federal changes then Minnesota taxable income would be lower, as would Minnesota income tax revenues.
- Minnesota's dependent care credit is tied to the federal dependent care credit. Extension of the increased qualifying expenses, credit rate, and phaseout floor for the federal dependent care credit results in higher state credits for some claimants.

Which of the EGTRRA and JGTRRA extensions do not affect Minnesota's income tax?

Because Minnesota sets its own income tax rates and brackets, Minnesota's income tax is not affected by the extension of lower federal individual income tax rates, marriage penalty relief through bracket adjustments, or the special rate for capital gain and dividend income. Because Minnesota does not offer a companion credit to the federal child credit, Minnesota's tax is not affected by keeping the federal child credit at $1,000 per child.

Will the federal changes automatically flow through to Minnesota's income tax?

The extension of the EGTRRA and JGTRRA tax reductions does not automatically flow through to Minnesota's income tax. Instead, the legislature will have to act to "conform" to the new definition of federal taxable income. Because adopting the EGTRRA and JGTRRA extensions at the state level would affect Minnesota taxable income, the Minnesota Department of Revenue (DOR) will prepare an official revenue estimate showing the amount of revenue that would be gained or foregone at the state level for each provision affecting state taxable income or state tax credits. The revenue gained or lost for each provision Minnesota conforms to would be carried in the state's budget.

What happens if Minnesota does not conform to the new federal tax law?

If Minnesota does not conform to the federal changes, then DOR will prepare income tax forms and approve tax preparation software developed by third parties (such as TaxCut and TurboTax) that calculate Minnesota taxable income and credits as though prior federal law were still in effect.

For example, in tax year 2011 married joint taxpayers would be required to add the difference between the increased standard deduction allowed at the federal level ($11,600) and the lower standard deduction that would have been in effect under prior federal law ($9,650). Affected taxpayers in the 7.05 percent state bracket would pay higher state taxes of $137 ($11,600 minus $9,650 times 7.05 percent).

Similarly, taxpayers who would have been subject to the limit on itemized deductions and the phaseout of exemptions that would have been in effect under prior federal law would be required to add the amount that would have been limited or phased out at the federal level to their state taxable income, and as a result would owe higher state income taxes.

Taxpayers in the phaseout range for the state dependent care credit would have to calculate the federal dependent care credit they would have been eligible for if the more generous program parameters had not been extended, and use that figure to determine their state credit. This would result in many taxpayers receiving smaller state dependent care credits.

What other provisions of TRUIRJCA affect Minnesota's income tax?

TRUIRJCA also extended several provisions that had expired following tax year 2009 for two years, through tax year 2011:

- Itemized deduction for state and local sales taxes
- More generous income limitations for charitable deduction of donations of qualified conservation easements, with higher limits for farmers and ranchers
- Deduction for higher education tuition expenses
- Allowance of direct transfers to charities from IRAs and Roth IRAs
- Deduction for educator classroom expenses

The revenue effects of conforming Minnesota's income tax to these items will be included in the TRUIRJCA estimate prepared by DOR.

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

HOUSE RESEARCH | Short Subjects

Nina Manzi and Joel Michael

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Capital Gains Taxation: Federal and State

What is capital gains income?

When a taxpayer sells a capital asset, such as stock holdings, a home, or longer-lived business assets, 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 and invested in 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?

The maximum federal income tax rate for most net long-term capital gains income is 15 percent in tax year 2011. There is no tax on capital gains income in 2011 for taxpayers in the 10 percent or 15 percent bracket for ordinary income—in tax year 2011 the 0 percent rate applies for married joint filers with taxable income under $69,000. The amount of net capital gains income that qualifies for the maximum 15 or 0 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 0 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 ($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. Beginning in January 2009, the exclusion is apportioned based on the amount of time in which the home was used as the principal residence, from January 2009 to the time of sale.

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 all 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 recognize the federal exclusion of up to $250,000 of gain realized on the sale of the taxpayer's home ($500,000 for married joint taxpayers) and the exclusion of part of the gain on qualified small business stock.

How do other states that impose an individual income tax treat capital gains income in tax year 2010?

- 21 states, including Minnesota, do not provide preferential treatment for capital gains income
- Eight states (Arkansas, Montana, New Mexico, North Dakota, Rhode Island, South Carolina, Vermont, and Wisconsin) exclude a portion of capital gains income, provide a lower rate, or allow a credit
- Four states exclude all or part of the gain on property located in the state (Colorado, Idaho, Iowa, and Oklahoma)
- Three states exclude gains on sale of stock of in-state companies (Colorado, Louisiana, and Oklahoma)
- Six states and the District of Columbia exclude all or part of the gain for certain investments, such as in new businesses or low-income housing (Arkansas, Maine, Missouri, Montana, Nebraska, and New York)
- Three states exclude gains on some or all state and local bonds (Connecticut, Kentucky, and Ohio)
- Kentucky excludes gains resulting from eminent domain

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

In tax year 2008, about 21 percent of all returns filed by Minnesota residents reported some capital gain or loss. Married taxpayers filing joint returns received 78 percent of capital gain income. Filers with incomes over $100,000 received over 88 percent of capital gain income, and capital gain income made up over 10 percent of total income for those returns reporting capital gains.

Federal adjusted gross income	$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
			returns with capital gains only	
Less than $50,000	$451	7.6%	14.8%	$2,205
$50,000 to $99,999	$238	4.0%	2.2%	$1,581
$100,000 to $500,000	$1,299	21.8%	5.0%	$8,910
Over $500,000	$3,966	66.6%	21.9%	$313,654
All incomes	$5,954	100.0%	10.1%	$11,596

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

Over two-fifths of taxpayers aged 65 and older reported some capital gains income in tax year 2008. The table shows the percent of gains by age of taxpayer.

Taxpayer age	$ of capital gains reported (millions)	% of all gains reported	% of income consisting of gains	Average gains per return
			returns with capital gains	
Less than 25	$51	0.9%	9.6%	$1,184
25 to 39	$234	3.9%	3.4%	$3,613
40 to 64	$3,592	60.3%	9.4%	$14,325
65 or older	$2,076	34.9%	16.4%	$13,443
All ages	$5,954	100.0%	10.2%	$11,596

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