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Short Subjects

Minnesota House of Representatives, House Research

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HOUSE RESEARCH | Short Subjects

Steve Hinze

Updated: January 2013

Property Tax 101: Basic Terms and Concepts

Estimated market value

The assessor determines each property's **estimated market value** based on sales of comparable properties, cost of construction minus depreciation, income generated by the property (if applicable), and other relevant available information.

Market value exclusions, taxable market value

For some properties, a portion of the market value is excluded from taxation. All homesteads with an estimated market value below $413,800 have a portion of the market value excluded under the homestead market value exclusion. Other market value exclusions are provided through the "Green Acres" program and the disabled veteran's exclusion. A property's **taxable market value** is its **estimated market value** less any applicable **market value exclusions**.

Net tax capacity, class rate

A property's **net tax capacity** is determined by multiplying the property's **taxable market value** by the relevant **class rate** or rates. Class rates are set by statute, vary by property type, and are uniform statewide.

Local taxing jurisdiction

A **local taxing jurisdiction** is any local unit of government that has the authority to levy property taxes. Examples are counties, school districts, cities, towns, and "special taxing districts" such as watershed districts, housing and redevelopment authorities, and regional development commissions.

Taxable net tax capacity

A taxing jurisdiction's **taxable net tax capacity** is the total **net tax capacity** of all properties within the jurisdiction, excluding property located in a tax increment financing district.

Levy, levy limit

Each local taxing jurisdiction certifies a **levy** equal to the amount it intends to raise from property taxes in the upcoming year. For some local taxing jurisdictions, the levy may be constrained by state-imposed **levy limits**.

Local tax rate, total local tax rate

The **local tax rate** of a taxing jurisdiction is determined by dividing the jurisdiction's **levy** by the jurisdiction's **taxable net tax capacity**. The **total local tax rate** for an individual property is the sum of the local tax rates of all taxing jurisdictions in which the property is located.

Market value levy and tax rate

Most voter-approved levies apply to the property's market value rather than its net tax capacity. The **market value tax rate** is determined by dividing the jurisdiction's **market value levy** by the total market value of all properties within the jurisdiction (excluding properties classified as agricultural or seasonal-recreational, since those property types are exempt from market value levies).

Gross tax, property tax credits, net tax

Property tax credits reduce the **gross tax** that would otherwise be due upon a property. The most common property tax credits are the agricultural market value credit, the taconite homestead credit, and the disparity reduction credit. The remaining amount after subtraction of property tax credits is the **net tax**.

Computation of Property Tax for a Hypothetical Property (Residential Homestead)

1. Determine the property's ***estimated market value***	$200,000
2. Determine the property's ***homestead market value exclusion***	$19,200
3. Determine the property's ***taxable market value***	$200,000 - $19,200 = $180,800
4. Determine the ***class rate*** based on property type	Residential homestead: 1.0%
5. Multiply taxable market value by class rate to obtain the ***net tax capacity***	$180,800 x 1.0% = $1,808
6. Determine the ***total local tax rate*** by summing the tax rates of all jurisdictions authorized to levy property taxes upon the property (i.e., jurisdictions whose boundaries include the property)	County 45% City/town 35 School district 25 Special districts 5 Total 110%
7. Multiply net tax capacity by total tax rate to determine the ***net tax capacity-based tax***	$1,808 x 110% = $1,989
8. Determine the total ***market value tax rate*** by summing the market value tax rate for all taxing jurisdictions authorized to levy property taxes upon the property	County 0.00% City/town 0.00 School district 0.15 Special districts 0.00 Total 0.15%
9. Multiply estimated market value by total market value tax rate to determine the ***market value-based tax***	$200,000 x 0.15% = $300
10. Add the net tax capacity-based tax to the market value-based tax to obtain the total ***net tax***	$1,989 + $300 = $2,289

For more information: Contact legislative analyst Steve Hinze at steve.hinze@house.mn.

HOUSE RESEARCH | Short Subjects

Steve Hinze

Updated: January 2013

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 2013, the cycle begins on January 2, 2012, and doesn't end until the final payments are made in October/November 2013.

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 2012 **Taxes Payable 2013**	**Assessment Year 2013** **Taxes Payable 2014**
2012	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)	
2013	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)
2014	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)

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HOUSE RESEARCH | Short Subjects

Steve Hinze **Updated: January 2013**

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 2013

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 $1,290,000	0.50	No	No
	Over $1,290,000	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 of various property tax exclusions and credits. Homesteads benefit from the homestead market value exclusion, which provides for up to $30,000 of a homestead's market value to be deducted before determining the taxes payable. Other exclusions are the disabled veterans' exclusion and the agricultural "Green Acres" program. Certain types of property also qualify for property tax credits that reduce the net tax on the property. The biggest property tax credit programs are the agricultural market value credit and the taconite homestead credit.

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 an Estimated Market Value of $200,000 (Property taxes payable in 2013)

Property Type	Class Rate(s)	Net Tax Capacity	Property Tax*		Effective Tax Rate
			Gross	Net	
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	1,808	2,168	2,168	1.08
Seasonal recreational residential (i.e., cabin)	1.0	2,000	2,309	2,309	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	5,235	5,235	2.62
Commercial/Industrial @ $2,000,000***	1.5/2.0	39,250	62,475	62,475	3.12

* 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 50 percent, and a state seasonal recreational tax rate of 20 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.

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HOUSE RESEARCH | Short Subjects

Deborah Dyson and Mark Shepard

Updated: January 2013

Compensation Limits for Local Government Employees

What is the compensation limit for local government employees?

State law limits the compensation for an employee of a political subdivision to 110 percent of the governor's salary, with annual adjustments based on the Consumer Price Index (CPI). The current salary of the governor is $120,303. The compensation for an employee of a political subdivision cannot exceed 110 percent of that amount, which is $132,333, adjusted annually to reflect any increase in the CPI for all urban consumers in the prior year. Minn. Stat. § 43A.17, subd. 9. As of January 1, 2013, the limit is $160,639. (For more information see the Department of Management and Budget website at http://www.mmb.state.mn.us/comp-salarycap-waiver.)

This compensation limit applies to employees of statutory and home rule charter cities, counties, towns, metropolitan and regional agencies, and other political subdivisions. The compensation limit does not apply to school districts, to hospitals, clinics, or health maintenance organizations owned by a governmental unit, or to medical doctors and doctors of osteopathy.

What is included in "compensation"?

The statute specifies what is considered compensation for purposes of the limit. The statutory limit compares the *compensation* of political subdivision employees to the *salary* of the governor. For political subdivision employees, compensation includes certain benefits as well as salary. The statute determines what is included and excluded for purposes of the compensation limit.

Included

- All deferred compensation
- All direct and indirect items of compensation that are not specifically excluded by the statute (e.g., cash allowance for personal use of a car is included)

Excluded

- Benefits that are provided for the majority of all other full-time employees of the political subdivision, vacation and sick leave, health and dental insurance, disability insurance, term life insurance, and pension benefits
- Dues paid to civic, professional, educational, or governmental organizations
- Reimbursement for actual expenses that are directly related to the job

The statute contains a process and criteria for granting exemptions

The Commissioner of Management and Budget (MMB) may increase the compensation limit for a position that the commissioner determines requires special expertise necessitating a higher salary to attract or retain a qualified person. In making this determination, the commissioner must consider salary rates paid to other people with similar responsibilities in the state and nation. Before granting an exception to the salary limit, the commissioner also must seek the advice of the Legislative Coordinating Commission.

Any increase must also be adjusted annually by any increase in the CPI from the prior year. Minn. Stat. § 43A.17, subds. 3 and 9. According to MMB, as of January 1, 2013, a local government may increase by 2.2 percent the compensation of an employee with an existing waiver for compensation to exceed $132,333. If the existing approved waiver amount is below $160,639, the local government may increase an employee's compensation to the $160,639 limit without a waiver.

The legislature has been addressing the issue of political subdivision salary caps since 1977

In 1977, the legislature provided that no political subdivision employee could be paid more than the Commissioner of Finance. The 1980 Legislature repealed the political subdivision salary cap. In 1983, the legislature enacted something similar to the current cap—compensation for local government employees was limited to 95 percent of the governor's salary. There have been various refinements to the law since 1983. Most significantly, in 1993 the legislature clarified what types of compensation are to be included when comparing a political subdivision employee's compensation to the governor's salary. In 2005, the legislature debated repealing the cap altogether but decided to increase the cap and allow for annual adjustments due to inflation.

There is a separate limit for state employees

The statute limiting political subdivision salaries does not cover state employees, but there is a separate limit for state employees. With very limited exceptions, no state employee may earn more than the head of the agency where the employee works. Minn. Stat. § 43A.17, subd. 1. State law assigns executive branch agency heads to two salary ranges, which are capped at 95 percent and 85 percent of the governor's salary. Minn. Stat. § 15A.0815, subds. 2 and 3. (These comparisons are based strictly on salary, not on total compensation.) The heads of the higher education systems are treated separately and are not limited by the governor's salary.

For more information: Contact legislative analysts Deborah Dyson at deborah.dyson@house.mn or Mark Shepard at 651-296-5051. Also see the House Research publication *State Agency Head Salaries*, June 2012.

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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 two 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.

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 Minnesota's Regular Income Tax and AMT
($ amounts are for the 2013 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	$10,150 (married joint) $6,100 (single) $8,950 (head of household)	$71,010 for married joint (phased out for income from $150,000 to $434,040) $53,260 for single and head of household (phased out for income from $112,500 to $325,540)
Personal exemptions	$3,900 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 $17.2 million in tax year 2013, from about 8,000 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.

HOUSE RESEARCH | Short Subjects

Matt Burress

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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 phased in an 8.5-cent tax increase, so that starting in fiscal year 2013, the rate for gasoline and diesel is 28.5 cents per gallon (and proportional for other fuel types). Laws 2008, ch. 152.

Gasoline Tax Rates

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—$21.2 million in 2012—is attributed to fuel use in nonhighway recreation, such as ATVs and motorboats, and transferred into Department of Natural Resources accounts for 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) 1.25 percent of the *base value* multiplied by a *depreciation factor*, plus (2) $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 instead have a flat tax. MVST is collected by auto dealers or when the vehicle is registered.

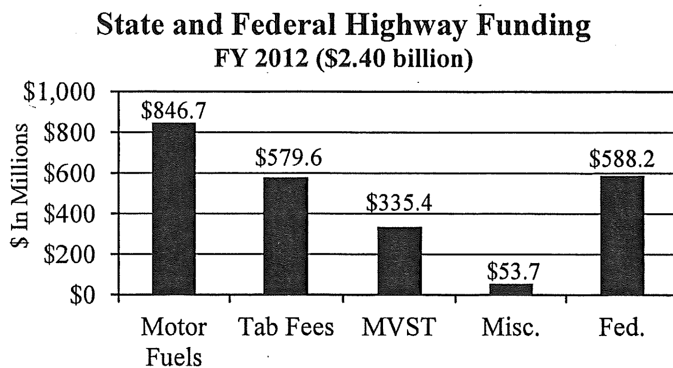
Historically, MVST revenue has gone to both transportation and the general fund. Voters in 2006 approved a constitutional amendment that dedicates all MVST revenue to transportation purposes, phased in over fiscal years 2008 to 2012. The Constitution also requires that "no more than 60 percent" of the 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 and after, the revenues are 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.

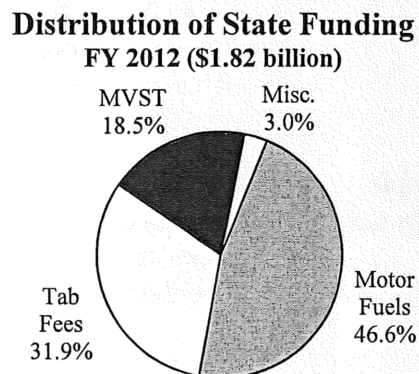
Other sources

Federal aid is another signficant funding source. In fiscal year 2012, it amounted to $393.99 million for trunk highways and $194.19 million for local roads. Additional funding for the state's trunk highway system comes from (1) debt financing in the form of trunk highway bonds, which in fiscal year 2012 amounted to $243.89 million; and (2) miscellaneous sources such as permit fees and fines.

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).





Notes: (1) "Motor fuels" category includes nonhighway fuel use transfers; (2) "MVST" category only contains highway fundng; (3) "Misc." category primarily consists of trunk highway system revenues; and (4) charts exclude bond proceeds.

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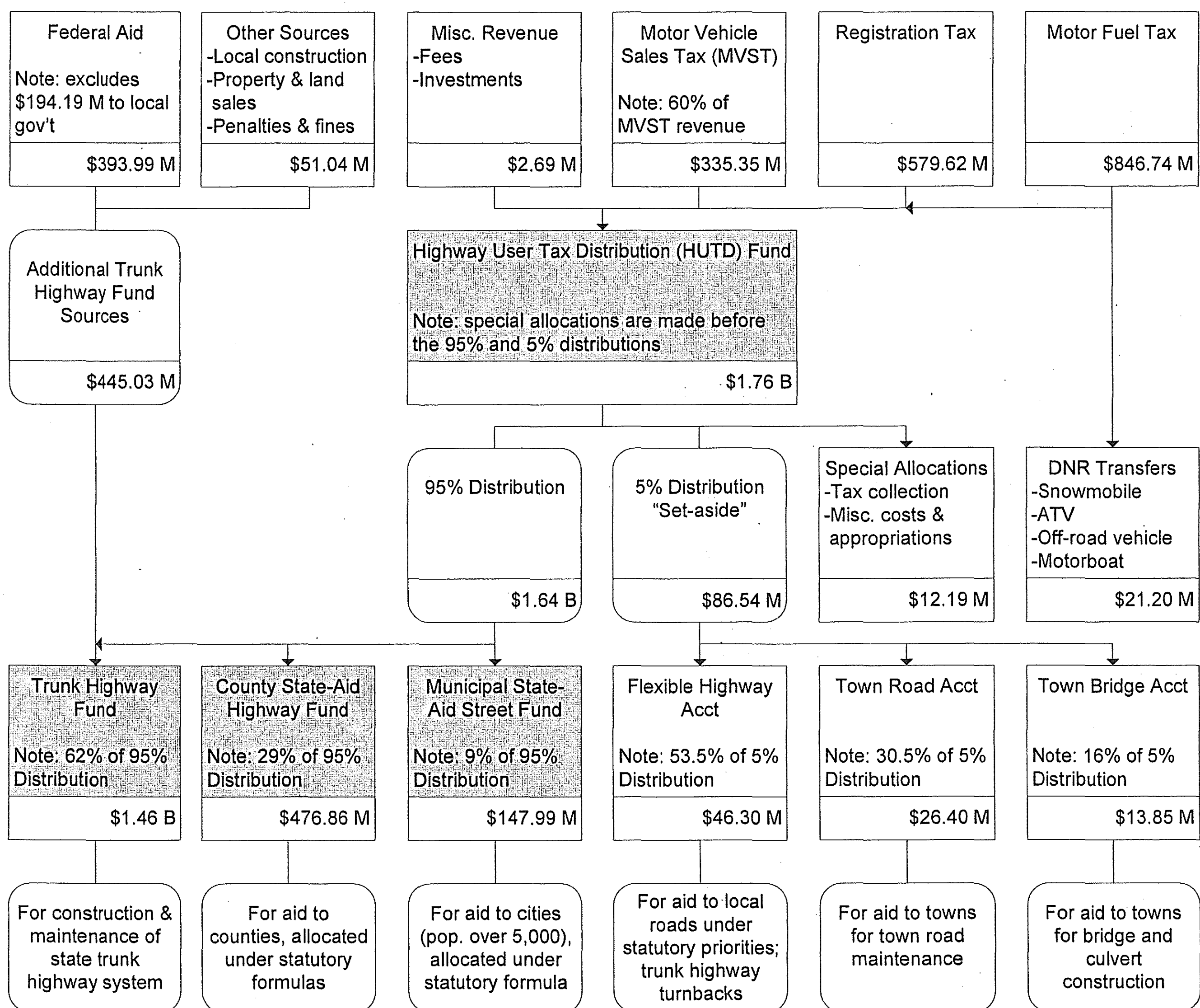
House Research | Short Subjects

Matt Burress Updated: January 2013

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. The allocations reflect a combination of constitutional and statutory formulas. The chart below summarizes the flow of highway funding from state and federal funds, using fiscal year 2012 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 authorized 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 as well as 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 phased in an 8.5-cent tax increase, so that starting in fiscal year 2013 the rate for gas and diesel fuel is 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 annually on motor vehicles using the highway system. The 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 other vehicles are mostly 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 a 6.5 percent rate in lieu of the general sales tax. Following a constitutional amendment adopted in the 2006 election, MVST revenue has phased in from the state general fund to be dedicated solely to highways and transit. Starting in fiscal year 2012, MVST is 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 after certain special allocations (such as for tax collection costs). 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 trunk highway system. The trunk highway fund also receives federal aid and revenues from 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

Nina Manzi and Steve Hinze

Updated: January 2013

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 17 percent of rent paid. 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 2013, based on rent paid in 2012 and 2012 household income, the maximum refund is $1,600. Renters whose income exceeds $56,219 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, 2013, will be paid beginning in August 2013. The deadline for filing claims based on rent paid in 2012 is August 15, 2014; taxpayers filing claims after that date will not receive a refund.

What is the average refund and total amount paid?

Statewide Renter Property Tax Refunds, Filed in 2011
(based on 2010 incomes and rent paid in 2010, taxes assumed to equal 19% of rent paid)

	Number of returns	Total amount	Average per return
Under 65 years old	223,050	$137.0 million	$614
Senior/disabled	86,350	$58.4 million	$676
Total: all renters	309,400	$195.4 million	$632

How has the percent of rent considered property taxes changed in recent years?

For refunds based on rent paid from 1998 to 2008, the percentage of rent constituting property taxes equaled 19 percent. Under Gov. Tim Pawlenty's June 2009 unallotment, subsequently enacted into law, the percentage of rent constituting property taxes was reduced from 19 percent to 15 percent for refunds based on rent paid in 2009 only. For refunds based on rent paid in 2010, the percentage returned to 19 percent. Legislation enacted in the 2011 reduced the rate to 17 percent for refunds based on rent paid in 2011 and following years.

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 2012 of $745, the fair market rent for a one-bedroom apartment in the metro area. The family in greater Minnesota paid monthly rent in 2012 of $472, 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 2013,
based on rent paid in 2012 and 2012 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	$1,520	$1,520	$963	$963
5	Statutory threshold percentage	1.4%	2.0%	1.4%	2.0%
6	Threshold % x income (3 x 5 = 6)	$210	$600	$210	$600
7	Property tax over threshold (4 – 6 = 7)	$1,310	$920	$753	$363
8	Copay percentage	15%	30%	15%	30%
9	Taxpayer copay amount (7 x 8 = 9)	$196	$276	$113	$109
10	Remaining tax over threshold (7 – 9 = 10)	$1,113	$644	$640	$254
11	Maximum refund allowed	$1,600	$1,600	$1,600	$1,600
12	Net property tax refund	$1,113	$644	$640	$254

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

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Lisa Larson **Updated: January 2013**

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 allows up to $2,500 to be deducted for each dependent in grades 7-12 and up to $1,625 for each dependent in grades K-6.

In tax year 2011 (fiscal year 2012) an estimated 222,000 returns claimed the deduction. The Department of Revenue estimates that the deduction will cost the state $18.6 million in tax year 2013 (fiscal year 2014).

What expenses qualify for the deduction?

Qualifying expenses for the deduction include payments for:

- 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 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 2010, 56,776 Minnesotans claimed a total of $15.3 million in K-12 education credits. The average credit was $269. In tax year 2013 (fiscal year 2014), the Department of Revenue estimates that Minnesota will claim $14.4 million in K-12 education credits.

What expenses qualify for the credit?

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

What are the tax benefits of the deduction and credit?

The deduction reduces an individual's taxable income. The tax benefit of the deduction 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 2013, a typical married couple with two dependents would need to have $25,750 of gross income before owing any state income tax.

The credit, in contrast, 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, ten states in addition to Minnesota provide income tax benefits for education-related expenses. **Arizona, Florida, Georgia, Indiana, Iowa, New Hampshire, Pennsylvania,** and **Rhode Island** all provide tax credits for contributions to nonprofit school tuition organizations that operate like charities; Puerto Rico also allows a similar credit. **New Hampshire, Pennsylvania,** and **Rhode Island** allow their credits for corporate taxpayers; the **Florida** credit is allowed against corporate, insurance premiums, severance, alcoholic beverage taxes, and sales taxes for certain taxpayers; and **Arizona, Georgia, Indiana,** and **Iowa** have credits for both individual and corporate taxpayers. **Arizona** also allows credits for individuals who pay extracurricular public school fees and who contribute to character education programs at public schools, and **Pennsylvania** also allows a corporate credit for contributions to innovative public school programs. **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.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Lisa Larson at 651-296-8036. Also see the House Research publication *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2011.

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HOUSE RESEARCH | Short Subjects

Pat Dalton

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The City LGA Program

The current formula was enacted in 2003 and modified in 2008

The city local government aid (LGA) program has existed since 1972. The current formula for the program was enacted in 2003. The 2003 formula was criticized for volatility and not recognizing needs of certain types of cities. These criticisms led to a modification of the formula in 2008. The legislature added two additional measures of need and took steps to reduce the year-to-year volatility in the program.

The majority of LGA is paid based on a city's "unmet need"

The current appropriation for city LGA is $426.4 million. About $26 million is distributed to specific cities while the remaining $400 million is distributed via the formula. The LGA formula pays a percentage of "unmet need" for each city that is based on the difference between (1) measures of city need and (2) the city's net tax capacity multiplied by an average city tax rate. There are different measures of city need depending on a city's population. These are displayed in the table on the next page.

LGA volatility is reduced by using two years of data and limiting annual changes

To mitigate the volatility of the LGA payments to individual cities, the program uses average data over two years to calculate most of a city's aid. In addition, the law limits the amount that the aid payment to an individual city can increase or decrease in any given year. These limits on annual changes vary by the size of the city and are displayed in the table on the next page.

For CY 2008-2013, most LGA payments have not been equal to the amount calculated under the formula

Due to state fiscal shortfalls, the state did not pay cities the LGA they were certified to receive in calendar years 2008 through 2010. The amount paid to each city was the amount calculated under the formula minus a percentage of each city's property tax levy plus aid. In general, the percentage cut was smaller for cities with a population under 1,000. Because of continuing state budget problems, LGA payments in 2011 and 2012 were frozen at the lesser of the amount each city was paid in 2010 or the amount it would have received under the formula in 2011. In 2013, cities with a population under 5,000 will receive the greater of their 2012 aid payment or their amount under the formula in 2013; all other cities receive an amount equal to their 2012 payment.

Beginning in CY 2014, LGA will again be distributed under the formula

Beginning in calendar year 2014, cities will again have their LGA payments determined by the LGA formula. However, because of the limitations on annual changes in payments to individual cities and the fact that the formula has not been used to distribute most aid for the last five years, few cities will get the amount determined by the formula. Most cities will get an amount equal to the maximum allowed gain or loss under the program while being phased up or down to the actual "formula amount."

Characteristics of the Current LGA Program

Funding level	$426.4 million annually
City aid base	$26.1 million annually to specific cities, mainly paid to "regional centers"
Formula aid	$400.3 million distributed based on each city's "small city aid" + "city jobs base" + a percentage of average "unmet need" for two years
"Unmet need"	= "Formula need" – (city net tax capacity x average city tax rate)
"Formula need"	For cities with a population of 2,500 or more: Need = Greater of $285 or 355.0547 + (5.0734098 x percentage of housing built before 1940) + (19.141678 x percentage of population decline over ten years) + (2504.06334 x three-year average road accident rate per 1,000) - (49.10638 x average household size) - 35.20915 if the city is in the seven-county metro area For cities under 2,500 population: Need = (2.387 x percentage of housing built before 1940) + (2.67591 x percentage of property classified as commercial/industrial) + (3.16042 x percentage of population decline over ten years) + (1.206 x a transformed population factor) - 62.772
Need measures added in 2008	"Small city aid" for cities with a population under 5,000 only: $6.89* per capita "City jobs base" for cities with population of 5,000 or more only: $24.42* x number of jobs in the city, partially reduced for "regional center" and limited to $4.725 million for any city *The original amounts were $8.50/capita and $25.20/job, but are adjusted based on the ratio of the current LGA appropriation to the original 2008 appropriation.
Limits on annual increases	No city's aid may *increase* by more than 10 percent of the city's property tax levy in the previous year.
Limits on annual decreases	No city with a population of 2,500 or more may have a *decrease* greater than the lesser of (1) $10 per capita; (2) 10 percent of its levy in the previous year; or (3) $300,000. No city with a population less than 2,500 may have a *decrease* greater than the lesser of (1) $10 per capita or (2) 5 percent of its 2003 aid amount.

For more information: Contact legislative analyst Pat Dalton at 651-296-7434.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi

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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. 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).

Three parameters of the federal credit—the 35 percent maximum credit percentage, the $3,000 and $6,000 qualifying expenses, and the $15,000 phaseout threshold—were made permanent under the American Taxpayer Relief Act of 2012 (ATRA).

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.

The state credit is subject to an income phaseout. (By contrast, the federal credit rate phases down to a minimum percentage but is never totally phased out.) In tax year 2013, the state phaseout begins when income exceeds $24,920, and the state credit is fully phased out when income exceeds $38,570. 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 2010, 143,664 Minnesotans claimed the federal dependent care credit and 36,544 claimed the state credit. These claims represent 5.6 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 is only available to filers with incomes below $37,030 (the 2010 ceiling, which is annually adjusted for inflation), most of the state credits are claimed by low-income filers.

How much is paid out in credits?

In tax year 2010, Minnesotans claimed $65.3 million of federal dependent care credits. The average federal dependent care credit was $455.

In tax year 2010, Minnesotans claimed $14.4 million of state dependent care credits. The average state dependent care credit was $395.

How does Minnesota compare with other states?

Nationwide, 4.3 percent of all income tax returns claimed the federal dependent care credit, compared to 5.6 percent in Minnesota. South Dakota had the highest percentage of returns claiming the federal credit at 6.4 percent, and West Virginia had the lowest at 2.3 percent.

The average federal dependent care credit in 2010 was $531 nationwide and $455 in Minnesota. The District of Columbia had the highest average credit at $603, and Montana had the lowest at $445. 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.

How is Minnesota affected by the ATRA changes to the federal credit?

Unless Minnesota enacts legislation to conform the state credit calculation phaseout to the larger federal credit allowed under ATRA, Minnesota claimants will have to determine their state credit by reference to the smaller federal credit that would have been in effect had ATRA not been enacted. That is because ATRA increased the federal credit for tax year 2013, relative to prior federal law.

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*, August 2012.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi **Updated: January 2013**

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 beginning in 2003. Like many provisions of EGTRRA, the expansion of the credit was scheduled to sunset after 2010, at which time it would have reverted to the $500 per child amount in effect in 1999. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA) extended the $1,000 per-child amount through 2012, and the American Taxpayer Relief Act (ATRA) of 2012 made the $1,000 per child amount permanent.

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; the refundable portion is referred to as the "additional child tax credit." In tax years 2009 through 2017, the additional child tax credit equals 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 $220 in 2013. They use $220 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 $220 as an offset to their tax liability and are paid the remaining $1,780 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:

- 15 percent 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 2001 law set the minimum amount at $10,000 and provided for it to increase annually for inflation; ATRA made the $10,000 as indexed for inflation permanent. The American Recovery and Reinvestment Act of 2009 temporarily reduced the indexed $10,000 to $3,000, not adjusted for inflation, for tax years 2009 and 2010 only; TRUIRJCA and ATRA extended the $3,000 threshold through 2017.

How much do Minnesotans claim?

In tax year 2010, 429,309 federal income tax returns filed by Minnesotans claimed $579 million in the nonrefundable portion of the federal child credit. The average amount claimed was $1,348. For the same year, 257,333 returns filed by Minnesotans claimed $349 million under the refundable additional child credit. Some of these returns also claimed the nonrefundable portion of the credit. The average additional child tax credit was $1,358.

What is the effect of ATRA on Minnesota recipients of the federal child credit?

Because ATRA made the $1,000 per child amount permanent and extended the enhanced refundability, about 140,000 more Minnesota households are expected to claim the child tax credit in 2013 than would have if the credit had decreased to $500 per child and the expanded refundability sunset. The total amount claimed by Minnesota filers is estimated to be about $570 million more than would have been claimed absent ATRA. The $570 million increase consists of $330 million due to maintaining the credit at $1,000 per child, and an additional $240 million due to maintaining the enhanced refundability.

Some provisions extended by ATRA will expire after tax year 2017, including the provision that decreased the earned income threshold from $10,000, indexed for inflation since 2001, to $3,000, not adjusted for inflation.

Unless Congress extends this provision beyond 2017, in 2018 the portion of the credit that is refundable will revert to being the greater of:

- 15 percent of earned income over $10,000, indexed for inflation since 2001, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit.

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

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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 cash 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 excludes recovery of amounts that were included in FAGI when the contributions 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, SIMPLE, and other retirement 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 2013, $250 of teacher classroom expenses and up to $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 2010, the most recent year for which data is available, 59 percent of Minnesotans claimed the standard deduction and 41 percent itemized.

How much is the standard deduction?

In tax year 2013, the standard deduction is as follows:

- $12,200 for married couples filing joint returns
- $6,100 for married couples filing separate returns
- $8,950 for head of household filers
- $6,100 for single filers

What itemized deductions are allowed?

In tax year 2013, itemized deductions are allowed for the following:

- Payments of state and local property taxes and either income or sales taxes
- Mortgage interest and mortgage insurance premiums
- Charitable contributions
- Medical expenses and health insurance premiums in excess of a percentage of FAGI (7.5 percent for filers age 65 and older, 10 percent for all others)
- 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 2013, the personal and dependent exemptions are $3,900 each. A family of four qualifies for four exemptions, totaling $15,600.

Are there limits on deductions and exemptions?

The federal American Taxpayer Relief Act of 2012 (ATRA) revived and made permanent the limitation on itemized deductions and phaseout of personal and dependent exemptions for taxpayers with incomes over a threshold.

The 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 FAGI over the applicable thresholds. But they are always guaranteed 20 percent of the deductions, no matter how high their FAGIs are.

ATRA also provides 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.

ATRA increased the income thresholds at which the limitation of itemized deductions and the phaseout of personal and dependent exemptions take effect, relative to prior federal law. It also provided for the limitation and the phaseout to begin at the same income thresholds; under prior law the deduction limitation began at a lower income level than did the exemption phaseout. The table shows the income thresholds for the itemized deduction limitation and the personal and dependent exemption phaseout in effect in tax year 2013. The income thresholds are adjusted annually for inflation.

Tax year 2013	Itemized deduction limit and personal and dependent exemption phaseout begins at
Married joint filers	$300,000
Married separate filers	$150,000
Single filers	$250,000
Head of household filers	$275,000

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 2012.

HOUSE RESEARCH | Short Subjects

Steve Hinze Updated: January 2013

County Program Aid

County program aid replaced several county aid programs

Prior to calendar year 2004, counties received property tax aid under a number of different programs. Beginning in 2004, the aid programs were consolidated into one general aid program, called county program aid (CPA). The county aid programs that were consolidated include the following:

- attached machinery aid (Minn. Stat. § 273.138)
- homestead and agricultural credit aid (HACA) (Minn. Stat. § 273.1398, subd. 2)
- manufactured home homestead and agricultural credit aid (Minn. Stat. § 273.166)
- county criminal justice aid (CCJA) (Minn. Stat. § 477A.0121)
- family preservation aid (FPA) (Minn. Stat. § 477A.0122)

County program aid consists of "need aid" and "tax-base equalization aid"

From calendar year 2005 on, CPA has been allocated by two formulas, need aid and tax-base equalization aid, with just under half the money being distributed through the need aid formula and just over half being distributed through the tax base equalization aid formula. The table on the next page shows how a county's aid is calculated under each formula.

Counties receiving less aid under the post-2004 formula receive transition aid

Seven counties whose relative *share* of the total CPA formula allocation in calendar year 2005 was significantly less than their share of 2004 program aid qualify for "transition aid." Each county's transition aid amount is permanently fixed at one-third of the amount it received in 2005. The total amount of transition aid for calendar year 2013 is $464,000.

County program aid amounts were reduced due to state budgetary conditions

For 2008 to 2011, county program aid payments were less than the levels that had been certified due to state budgetary conditions. In 2010, the total appropriation was permanently reduced by approximately $34 million, and then further reduced by another $32 million in 2011.

Calculation of County Program Aid

Need Aid	Tax-base Equalization Aid
Share of Appropriation: $100.5 million (CY 2005-2008) $111.5 million (CY 2009) $113.7 million (CY 2010) $96.4 million (CY 2011-2012) $80.8 million (CY 2013 and thereafter)	**Share of Appropriation:** $105 million (CY 2005-2008) $116.1 million (CY 2009) $118.5 million (CY 2010) $101.3 million (CY 2011-2012) $84.9 million (CY 2013 and thereafter)
Reductions from the appropriation: $500,000 annually for court-ordered counsel and public defense costs	**Reduction from the appropriation:** up to $214,000 annually to pay for the preparation of local impact notes
Factors used in the formula: • **age-adjusted population,** which ranges from 80% to 180% of the county's actual population based on the percentage of the county's population over 65 years, compared to the statewide average • **average monthly number of households receiving food stamps** in the county over the last three years • **average number of Part I crimes** reported in the county over the last three years (These are the most serious crimes)	**Tax-base equalization factor used in the formula:** **Factor** = N times ($185 x population - 9.45% of the county adjusted net tax capacity) **where N equals:** • 3 if the county population is less than 10,000 • 2 if the county's population is at least 10,000 but less than 12,500 • 1 if the county's population is at least 12,500 but less than 500,000 • 0.25 if the county's population is 500,000 or more
The formula: • 40% of the appropriation is distributed to each county based on its relative share of the total age-adjusted population in the state • 40% of the appropriation is distributed to each county based on its relative share of the total average monthly number of households receiving food stamps in the state • 20% of the appropriation is distributed to each county based on its relative share of the average number of Part I crimes reported in the state	**The formula:** • 100% of the appropriation is distributed based on each county's relative share of the sum of the tax-base equalization factors for all the counties in the state

For more information: Contact legislative analyst Steve Hinze at 651-296-8956. Also see the House Research publication *Aid Cuts to Local Governments in CY 2003 and 2004*, February 2004.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Jim Cleary

Updated: January 2013

Minnesota Income Tax Credit for Past Military Service

What is the income tax credit for past military service?

The credit for past military service 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. Eligible individuals use form M-1C to claim the credit as part of their income tax return.

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 2013, a single veteran with no dependents who claims the standard deduction would need to have $23,970 of federal adjusted gross income (FAGI) to receive the full $750 credit.

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

A nonrefundable credit and an income tax subtraction both reduce tax liability, but in different ways. A credit is a dollar-for-dollar reduction in tax liability, while a subtraction reduces taxable income, which reduces 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 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 FAGI).

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 military service credit?

A qualifying veteran 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 compensation 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 credit.

How many individuals claimed the credit in 2011, and how much did they claim?

In tax year 2011, 1,537 returns claimed about $1 million in credits, for an average of $671. In tax year 2009, 1,507 returns claimed about $970,000 in credits, for an average credit of $646. In tax year 2010, 1,616 returns claimed about $1.065 million in credits, for an average of $659. Usage of the credit in the first three years it has been in effect has been stable and 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 **Updated: February 2013**

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 2013, individuals with more than $3,300 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 2013, 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	$487	$122	$7,970	$7,970	$14,340	$14,350
1 child	$3,250	$973	$17,530	$20,830	$37,870	$37,815
2 children	$5,372	$1,879	$17,530	$24,720	$43,038	$42,963
3 or more children	$6,044	$1,879	$17,530	$24,720	$46,227	$42,963
Married claimants						
No children	$487	$122	$13,310	$7,970	$19,680	$14,350
1 child	$3,250	$973	$22,870	$20,830	$43,210	$37,815
2 children	$5,372	$1,879	$22,870	$24,720	$48,378	$42,963
3 or more children	$6,044	$1,879	$22,870	$24,720	$51,567	$42,963

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 2010, 349,510 Minnesota returns claimed the EITC and 330,040 claimed the WFC. These claims represent 13.6 percent of all federal returns filed by Minnesotans and 12.8 percent of all state returns filed by Minnesota residents. The number of EITC claims exceeds the number of WFC claims mostly because in 2010 the EITC income phaseout for married claimants was extended to higher incomes than

was the WFC phaseout, and because the higher EITC rate for families with three or more children resulted in the EITC for large families extending to higher incomes than did the WFC.

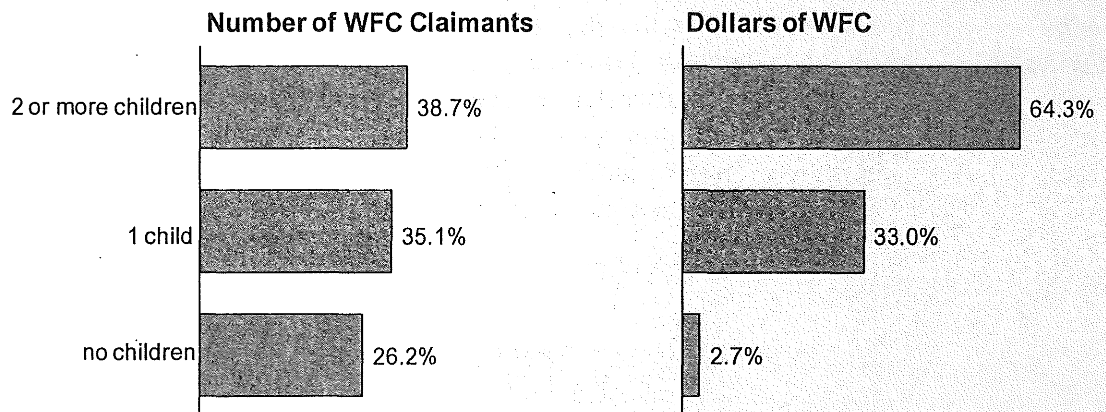
How much is paid out in credits?

In tax year 2010, Minnesotans claimed $666 million in EITC, of which $84 million offset tax liability, and the remaining $582 million was paid as a refund. The average EITC claimed by Minnesotans was $1,906.

Minnesota returns claimed an additional $194 million in WFC, of which $35 million offset tax liability, and the remaining $159 million was paid as a refund. The average WFC was $586.

How are the credits distributed among different types of families?

Seventy-one 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 2010. Individuals without children filed 26.2 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?

Over half of the returns claiming credits came from the Twin Cities metropolitan area, but these seven counties generated about 55 percent of all income tax returns filed. Put another way, in 2010, as in previous years, nonmetro filers were slightly more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 19.1 percent of all income tax returns claimed the EITC, compared to 13.6 percent in Minnesota. The average EITC nationwide in 2010 was $2,202; it was $1,906 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above-average incomes.

Twenty-four other states and the District of Columbia provide 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.

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

Nina Manzi and Janelle Taylor

Updated: February 2013

Minnesota's Nongame Wildlife Checkoff

What is the nongame wildlife checkoff?

Minnesota's nongame wildlife checkoff allows individuals to make contributions on their individual income tax or property tax refund return to the state's nongame wildlife fund. Corporate taxpayers may also contribute on their corporate franchise tax returns. Taxpayers who wish to contribute fill in the amount of their contribution on their income tax or property tax refund form. The amount of the contribution is then either added to their tax due or subtracted from their refund. The checkoff was enacted and first appeared on tax forms in 1980.

How much do taxpayers contribute to the nongame wildlife checkoff?

In 2011, over 65,000 individuals used the nongame wildlife checkoff to contribute just over $1 million to the nongame wildlife fund on their individual income tax or property tax refund forms. The average contribution was about $16. About 1.9 percent of all filers made contributions—2.1 percent of income tax filers and 1.3 percent of property tax refund filers. Since 1998, taxpayers have contributed about $1 million per year through the checkoff, but the share of filers making contributions was about 3 percent in the mid-2000s, and has since leveled off at about 2 percent.

Nongame Wildlife Checkoff Contributions, 1998 to 2011

Year	% contributing	$ contributed	Average contribution
1998	2.9%	$972,996	$11.41
1999	2.0	1,003,721	12.01
2000	2.9	1,028,790	12.16
2001	3.0	1,134,319	13.23
2002	3.0	1,160,518	13.07
2003	3.0	1,154,574	13.11
2004	2.8	1,171,942	13.75
2005	2.6	1,098,310	14.12
2006	2.1	1,030,219	15.31
2007	2.1	1,075,785	15.34
2008	2.1	1,093,113	15.46
2009	2.1	1,086,545	15.72
2010	1.9	1,061,164	17.09
2011	1.9	1,052,251	16.12
Source: Minnesota Department of Revenue			

What are contributions to the checkoff used for?

Contributions to the nongame wildlife checkoff go into the nongame wildlife fund and are appropriated to the Department of Natural Resources for its nongame wildlife program. Although donations from the nongame wildlife checkoff provide the majority of the funding for the nongame wildlife program, the program also receives funding from the general fund, the game and fish fund, and other sources.

The nongame wildlife program focuses on nongame wildlife species that have been identified as being rare, declining, or vulnerable in the state; these species are known as "species of greatest conservation need." The program supports six regional wildlife specialists who work toward three major goals designed to protect these species:

- Stabilizing and increasing the populations of the species
- Improving knowledge of the species
- Enhancing people's appreciation and enjoyment of the species

What are some recent projects funded through the nongame wildlife checkoff?

The nongame wildlife program has supported a number of projects in recent years, including the Project WILD program, which is an environmental and conservation education program designed to train K-12 and other youth and environmental educators on how to develop awareness of and foster responsible actions towards wildlife and related natural resources. Other projects have included surveys of various species including loons, bald eagles, frogs, and dragonflies, and the acquisition of lands for various wildlife management areas and aquatic management areas across the state to provide habitat for many wildlife species.

How many other states have a nongame wildlife checkoff?

Thirty-six of the 42 states (and the District of Columbia) that have an individual income tax also have a nongame wildlife checkoff. Most states have more than one checkoff; Virginia has the most, with 27. Only four states offer only the nongame wildlife checkoff—Indiana, Minnesota, Nebraska, and North Carolina.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Janelle Taylor at 651-296-5039.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi **Updated: March 2013**

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 2013. These items are subject to Minnesota tax, but not federal tax.

- **State income tax deduction.** Filers who claimed a federal itemized deduction for state income 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.** However, federal law prohibits states from taxing interest paid on bonds issued by United States possessions, such as Puerto Rico.
- **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.**
- **Net operating losses allowed at the federal level under a different schedule than at the state level.**
- **The additional standard deduction amount allowed to married filers at the federal level.**
- **The amount of itemized deductions subject to limitation and personal and dependent exemptions subject to phaseout** under federal law prior to enactment of the American Taxpayer Relief Act (ATRA).

What subtractions does Minnesota allow from taxable income?

Minnesota allows the following *subtractions* from federal taxable income for tax year 2013. The estimated reductions in revenue shown below are taken from the Department of Revenue's *Tax Expenditure Budget for 2012-2015*. Revenue estimates made during the 2013 legislative session will differ because they will be based on a more recent economic forecast and because the methodology used to prepare revenue estimates differs somewhat from tax expenditure estimates.

- **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, which are subject to federal income tax:
    - U.S. bond interest
    - Railroad retirement benefits
    - On-reservation earnings of enrolled tribal members
- **K-12 dependent education expenses** ($18.6 million in fiscal year 2014). 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** ($10.3 million in fiscal year 2014).
- **Compensation for most military service in Minnesota** ($3.8 million in fiscal year 2014). 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** ($8.0 million in fiscal year 2014). 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** ($0.7 million in fiscal year 2014). 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** ($3.0 million in fiscal year 2014). 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 2014). 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 2014). 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** ($40,000 in fiscal year 2014). 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 (estimate derived from a 2013 Department of Revenue bill analysis)
- **National service education awards** ($100,000 in fiscal year 2014). Allowed for scholarships received for AmeriCorps service.
- **Bonus depreciation, section 179 expensing, income from the discharge of indebtedness, and net operating losses.** Allowed for amounts included in Minnesota taxable income, but not federal taxable income, in earlier tax years.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research publications *Income Tax Terms: Deductions and Credits*, August 2012; and *Minnesota's Elderly Exclusion* (web only) on the income tax page of the House Research website: www.house.mn/hrd/.

Nina Manzi and Joel Michael Updated: April 2013

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 2013, 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 by the amount over $2 million, so that businesses that place in service more than $2.5 million in qualifying property are not eligible for section 179 expensing.

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

In tax year 2013, 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 2013 and 16 percent per year in tax years 2014 through 2018.

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

In 2002 businesses could claim up to $24,000 in section 179 expensing, and this phased out for businesses with total expenses from $200,000 to $224,000. The $24,000 allowance was scheduled to increase to $25,000 in 2003, but Congress temporarily increased the allowance to $100,000. This was the first of a series of congressional actions that provided temporary increases in the maximum allowance and the "phaseout" limit; Congress has also periodically indexed for inflation the temporarily increased amounts. This legislation is summarized in the following table.

Summary of Federal Section 179 Legislation 2003-2014

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	Increased to $250,000	Increased to $800,000	No	2010
2010 to 2013	Increased to $500,000	Increased to $2 million	No	2014
2014	$25,000	$200,000	No	None

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

Prior to 2006, Minnesota conformed to federal section 179 expensing allowances. At that time, businesses could claim the same amount under the Minnesota tax as they could under the federal tax. Since then, the legislature has elected not to conform to the higher federal section 179 allowances. For 2006 to 2012, Minnesota allowed the $25,000 section 179 expensing amount in effect before tax year 2003, when the federal government first begin allowing increased section 179 expensing. Unless Minnesota enacts legislation to conform to the increased federal amounts for 2013, the state will continue to limit section 179 expensing to the amount allowed under federal law before 2003.

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
2010-2013	500,000	2,000,000	25,000	200,000
2014	25,000	200,000	25,000	200,000

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

Emily Cleveland Updated: June 2013

Minors' Consent for Health Care

Minors may not receive health care services without their parents' or guardians' consent, unless specified otherwise in statute.

Specific Services

A minor may consent for medical, mental, or other health services for the following:

- to determine the presence or treatment of pregnancy and conditions associated with pregnancy
- for sexually transmitted infections
- for alcohol or other drug abuse (Minn. Stat. § 144.343, subd. 1)

In addition, minors may consent for:

- hepatitis B vaccinations (Minn. Stat. § 144.3441) and
- blood donation (only those 17 and over; a 16-year-old can donate with written consent from a parent or guardian) (Minn. Stat. § 145.41).

Emergency Treatment

Health services may be provided to minors without the consent of a parent if, in the health professional's judgment, treatment should be given without delay, and if obtaining consent would result in delay or denial of treatment (Minn. Stat. § 144.344).

Abortion

Minors seeking an abortion must notify both parents of the intended abortion and wait 48 hours, or seek judicial approval for the procedure. A court may authorize an abortion if it finds either:

- that the pregnant minor is mature and capable of giving informed consent, or
- that authorizing the abortion without notification would be in her best interests.

An expedited, confidential appeal is available to any minor for whom the court denies an order authorizing an abortion without notification. An order authorizing an abortion without parental notification is not subject to appeal (Minn. Stat. § 144.343, subds. 2-7).

Marriage or Giving Birth

Any minor who has been married or has given birth may consent for personal medical, mental, dental, or other health services or for services for the minor's child (Minn. Stat. § 144.342).

Voluntary Institutional Treatment	Any person 16 years or older may request informal admission to a treatment facility for observation or treatment of mental illness, chemical dependency, or mental retardation and may give valid consent for hospitalization, routine diagnostic evaluation, and emergency or short-term acute care (Minn. Stat. §§ 253B.03, subd. 6(d); 253B.04, subd. 1).
Access to Health Records	Parents and guardians have access to their minor children's medical records, unless the minor legally consents for services specifically listed under the Consent of Minors for Health Services statute (Minn. Stat. §§ 144.341-144.347). In that case, parents or guardians do not have access to the minor's health care records without the minor's authorization (Minn. Stat. § 144.291, subd. 2, para. (g)). However, if a health professional believes that it is in the best interest of the minor, the health professional may inform the minor's parents of the treatment (Minn. Stat. § 144.346).
Living Apart from Parents and Managing Own Financial Affairs	A minor living apart from his or her parents or legal guardian and who is managing his or her own financial affairs may consent for his or her own medical, mental, or dental care services. This exception applies to a minor regardless of whether the minor's parents have consented to the minor living apart, or regardless of the extent or source of the minor's income (Minn. Stat. § 144.341).
Representation to Persons Rendering Service	If a minor represents to a health professional that he or she is able to give effective consent for medical, mental, dental, or other health services, but is in fact not able to do so, his or her consent is effective if relied upon in good faith by the person rendering the health service (Minn. Stat. § 144.345).
Financial Responsibility	A minor who consents for health services is financially responsible for the cost of the services (Minn. Stat. § 144.347).

For more information: Also see the House Research publication *Youth and the Law*, December 2012.

HOUSE RESEARCH | Short Subjects

Emily Cleveland
Updated: June 2013

Freedom to Breathe Act of 2007

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

The Freedom to Breathe Act expanded the prohibition of smoking

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

The Freedom to Breathe Act further prohibited smoking in public places and at public meetings, and banned "designated smoking areas." The act also prohibited smoking in places of employment and in public transportation.

Smoking is prohibited in places of employment

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

Places of employment include the following:

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

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

Smoking is prohibited in public transportation

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

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

Smoking is prohibited in private residences used as places of employment

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

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

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

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

Entities studied the impact on lawful gambling

The act directed the Gambling Control Board to study the impact of the statewide smoking ban on lawful gambling. The Gambling Control Board reported the results of its study on March 28, 2008. This study reported that the impact in the first three months of implementation of the statewide ban was a factor in decreased lawful gambling receipts.

The act expanded eligibility for the dislocated worker program

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

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

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

HOUSE RESEARCH | **Short Subjects**

Lisa Larson

July 2013

Minnesota's New High School Assessments

The 2013 Legislature enacted a new testing law that changes the requirements for students to graduate from high school (Laws 2013, ch. 116). The new assessments focus on math, reading and writing, and career expectations and college readiness. In addition to changing future testing requirements, the law also allows students who previously did not pass a "high stakes" test to take an alternate assessment in order to graduate.

Students who meet credit requirements but did not pass a "high stakes" test can take an alternate assessment and graduate from high school

Under a new state testing law that is effective immediately, students in grade 8 in any school year through the 2011-2012 school year who met state and district credit requirements but did not pass the Minnesota Comprehensive Assessment (MCA), Graduation-Required Assessments for Diploma (GRAD), or basic skills tests can take an alternate assessment and still graduate from high school. These students no longer need to pass the grade 9 writing GRAD test, the grade 10 reading MCA or GRAD test, or the grade 11 math MCA or GRAD test. The alternate assessments include the following:

- the writing, reading, or math GRAD test (A student who did not pass and was not required to pass the math GRAD test under a 2009 waiver need not retake the test. See Laws 2009, ch. 96.)
- the WorkKeys jobs skills assessment
- the Compass college placement test
- the ACT assessment for college admission
- a nationally recognized armed services vocational aptitude test
- an alternative, equivalent assessment

No specified score, level of proficiency is required

Students are not required to achieve a specified score or level of proficiency on any of the alternate assessments in order to graduate from high school or on any of the new assessments that apply to students in grade 8 beginning in the 2012-2013 school year and later.

Students are subject to new career and college readiness assessments

Students in grade 8 in the 2012-2013 school year and thereafter are subject to new assessments, premised on expectations for careers and college readiness. These expectations are based on a continuum of empirically derived, clearly defined career and college-ready benchmarks. These benchmarks let students, parents, and teachers know how well students must perform to have a reasonable chance to succeed in a career or college without need for postsecondary remediation.

The education commissioner, after consulting with local school officials, educators, and Minnesota's public postsecondary institutions, will identify the foundational knowledge and skills students need for career and college readiness, and targeted interventions to help students who are not yet ready. The commissioner will then contract for the assessments through a request for proposal process.

Minnesota's new suite of assessments include career exploration and planning; math, reading, and writing tests; and college placement and entrance exams

The requirements for the new suite of assessments include the following:

- **Career exploration and planning:** Beginning no later than grade 9, students undergo a career exploration assessment based on a student's interests, aptitudes, and aspirations. The transition plan helps students and their families explore career options and postsecondary education leading to an industry-recognized credential, an associate's degree, or a bachelor's degree.
- **Math, reading, and writing tests:** Students in grades 8 and 10 take math, reading, and writing tests that are predicative of a nationally normed assessment for career and college readiness. The tests will be used to monitor students' continuous development of and growth in acquiring requisite knowledge and skills and to analyze students' academic progress and performance levels.
- **College placement exam:** Students in grades 10 and 11 take a college placement diagnostic exam if they have shown that they are not yet ready for a career or college, based on their growth in academic achievement between grades 8 and 10. Results of the exam will be used to diagnose areas where students need curriculum or instructional adjustments, targeted interventions, or remediation; identify the instructional tools and best practices needed to support students; and improve students' knowledge and skills so they can graduate and have a reasonable chance to succeed in a career or college without remediation. Students may participate in targeted instruction, intervention, or remediation through grade 12.
- **College entrance exam:** Students in grades 11 and 12 who are academically ready take a nationally normed college entrance exam. Students in grades 11 and 12 who demonstrate attainment of required state academic standards and career and college readiness benchmarks are encouraged to participate in courses for college credit, including sequential courses of study within career areas.

Eligible students take an alternative assessment

Students with an individualized education program may satisfy state assessment requirements by achieving an individual score on state-identified alternative assessments.

Adult basic education students must be informed about targeted interventions

The education commissioner and the chancellor of the Minnesota State Colleges and Universities must collaborate in aligning instruction and assessments to give adult basic education students diagnostic information about the targeted interventions they need to seek postsecondary education or employment without need for postsecondary remediation.

Students must continue to take reading and math MCAs

Students will continue to take the grade 10 reading MCA and the grade 11 math MCA to meet federal testing requirements under the No Child Left Behind Act. However, the education commissioner must determine the alignment of the new suite of assessments and state academic standards and, to the extent alignment exists, the commissioner must immediately seek federal approval to replace the MCAs with these new assessments.

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

HOUSE RESEARCH | **Short Subjects**

Andrew Biggerstaff **July 2013**

The Marketplace Fairness Act of 2013

An effort is underway in Congress to pass a bill that would allow taxes to be collected for online purchases

Under longstanding Supreme Court precedents, state and local governments cannot require remote sellers—retailers with no employees or physical property in the state—to collect their sales and use taxes. As consumers make more purchases online, the inability to collect the taxes on these sales has resulted in growing state revenue losses. Purchasers are obligated to pay the tax (technically "use" tax), but it is impractical for states to collect it from them when the seller does not do so. Since the 1990s, states have sought federal legislation authorizing them to compel remote sellers to collect these taxes (a power that the Supreme Court has stated Congress has under the Commerce Clause).

The U.S. Senate responded by passing the Marketplace Fairness Act (S. 743) on May 6, 2013, which provides states with authority to require remote sellers to collect and remit tax on sales. After passage by the Senate, the bill was referred to the House Subcommittee on Regulatory Reform, Commercial and Antitrust Law on June 14, 2013.

States can qualify to collect taxes in two ways

A state can qualify under the act to require remote sellers to collect its taxes in either of two ways:

- By being a member of the Streamlined Sales and Use Tax Agreement (SSUTA), which is a voluntary agreement entered into by roughly 28 states that provides uniform tax policies and collection procedures in an effort to simplify tax administration for remote sellers; or
- By meeting a few key requirements in the act. First, the state must establish a single entity responsible for tax administration (e.g., the state department of revenue). Second, the state must also provide uniform tax rules for remote sellers. Third, the state must provide remote sellers with software (at no charge) that calculates the tax and files the returns. Finally, the state must relieve both the remote seller and the software provider from liability for incorrect calculation, remittance, or noncollection of sales and use taxes if the liability is an error by the software provider.

Small sellers are excluded

As passed by the Senate, the act excludes any remote seller who had less than $1 million in gross receipts in the previous calendar year from any collection requirements. However, in certain circumstances, the act requires remote sellers to aggregate their gross receipts in applying the $1 million test. For instance, if two or more remote sellers are related entities under the Internal Revenue Code (e.g., they are controlled subsidiaries or affiliates or close relatives are controlling owners), they must aggregate their annual gross receipts. Therefore, a seller could not create multiple businesses, each with less than $1 million in gross receipts, to avoid collecting taxes under the act.

There is a 180-day notice requirement The act imposes a 180-day mandatory notice period. This requirement, in combination with the act's effective date, means that a state cannot use its authority until the first day of a calendar quarter that occurs at least 180 days after the later of the state's published notice or enactment of the act.

Minnesota intends to collect the tax Minnesota published its intent to collect tax under the act by the legislature's enactment of the 2013 omnibus tax bill into law on May 24, 2013. Laws 2013, ch. 143, art. 8, § 18. If Congress enacts the Marketplace Fairness Act in 2013, the earliest that Minnesota could begin collecting sales tax would be January 1, 2014. Because Minnesota is a member of SSUTA and has published notice, the state could begin requiring collection after the mandatory notice period.

The act is limited to sales and use taxes The act limits its authority to sales and use taxes. Specifically, enactment of the Marketplace Fairness Act will not subject a remote seller to any other type of taxation (e.g., franchise, income, or occupation taxes).

The act also does not create any nexus or alter the standards used to determine nexus between a state and an individual. The act also allows sellers to choose a third-party certified software provider if they prefer not to use the software provided by the state.

States retain licensing and regulatory powers Under the act, states retain the authority to require licenses and to regulate business of any person. States can require remote sellers to qualify to conduct business in the state, and to pay any necessary licensing fees associated with doing business.

The act adopts SSUTA sourcing rules The act borrows many sourcing rules from the SSUTA. The location to which a remote sale is sourced is the location where that product or service is received by the purchaser, based on the instructions provided by the purchaser as part of the sale. If no delivery location is specified, the seller must make reasonable effort to determine the purchaser's location. If the seller cannot obtain that information, the sale is sourced to the address of the remote seller.

The future of the bill is uncertain The bill was referred to the House Committee on Judiciary, and later referred to the Subcommittee on Regulatory Reform, Commercial and Antitrust Law, where it awaits further action. Whether the House will act on the bill or if it does, what form that will take, is unclear at this point.

For more information: Contact legislative analyst Andrew Biggerstaff at 651-296-8959.

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

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HOUSE RESEARCH | Short Subjects

Joel Michael Updated: July 2013

Corporate Franchise Tax: Foreign Source Income Provisions

The 2013 Legislature repealed the special foreign source income provisions under the corporate franchise tax. Laws 2013, ch. 143, art. 8. As a result, the discussion in this publication is now only of historical interest and does not apply after tax year 2012.

What is an FOC?

Prior to their repeal in 2013, foreign operating corporations (FOCs) qualified for special tax treatment under the corporate franchise tax. To be an FOC, a corporation was required to:

- Be a domestic corporation that was part of a unitary group, one member of which is taxable in Minnesota;
- Derive 80 percent or more of its gross income from active foreign business income.

What tax benefits were provided to FOCs?

In broad terms, 80 percent of an FOC's income was exempt as "deemed dividends." The FOC's income was allocated to its shareholders and "deemed" to be a dividend that qualified for the dividend-received deduction; under Minnesota law dividends received by a corporation qualify for an 80 percent deduction.

What tax benefits were provided for foreign royalty and similar payments?

When an FOC or a foreign corporation paid royalties and fees to another entity in a unitary business, the receiving corporation was allowed to subtract 80 percent of these amounts if the FOC is part of its unitary business. This was referred to as the foreign royalty subtraction or deduction (often referred to by its acronym, FRD). It did not apply to income derived from U.S. sources as defined under the federal tax law. The 2013 Legislature also repealed the FRD.

Thus, under these two provisions, 80 percent of a unitary business's foreign source income that either flowed through an FOC or a foreign corporation was exempt from tax.

How much did the repeal increase state revenues?

The Department of Revenue (DOR) estimated that the 2013 legislation repealing the FOC and FRD provisions will increase state corporate franchise tax revenues by about $98 million per fiscal year. About 80 percent of this revenue was attributed to repeal of the foreign royalty subtraction or deduction.

When were the FOC provisions adopted?

The FOC provisions were adopted by the 1988 Legislature and remained largely unchanged until the 2008 Legislature based the definition of FOCs on the income sources of the corporation (i.e., requiring 80 percent of its income to be from a foreign source). Prior to that, the test was based on the location of the corporation's property and payroll factors.

What is the policy rationale for FOCs?

The FOC provisions were a response to the adoption of combined reporting apportionment in the early 1980s. Supporters argued that they were necessary to appropriately tax foreign operations under Minnesota's "water's edge"

combined reporting system. This method excludes foreign corporations from the unitary group, while including foreign operations of domestic corporations. As a result, tax is deferred on the income of foreign subsidiaries or affiliates until it is "repatriated" or paid to a domestic corporation. If the income is paid as a dividend, only 20 percent of it is taxed. By contrast, income from foreign operations of other domestic corporations is fully taxed immediately.

The FOC and foreign royalty provisions had two primary policy purposes:

- They allowed foreign operations of domestic corporations to qualify for about the same state tax treatment as foreign corporations by satisfying the FOC rules.
- They provided "factor relief" for nondividend income paid by foreign corporations and FOCs. When a foreign subsidiary or FOC makes royalty or similar payments to a U.S. corporation, this income is fully taxable; the apportionment formula does not take into account the foreign sales, payroll, and property that helped generate the income because these corporations and their factors are not included in the combined report. The royalty subtraction excluded 80 percent of this income to adjust for the absence of the foreign and FOC factors in the apportionment formula.

What was the rationale for the 2008 legislative changes and the repeal of the foreign source income provisions?

In the late 1990s, DOR and legislators became concerned that some corporations were abusing the FOC provisions by shifting income from domestic operations into FOCs. (The literal language of the provisions allowed this, because the FOC definition then considered only the location of tangible property and employees.) Corporations typically did this by assigning intangible property to their FOCs. The income (royalties, fees, interest, and so forth) received for use of the intangibles could be from domestic sources and still qualify for the 80 percent discount on taxes.

The 2008 legislation foreclosed these possibilities by requiring an FOC's income to be derived 80 percent from foreign sources under federal tax rules. However, this did not fully eliminate the possibilities for abuse. Federal definitions of foreign versus domestic income also depend upon accurate transfer pricing. Federal tax officials have expressed concerns regarding their ability to prevent taxpayers from recharacterizing or artificially shifting income to foreign countries with lower tax rates through transfer pricing practices. This type of federal tax avoidance or evasion can also affect Minnesota tax liability.

The adoption of 100 percent sales apportionment (effective for tax year 2014) means, in practical effect, that the location of employees and property no longer affects a multinational corporation's Minnesota tax liability. Given this and the continuing potential for distortion through transfer pricing practices, the legislature considered that the foreign source income provisions were no longer necessary—either to accurately measure the Minnesota tax base or to make the state an attractive location for multinational corporations.

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

HOUSE RESEARCH | **Short Subjects**

Joel Michael

Updated: July 2013

MinnesotaCare Provider Taxes

What are the taxes?

Minnesota imposes a series of gross revenue taxes on various types of providers of health care goods and services. Revenues collected under these taxes are used to pay for the MinnesotaCare program, which provides state-subsidized health care coverage for low-income individuals.

Who is subject to the tax?

Provider taxes apply to the following:

- "Health care providers," including licensed health care professionals such as physicians, dentists, nurses, psychologists, physical therapists, and chiropractors; unlicensed individuals providing services reimbursed under Minnesota's Medicaid program; staff model health plan companies (an HMO where services are provided by employees); ambulance services; opticians; and sellers of hearing aids
- Hospitals
- Surgical centers
- Wholesale drug distributors

What entities are exempt from the tax?

MinnesotaCare provider taxes do not apply to the following:

- Nursing homes and other residential care facilities, such as board and care homes, adult foster homes, boarding care homes, and adult day care centers
- Home health agencies
- Providers of personal care services
- Providers of private duty nursing services
- An entity that employs health care providers to service only their employees
- An educational institution that provides services to its students, if it does not charge for extended coverage

What is the tax base?

The taxes apply to the gross revenues derived from "patient services," which include most services provided to patients, such as diagnostic and therapeutic services, and bed and board. Some services are explicitly excluded:

- Services provided to nursing homes and in connection with assisted living and congregate housing programs
- Exams for insurance, employment, litigation, and so forth
- Certain mental health services
- Hospice services
- Specified residential services for the developmentally disabled

What is the tax rate?

The tax rate is 2 percent. A temporary 1.5 percent rate applied from 1998 through 2003.

What exemptions apply?

Exemptions from the tax apply to the following payments:

- For services provided under Medicare
- For home health care services
- Made from the state chemical dependency fund
- Funded by charitable donations not designated for an individual or group
- Under programs funding research on human subjects under federal law
- Made by the federal employee and military (Tricare) health insurance plans that cover federal workers and military personnel and retirees
- From providers that were already subject to the tax

Are credits allowed?

Credits are allowed for taxes paid to other states and for qualifying research expenditures. The research credit is subject to an annual cap of $2.5 million; the commissioner of revenue sets the credit rate to equal the cap amount.

How is the tax paid?

Providers make quarterly estimated payments; an annual return is filed to reconcile the estimated payments with the final liability for the tax year. All payments and returns must be filed and made electronically. The Department of Revenue administers the tax. Providers may itemize the tax on patient bills.

How are drugs taxed?

Legend drugs (i.e., those requiring prescriptions under FDA regulations) are taxed under a wholesale drug tax equal to 2 percent rate to the wholesale price. A use tax applies when drugs are purchased for resale in Minnesota from an out-of-state seller who does not have nexus and, thus, cannot be required to pay the tax. The use tax does not apply to purchases by individuals for their own use.

Is the tax permanent?

Under legislation enacted in 2011, the provider taxes will expire on January 1, 2020.

How much revenue is collected from the taxes?

In February 2013, the Department of Management and Budget estimated that the MinnesotaCare provider taxes will yield $527 million in revenues for the health care access fund in fiscal year 2014. Because health costs are rising at a rapid rate and because consumption of health services is also increasing steadily, these revenues are likely to rise at a faster rate than most other state tax sources.

Are these the only sources of revenue for the health care access fund?

No, the revenues from applying the insurance premiums tax to health maintenance organizations (HMOs) and nonprofit health services corporations (such as Blue Cross) are deposited in the health care access fund and used to pay for MinnesotaCare. In addition, other revenues from the program, such as premium payments by participants and some federal funding, go to the fund.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn; taxpayer questions about how the tax applies to specific situations should contact the Department of Revenue at 651-282-5533.

HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff and Joel Michael

Updated: July 2013

Alcoholic Beverage Taxes

Two special state taxes apply to alcoholic beverages: excise taxes and a gross receipts tax

Minnesota imposes two types of special taxes on alcoholic beverages:

- **Special excise taxes** are imposed on manufacturers or wholesalers of these products. These taxes are a fixed dollar amount per unit (per barrel or liter). The tax rates vary by beverage type. See the table below for tax rates.
- A **special gross receipts tax** of 2.5 percent applies to retailers making both on-sale (to be consumed in bars or restaurants) and off-sale (in liquor stores or by other sellers) sales.

Excise tax rates are set as a dollar amount per volume of the beverage

Manufacturers of beer and wholesalers of distilled spirits and wines pay the special excise taxes. If the beer manufacturer doesn't pay, the wholesaler or importer is liable for the tax. The table shows the rates for the most common beverage categories. Higher rates apply to wines with alcoholic contents that exceed 21 percent and 24 percent, but little or none of these products are sold. A special "bottle tax" of one cent per bottle also applies to each wine and liquor bottle that is 200 milliliters or larger.

Beverage Type	Excise Tax per Gallon	Excise Tax per Liter
Beer < 3.2% alcohol	$.08	NA
Beer > 3.2% alcohol	.15	NA
Cider < 7% alcohol	.15	NA
Low-alcohol dairy cocktails	.08	$.02
Wine < 14% alcohol	.30	.08
Wine > 14% alcohol	.95	.25
Sparkling wine	1.82	.48
Distilled spirits	5.03	1.33

Because the excise taxes are fixed dollar amounts, they don't vary by the price of the product. Higher priced products pay the same tax as lower priced products. Moreover, revenues grow only as more liters or barrels of the products are sold; revenues don't increase with inflation (price increases). For revenues to keep pace with inflation, the legislature must adjust the tax rates periodically. It has done this only sporadically (most recently in 1987).

Few exemptions apply

The law exempts the following from the excise tax:

- Sacramental wine
- Products sold to food processors and pharmaceutical companies
- The first 25,000 barrels of beer produced by a brewery with annual production of less than 250,000 barrels (A barrel is 31 gallons.)

Revenues go to the general fund

Revenues from both the excise taxes and the gross receipts tax go to the general fund. Fiscal year 2012 revenues from the excise taxes were about $80 million and from the gross receipts tax, $75 million. Thus, the gross receipts tax raises about 48 percent of alcohol tax revenues. The table to the right shows the collections by beverage type for the excise tax and for the additional sales tax. The excise tax revenue from liquor reflects the higher rates imposed on these products, rather than their share of the market (measured by dollars spent). The sales tax imposes a much higher tax burden on wine and beer than the excise tax does.

Beverage Type	FY2012 Revenues (000)	% of Total
Beer < 3.2%	$288	0.36%
Beer > 3.2%	15,824	19.76%
Cider	75	0.09%
Wine < 14%	3,789	4.73%
Wine > 14%	602	0.75%
Sparkling Wine	951	1.19%
Distilled Spirits	58,566	73.12%
Excise tax total	80,095	51.70%
2.5% gross receipts tax	74,898	48.30%
Total	**$154,993**	
Source: MN Department of Revenue		

Minnesota tax compared with other states

Minnesota's wine and beer excise taxes are average or below average compared with most other states. Minnesota's tax on distilled spirits (liquor) is among the higher taxes for states with excise taxes. A number of states (including Iowa) have state liquor monopolies and a portion of the price markup is a *de facto* tax; it is difficult to compare the tax burden with these states. The table compares Minnesota's tax rates with its bordering states. However, only North Dakota imposes a gross receipts tax (at a 2 percent rate) similar to Minnesota's. Thus, the total Minnesota alcohol tax burden is higher than suggested by simply comparing excise tax burdens.

Excise Tax Rates (per gallon) Bordering States			
	Strong Beer	Table Wine	Liquor
IA	$.19	$1.75	NA
MN	**.15**	**.30**	**$5.03**
ND	.16	.50	2.50
SD	.27	.93	3.93
WI	.06	.25	3.25
Source: Federation of Tax Administrators			

Tax relative to alcohol content varies

The excise taxes are imposed on the volume of the beverage, not its alcoholic content. (The federal tax on distilled spirits, by contrast, is imposed explicitly on alcoholic content.) Since alcoholic content varies significantly within beverage type, it is difficult to generalize about the tax on alcohol content. But when looking at averages for beverage types, it is apparent that alcohol in beer and wine is lightly taxed compared with liquor. The excise tax per an ounce of alcohol in liquor is about nine cents, while it is between two and three cents for wine and beer.

Tax is regressive

The alcohol taxes are regressive; they constitute a higher share of income for lower income families and individuals, on average. The Department of Revenue's *Tax Incidence Study* indicates they are less regressive than the tobacco taxes but more regressive than the general sales tax.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn or Andrew Biggerstaff at andrew.biggerstaff@house.mn.

HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff

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Mortgage and Deed Taxes: An Overview

What are the mortgage registry and deed taxes?

The mortgage registry tax (MRT) and deed taxes are two separate state taxes that apply to many real estate transactions. The MRT is based on the amount of debt secured by a mortgage of real property and is imposed when the mortgage is recorded. The deed tax is a transfer tax; it is imposed on the value of real property transferred. While these taxes are independent of each other, they are often thought of together, since many property transactions trigger both taxes.

What are the rates?

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

How does it work?

The following example illustrates how each tax applies to a typical home purchase.

Mortgage Registry Tax

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

Principal debt x 0.23% = MRT liability

$130,000 x 0.23% = $299

The Andersons owe $299 in MRT.

Deed Tax

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

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

$150,000 x 0.33% = $495

$495 must be paid when the deed is recorded.

Who is responsible for paying the tax?

The mortgagor (borrower) is liable for the MRT, while the seller is liable for the deed tax. As a practical matter, the lender usually collects both of the taxes at closing and remits them to the county when the mortgage and deed are recorded.

The deed tax is collected from the seller at closing. But since the deed tax must be paid to record a deed and since it is primarily in the buyer's interest to record the deed, the tax may fall on the buyer if the seller fails to pay the tax.

Who collects the money?

County treasurers collect these taxes. They remit 97 percent of the revenues to the state for deposit in the state general fund. The county retains the other 3 percent

for its administrative expenses.

How much is collected?

The table below shows the MRT and deed tax collected by the state since 2002. The amounts reflect only the state's 97 percent share.

Collections are sensitive to the volume and value of real estate transactions; MRT collections are also sensitive to refinancing activity. Following the effects of the 2007-2009 recession, historically low interest rates and a slowly improving economy have spurred growth in collections for the past two years.

State MRT and Deed Tax Revenue (in millions)

Fiscal Year	Mortgage	Deed	Total	Change (from previous year)	Percent Change (from previous year)
2002	145.1	86.1	231.2	72.0	45.2%
2003	203.4	94.3	297.7	66.5	28.8%
2004*	230.2	120.6	350.7	53.0	17.8%
2005*	162.2	124.2	286.4	-64.3	-18.3%
2006	173.6	136.4	310.0	23.6	8.2%
2007	149.6	111.5	261.1	-48.9	-15.8%
2008	114.4	84.3	198.7	-62.5	-23.9%
2009	101.2	59.7	160.9	-37.8	-19.0%
2010	94.6	58.5	153.1	-7.8	-4.8%
2011	98.9	54.6	153.5	0.4	2.6%
2012	103.0	57.1	160.1	6.6	4.3%
2013**	132.1	72.8	204.9	44.8	27.9%

* Accelerating the June payment began in fiscal year 2004 and distorts the change amounts and percentages for fiscal years 2004 and 2005.
** These numbers represent estimates.
Source: 2000–2012, Department of Revenue; 2013, Minnesota Management & Budget, February 2013 Forecast

Are there exemptions from the taxes?

Both taxes have multiple exemptions. MRT exemptions include contracts for deed, certain agricultural mortgages, marriage dissolution decrees, and certain low- and moderate-income housing mortgages. Common deed tax exemptions are mortgages, plats, wills and testamentary distributions, leases, sheriff's foreclosure sale certificates, and marriage dissolution decrees.

Can local governments also impose mortgage and deed taxes?

State law authorizes Ramsey and Hennepin county to impose local mortgage and deed taxes. Both of these county taxes have rates of 0.0001 (or 0.01 percent) for both taxes. The taxes expire on January 1, 2028, unless extended by the legislature. Bills have been introduced (and have passed one or both houses) to authorize Anoka, Dakota, and St. Louis counties to also impose local mortgage and deed taxes. These proposals have not been enacted into law.

For more information: Contact legislative analyst Andrew Biggerstaff at andrew.biggerstaff@house.mn. Also see the House Research publication *Mortgage and Deed Taxes in Minnesota*, April 2002.

HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff and Joel Michael

Updated: July 2013

Cigarette and Tobacco Excise Taxes and Fees

Minnesota imposes a $2.83/pack excise tax on cigarettes; this rate is annually indexed for inflation

Under 2013 legislation, Minnesota imposes an excise tax on the sale or possession of cigarettes of $2.83 per pack of 20. Before enactment of this legislation, the state imposed an excise tax of 48 cents per pack and a health impact fee of 75 cents per pack for a combined tax and fee of $1.23. The 2013 legislation replaced the health impact fee with an equivalent tax and also increased the total tax burden by $1.60 per pack.

The excise tax on cigarettes is imposed on a "per unit" basis—i.e., on the number of cigarettes sold, not as a percentage of the sale price. As a result, the tax does not vary based on the price of the brand purchased or change as the prices rise or fall. However, the 2013 legislation requires the tax rate to be annually adjusted (each January 1) for the change in the average retail price of cigarettes in the state.

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

Since 2005, cigarette sales have been exempt from state and local sales taxes. A per-pack tax applies instead of the sales tax. The commissioner of revenue annually sets this in-lieu tax based on a survey of Minnesota retail cigarette prices. The rate is set as an average of these prices and is reset January 1 for the calendar year. Effective July 1, 2013, the rate is 49.3 cents/pack. The tax does not replace local sales taxes, although cigarettes 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 similar economic effects to cigarette taxes, since these settlement payments are passed along to consumers (nationally) as higher cigarette prices. However, they do not affect companies that were not part of the lawsuit or that have not entered the Master Settlement Agreement as participating manufacturers. To compensate for the lower prices of cigarettes produced by nonsettling companies, the 2003 Legislature imposed a 35-cent per-pack fee on those cigarettes. The 2013 Legislature increased this fee to 50 cents.

A 95 percent excise tax applies to other tobacco products

An excise tax of 95 percent of the wholesale price applies to other tobacco products, such as cigars, pipe tobacco, snuff, and chewing tobacco. Since this tax is a percentage of price, it fluctuates as the prices of the products change with two exceptions to this general rule, both enacted by the 2013 Legislature:

- Effective January 1, 2014, a minimum tax will apply to each container of moist snuff equal to the tax rate on a pack of 20 cigarettes.
- Premium cigars (hand-rolled with a wholesale price of $2/cigar or more) are subject to a maximum tax of $3.50/cigar.

A use tax can apply, if Minnesota tax has otherwise not been paid

A use tax applies to consumers who purchase untaxed cigarettes (e.g., over the Internet or in-person in another state) for use in Minnesota. The tax is the same as the rate of the excise tax. The use tax does not apply to one carton of cigarettes purchased in another state and brought into the state by the individual. For larger quantities brought into the state and for any quantity shipped to the consumer in Minnesota, the use tax applies.

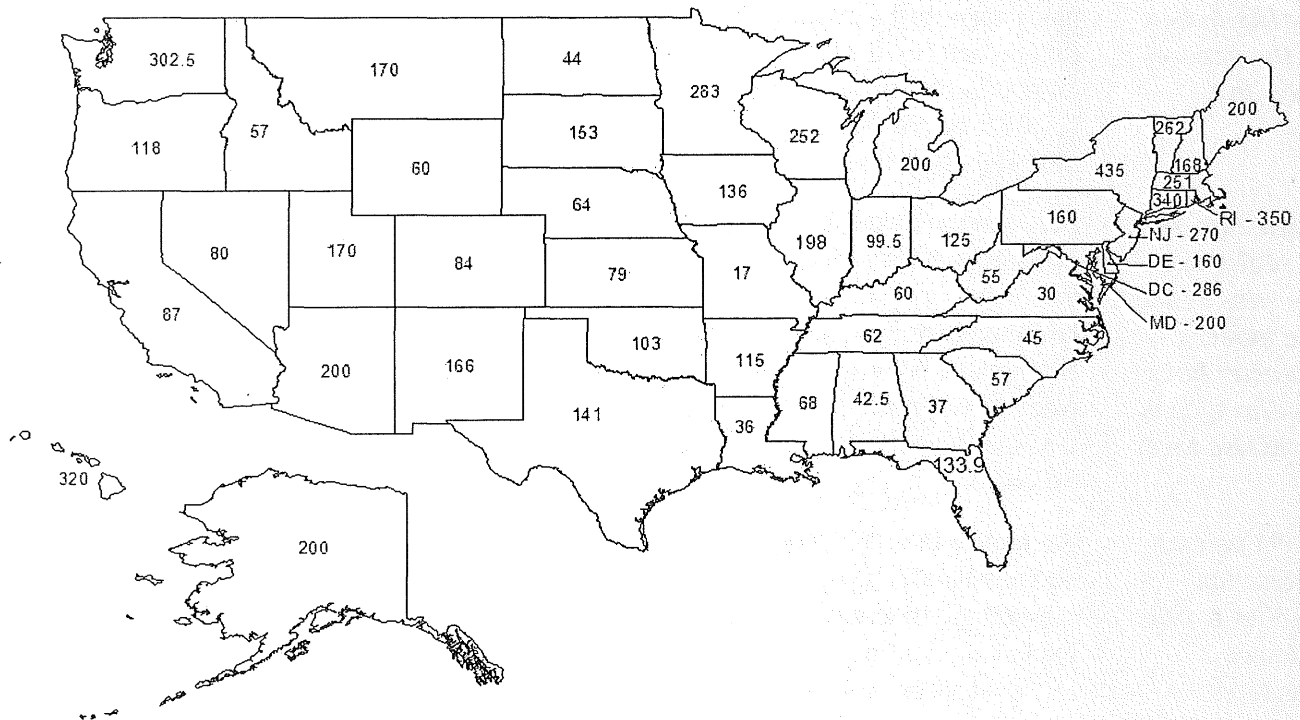
The taxes are estimated to yield revenues of $621 million in FY 2014

For fiscal year 2014, Minnesota Management and Budget estimates collections from the two excise taxes and the sales tax on cigarettes will be $621.4 million (2013 end of session estimates). 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, $3.94 million to the medical education and research account, and the rest to the state general fund.

Minnesota has higher excise tax rate than the neighboring states

Because cigarettes can easily be transported, the tax rates in other states (especially border states) are important. As a result of the 2013 legislation, Minnesota excise tax ($2.83/pack) is now higher than any of the bordering states: Wisconsin ($2.52), South Dakota ($1.53), Iowa ($1.36), North Dakota (44 cents). 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 7/1/2013
cents per pack



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

For more information: Contact legislative analyst Andrew Biggerstaff at andrew.biggerstaff@house.mn or Joel Michael at joel.michael@house.mn.

Joel Michael Updated: July 2013

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 2005 legislation, Minnesota is phasing in single sales apportionment over an eight-year period that began in tax year 2007. The table shows the remaining phase-in schedule.

Tax year	Sales	Property	Payroll
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, such as a national consumer products company with few facilities in Minnesota.

"Throwback rules" affect the benefit to taxpayers of single sales apportionment

Over half of the states with corporate taxes also use "throwback rules" in defining the sales factor. Throwback rules treat sales to out-of-state buyers as in-state sales, if the buyer's state cannot tax the business/seller or if the purchaser is a federal government agency. These "thrown-back" sales increase in-state sales factor and corporate tax, decreasing the benefits to the taxpayer of single sales apportionment. Minnesota does not have a throwback rule.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is a competitiveness argument: It helps Minnesota attract or retain 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, single sales apportionment 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 this argument.

Policy concerns with single sales apportionment: equity and tax theory

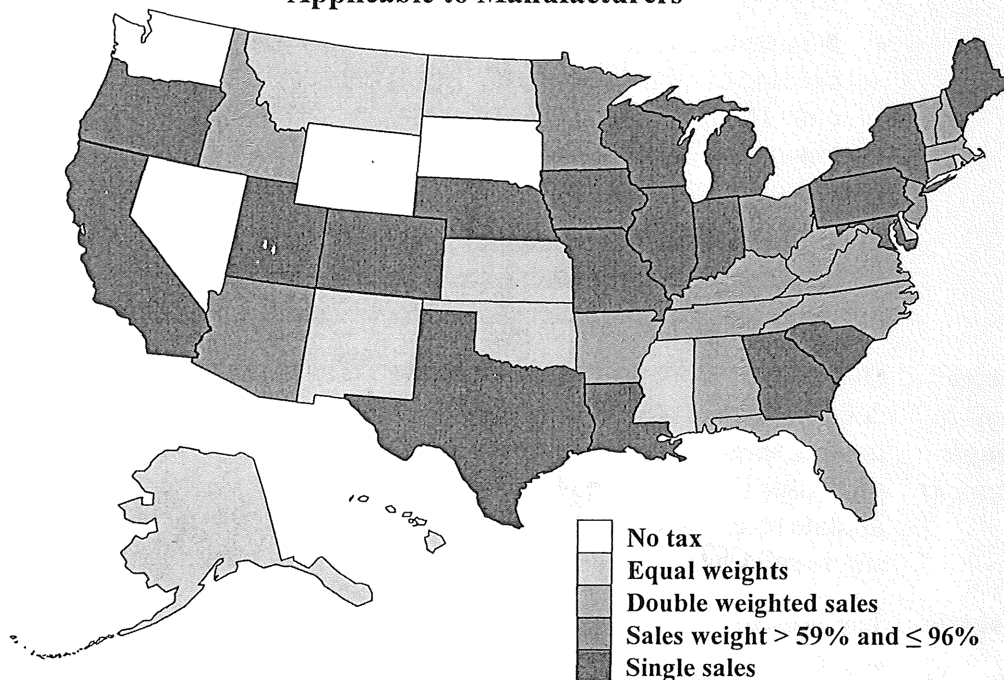
Opponents of single sales apportionment argue that it shifts the tax burden from capital (the property factor) to consumption, reducing the tax's progressivity. Some also question as an empirical matter whether it has the desired effects on competitiveness. Tax theorists argue that if the corporate tax 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. Both factors contribute to the production of income and the consumption of government services.

Sales-weighted apportionment reduces revenues

Compared with equally weighting each apportionment factor, weighting sales more heavily reduces tax revenues. The Department of Revenue's *Tax Expenditure Budget* (February 2012) shows an expenditure cost of $260 million for fiscal year 2013, rising to $303 million in 2015 when single sales applies.

Trend in other states to heavier sales weighting

States are increasingly shifting their apportionment formulas to more heavily weighted sales. Effective for tax year 2013, 18 states use or allow single sales as their apportionment formula for manufacturers. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Indiana, Iowa, Michigan, Missouri, Nebraska, and Wisconsin. New Jersey and Virginia (in addition to Minnesota) are scheduled to use single sales in 2014, and Arizona in 2017. The map below shows the apportionment formulas for manufacturers as of tax year 2013. Some states allow elections between two formulas. The map shows these with the highest permitted sales weighting.



Source: Federation of Tax Administrators and CCH

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publication *Apportionment of Corporate Franchise Tax*, July 2013.

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

Danyell Punelli

Revised: July 2013

General Assistance

General Assistance (GA) is a state program that provides cash assistance to individuals or childless couples who are not eligible for federally funded assistance programs, but who are unable to provide for themselves (Minn. Stat. § 256D.01).

Eligibility

An applicant qualifies for GA if he or she meets the eligibility requirements and has income and assets below the limits established by the state legislature and the Department of Human Services (DHS). Assistance is available as long as the individual continues to meet eligibility requirements; there is no set time limit.

In addition to having financial need, a GA applicant must also meet the following conditions:

- Be a resident of Minnesota
- Be ineligible for aid from any cash assistance program that uses federal funds (i.e., Minnesota Family Investment Program or Supplemental Security Income)
- Be a citizen of the United States
- Be unable to work because the person:
  1. Has a professionally certified illness, injury, or incapacity expected to continue for more than 45 days and that prevents the person from getting or keeping a job
  2. Has been diagnosed as having a developmental disability or mental illness
  3. Is unable to seek or retain employment due to advanced age
  4. Is needed in the home to care for a person whose age or medical condition requires continuous care
  5. Is placed in a licensed or certified facility for care or treatment under a plan approved by the local human services agency
  6. Resides in a shelter for battered women
  7. Has an application pending for or is appealing a termination of Social Security disability payments, so long as the person has a professionally certified illness or disability
  8. Is assessed as not employable
  9. Is under age 18 in specified circumstances and with consent of the local agency
  10. Is eligible for displaced homemaker services and is enrolled as a full-time student
  11. Has had an alcohol or drug addiction that is a material factor that contributes to the person's disability
  12. Is involved with protective or court-ordered services that prevent working at least four hours per day

13. Is over age 18 and whose primary language is not English and is attending high school at least part-time
14. Has a condition that qualifies as a specific learning disability

GA is not provided to:

- Fugitive felons and parole and probation violators; or
- Persons who have fraudulently misrepresented residency to obtain assistance in two or more states; these people are not eligible to receive GA for ten years.

Benefits

GA recipients receive a monthly cash assistance payment, called a grant. The amount of a recipient's grant is determined by subtracting the recipient's net income from the applicable monthly GA assistance standard.

Monthly GA Standards for Single Persons and Childless Couples

Eligible Units	Monthly Standard
One adult	$203
Emancipated minor	203
One adult, living with parent(s) who have no minor children	203
Minor not living with parent, stepparent, or legal custodian (with approved social services plan)	250
Married couple with no children	260
One adult, living in a medical facility or in group residential housing	92

Unlike MFIP, the GA program does not include an employment and training component. GA recipients are not required to participate in any employment and training services as a condition of receiving benefits.

Funding and Expenditures

The state pays for the costs of GA benefits. In state fiscal year 2013, the state estimated paying $53,358,794 in benefits to GA recipients.

Recipient Profile

Most GA recipients are single persons. Childless couples may also be eligible for GA. In state fiscal year 2013, the average monthly number of GA cases was projected to be 23,593.

For more information: Contact legislative analyst Danyell Punelli at 651-296-5058. Also see the House Research publication *Minnesota Family Assistance*, November 2012.

HOUSE RESEARCH | Short Subjects

Colbey Sullivan

Updated: July 2013

Genetically Engineered Crops

What are genetically engineered organisms?

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

What is an example?

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

Are agricultural GEOs regulated?

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

What agencies are involved?

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

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

What criteria does the MDA use?

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

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

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

Do Minnesota farmers plant GEOs?

In general, farmers in Minnesota and across the country have adopted GE corn and soybeans. According to the USDA, GE varieties comprised almost 90 percent of all corn planted in Minnesota in 2012. In 2000, GE corn was a significantly smaller share of the total, at 37 percent. For soybeans, Minnesota farmers planted 91 percent of total acres to GE varieties in 2012, up from 46 percent in 2000. Farms nationwide displayed a similar trend over the period, with GE corn growing from 25 percent in 2000 to 88 percent in 2012, and GE soybeans up from 54 percent to 93 percent over the same period.

Responding to consumer demand for GEO-free foods, a portion of Minnesota farmers do not grow GE crop varieties. Under state and federal law, certified organic farmers and handlers cannot grow or process GE crops. Minn. Stat. § 31.925.

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

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

Are traditional methods considered GE?

No, traditional agricultural practices such as the selective breeding of livestock or the hybridization of crops are not considered genetic engineering under Minnesota law.

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

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: July 2013

Corporate Franchise Tax

Corporate franchise tax applies to "C" corporations

The corporate franchise tax, also frequently referred to as the corporate income tax, applies to "C" corporations (i.e., corporations and some partnerships) that are taxable under subchapter "C" of the Internal Revenue Code. Entities exempt from the tax include the following:

- "Pass-through entities" (e.g., most partnerships and limited liability companies, and "S" corporations); the owners of these entities (shareholders, partners, or LLC members) pay tax on their respective shares of the business entity's income under the individual income tax. The entities are subject to the minimum fee (see below). By contrast, shareholders of C corporations must pay tax under the individual income tax when the corporate profits are distributed as dividends.
- Insurance companies (Insurers pay a premium tax instead)
- Credit unions
- Charitable organizations and other entities exempt from the federal income tax

Tax base is profits

The tax base is taxable income, essentially the profits of C corporations. State law defines the tax base by reference to the definition of taxable income under the federal corporate income tax. For example, federal depreciation rules are generally followed, except "bonus depreciation" and section 179 expensing are subject to special Minnesota rules. Minnesota deviates from the federal rules in various ways. It taxes some income that is exempt under federal law, such as state and local bond interest, and does not allow percentage depletion.

Tax rate is 9.8 percent

A flat tax rate of 9.8 percent applies to Minnesota taxable income.

Income is apportioned to Minnesota based on the percentage of the corporation's sales made to buyers located in Minnesota

Many corporations operate in more than one state. Under the U.S. Constitution, a state can legally tax only the income of a business that is "fairly apportioned" to its activity in the state. All states do this using formula apportionment (i.e., based on the in-state percentage of one or more factors).

Minnesota apportions a multistate corporation's income using a weighted three-factor formula of sales (96 percent weight), property (2 percent), and payroll (2 percent) for tax year 2013. Beginning with tax year 2014, Minnesota will base its apportionment solely on the sales factor. For unitary businesses operating through several corporations (e.g., parent-subsidiary), all of their income is combined. This is referred to as the "combined reporting" method of apportionment. (For more information on apportionment, see the separate Short Subject, *Apportionment of Corporate Franchise Tax*.)

Various tax credits apply

The corporate franchise tax is reduced by various tax credits. These include credits for the following:

- Research and development
- Tax paid to another state
- Historic structure rehabilitation credit
- Jobs credit under the JOBZ program

Revenues go to the general fund

Fiscal year 2012 actual revenues were $1.04 billion or about 5 percent of general fund revenues. Revenues are deposited in the general fund. Minnesota Management and Budget estimated in February 2013 that corporate franchise tax collections will be $1.17 billion in fiscal year 2013 and $1.04 billion in fiscal year 2014.

Revenues are elastic but very volatile

Revenues under the tax are elastic; they grow as the size of the economy grows. But they are also the most volatile of the major state taxes. When the economy goes into recession, corporate profits and the franchise tax revenues can drop quite precipitously. For example, in fiscal year 2007 (an expansion year), revenues were $1.17 billion; by fiscal year 2010 (a recession year) they had dropped to $663 million (a reduction of 43 percent reduction from 2007), and by fiscal year 2012 they had recovered to $1.04 billion (an increase of 57 percent from 2010).

A minimum tax applies

An alternative minimum tax or AMT applies under the franchise tax. This tax closely follows the similar federal AMT. A corporation must compute its tax under the AMT, using a broader tax base (e.g., less generous depreciation rules) and lower tax rate (5.8 percent). If the AMT results in a higher tax, the corporation must pay this amount.

A minimum fee applies to most entities

All corporations (both S and C corporations), partnerships, and LLCs must pay a minimum fee based on the sum of their Minnesota property, payroll, and sales. This fee is an "add-on" fee that is paid in addition to the tax computed under the regular tax or AMT. The schedule for the fee is shown to the right. The 2013 Legislature increased these fee amounts and provided that they would be annually adjusted for inflation in the future.

Fee Schedule

Minnesota Property, Payroll, and Sales	Fee
Less than $930,000	0
$930,000 - $1,869,999	$190
$1,870,000 - $9,339,999	$560
$9,340,000 - $18,679,999	$1,870
$18,680,000 - $37,359,999	$3,740
$37,360,000 or more	$9,340

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publications *Single Sales Apportionment of Corporate Franchise Tax*, July 2013, and *Apportionment of Corporate Franchise Tax*, July 2013.

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: July 2013

Apportionment of Corporate Franchise Tax

Apportionment is constitutionally required

A state can constitutionally tax only the income of a multistate corporation that is "fairly apportioned" to the state. The reason for this requirement seems obvious: if a business operates in several states and each state could tax all of its income, the business could easily be subject to multiple taxation. Aside from being unfair, this would discourage a business from operating in multiple states; it would interfere with interstate commerce.

All states use formula apportionment

A state can apportion income using separate accounting or formula apportionment. Separate accounting traces income to the state where it was earned using standard accounting methods. Formula apportionment uses a proxy or rough measure to determine the in-state share of income (e.g., the percentage of the business's in-state sales to its total sales). All states use some type of formula apportionment. Using separate accounting would be expensive, difficult to do, and subject to manipulation.

Minnesota uses a weighted three-factor formula

Minnesota uses a weighted three-factor formula of sales, property, and payroll, but will use apportionment based only on sales in tax year 2014. The formula for tax year 2013 weights sales at 96 percent, property at 2 percent, and payroll at 2 percent. The Minnesota percentage for each factor is multiplied by the weight, and the three factors are added to determine the Minnesota percentage of the corporation's total income. Here is how this is expressed as a formula:

$$MN\ percent = \left(0.96 \times \frac{MnSales}{TotalSales}\right) + \left(0.02 \times \frac{MnProperty}{TotalProperty}\right) + \left(0.02 \times \frac{MnPayroll}{TotalPayroll}\right)$$

Sales are defined on a destination basis; that is, the location of the buyer generally determines whether the sale is a Minnesota sale. The property factor is the value of real and tangible personal property in Minnesota. Leased property is included; its value equals the lease payments multiplied by eight. Payroll is the amount paid to employees.

Special formulas apply to some industries

Special apportionment rules apply to some industries. Mail-order companies that have substantially all of their operations in Minnesota use a sales-only formula. A separate formula for financial institutions includes deposits and intangible property (e.g., receivables and loans), since these are important contributors to their profits.

No throwback rule applies

The Uniform Division of Income for Tax Purposes Act (adopted by a group of states) provides that sales to buyers in a state in which the corporation cannot be taxed and sales to the federal government are "thrown back." Under a throwback rule, these sales are assigned to the seller's location. Minnesota has not adopted a throwback rule. This favors businesses making sales from Minnesota to the federal government or to states where they can't be taxed, since it reduces their Minnesota tax. Minnesota's apportionment formula does not affect the tax owed to another state, in any case.

Minnesota uses combined reporting for "complex" corporations

Special rules apply to complex corporations (i.e., those with multiple corporations, such parent-subsidiary corporations). If these corporations are part of a "unitary business," Minnesota requires them to file a combined report. Under combined reporting, each corporation in the unitary group calculates its tax using the total income of the unitary group and its own factors as the numerator and the total group's factors as the denominator. Under a 2013 change, sales made by domestic corporations that are part of the unitary group, but that do not have Minnesota nexus, must be included in the numerator of a corporation with nexus.

Combined reporting prevents most transactions among related corporations in the unitary group from affecting the tax liability of the group. In effect, the apportionment formula divides the unitary business's income among the states without regard to how the business allocates the income among its various corporate entities.

Formula apportionment has important economic effects

Public finance economists generally agree that apportionment formulas are a very important feature of state corporate taxes. They essentially make the tax the same as a tax directly on the factors. For example, the tax on the portion of income assigned using the sales factor is similar, in economic effect, to a sales tax. This affects both:

- the incidence of the tax (i.e., who bears the real burden of the tax); and
- the incentive effects of the tax (i.e., the impact of the tax on behavior).

Incidence effects vary by factor weights

Following conventional economic theory, the portion of the tax that is apportioned by sales will be a tax on consumption or consumers, similar to a sales tax. The portion on payroll is a tax on labor income and the portion on property falls on capital. (Caveat: Capital is mobile; it can move between states. In the long run, a state cannot increase the portion of the tax on capital much beyond the average imposed by other states. If it does, capital will flow to other states where higher rates of return are available.)

Minnesota is phasing in single sales apportionment to encourage in-state investment

Weighting sales more heavily generally encourages export businesses. Since sales are assigned to the buyer's location and there is no throwback rule, export or non-Minnesota sales will reduce the amount of income taxable by Minnesota. Thus, increasing the weight for sales creates an incentive for companies to invest in Minnesota property or to hire more employees to sell products outside of Minnesota. The property and payroll factors, by contrast, would assign more income to Minnesota, increasing the tax, because the investment increases Minnesota property and payroll. It was following this logic that the legislature provided for a gradual shift of apportionment to relying only on sales. Apportionment based only on sales will become effective for tax year 2014.

Other states are also adopting single sales apportionment

After the U.S. Supreme Court ruled sales-only apportionment was valid in 1978, many states increased their reliance on the sales factor because of these incentive effects.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publications *Single Sales Apportionment of Corporate Franchise Tax,* July 2013, and *Corporate Franchise Taxation*, July 2013.

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

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Danyell Punelli

Revised: July 2013

Minnesota Family Investment Program

The Minnesota Family Investment Program (MFIP) is a jointly funded, federal-state program that provides income assistance to eligible low-income families. MFIP is the state's response to the 1996 federal welfare reform law, which replaced the Aid to Families with Dependent Children (AFDC) program with Temporary Assistance for Needy Families (TANF), a block grant program to states.

Who is eligible for MFIP?

A family must have income and assets below the program's limits. The income limit increases with family size. Families do not exit MFIP until their income reaches 115 percent of the federal poverty guidelines (FPG). The 2013 FPG for a family of three is $19,530 (115 percent of FPG for a family of three equals $22,460). Assets are limited to $2,000 for MFIP applicants and $5,000 for ongoing recipients, excluding certain items. In addition, families must meet the following eligibility requirements:

- have a minor child in the home (or be pregnant)
- be residents of Minnesota
- be U.S. citizens, qualified noncitizens, or noncitizens otherwise lawfully residing in the United States
- assign rights to child support to the state
- have received fewer than 60 months assistance total from any state
- satisfy any other eligibility requirements of the program

Families are subject to a *lifetime limit of 60 months of assistance*. Some families may be eligible for assistance extensions past the 60-month limit if they meet specific criteria for one of the following extension categories: ill or incapacitated, hard-to-employ, and employed participants.

MFIP participants may be eligible for other benefits such as child care assistance and Medical Assistance.

How much are monthly benefits?

The MFIP grant is based on a transitional standard that increases with family size. For example, a family of three's monthly benefit in 2013 is currently $1,005; a family of four's benefit is $1,225. For families without earnings, the monthly grant equals the transitional standard. For families with earnings, the monthly grant equals the "family wage level" (110 percent of the transitional standard minus the family's net earned income). The MFIP grant is composed of a cash portion and a food portion, both of which are issued by counties in electronic debit card form.

What are the work requirements?

MFIP caregivers (i.e., persons who live with and provide care and support to minor children) are required to spend a specified number of hours every week engaged in work or work activities. Examples of acceptable activities include job search

activities, unsubsidized employment, and on-the-job training.

Employment plans must be tailored to recognize the special circumstances of MFIP participants who meet certain criteria, such as being over age 60, being ill or incapacitated, caring for a disabled child, or being the victim of family violence.

Postsecondary education is not routinely available to MFIP caregivers. Job counselors may approve postsecondary education only when the education program meets specific MFIP criteria.

Special requirements exist for *caregivers under age 20*. In most cases, education is the first priority for teen MFIP participants.

How do sanctions work?

MFIP participants who do not meet the program requirements may be sanctioned through reduction of their monthly grant. Sanctions last until one month after a participant comes into compliance. An MFIP case must be closed after the seventh occurrence of noncompliance.

What are MFIP's funding streams and expenditures?

MFIP is funded with a combination of federal funds and state appropriations. Minnesota received approximately $268 million annually in TANF block grant funding in federal fiscal years 1998 to 2013 (this amount is subject to federal reauthorization). In addition, federal law includes a maintenance of effort (MOE) provision that requires a state to spend 75 percent to 80 percent of the amount it spent in 1994 under its old AFDC and related programs to assist needy families. In fiscal year 2013, the state's required MOE amount was $176.7 million per year. The MOE requirement is met through state spending on programs such as MFIP, child care assistance, and the working family tax credit. TANF is used for MFIP and a variety of other programs that assist low-income families.

According to the Department of Human Services, for state fiscal year 2012, total expenditures were $167.5 million for the cash portion and $166.1 million for the food portion of the MFIP grants. In terms of funding, $72.1 million was financed with federal TANF funds, $165.4 million was from federal Supplemental Nutrition Assistance Program funds, and $96.1 million was from state appropriations.

How many families receive MFIP?

In fiscal year 2013, in an average month an estimated 40,521 families and a total of 110,761 participants were receiving MFIP assistance.

For more information: See the House Research publication *Minnesota Family Assistance*, November 2012, and the following Short Subjects: *Minnesota Family Investment Program Time Limit Exemptions and Extensions,* July 2004, and *MFIP Cases Reaching the 60-Month Time Limit,* July 2009.

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

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HOUSE RESEARCH | Short Subjects

Danyell Punelli

Updated: July 2013

Child Care Assistance

What is child care assistance?

Child care assistance programs subsidize the child care expenses of eligible low-income families. The Minnesota Department of Human Services administers two child care assistance programs: Minnesota Family Investment Program (MFIP) child care assistance and Basic Sliding Fee (BSF) child care assistance. MFIP child care subsidizes the child care costs of families receiving cash assistance through MFIP and provides child care assistance for eligible families for the first 12 months after the family leaves MFIP cash assistance (transition year child care). BSF child care provides a child care subsidy to low-income working families who are not receiving cash assistance from MFIP.

What are the eligibility requirements for child care assistance?

To be eligible for child care assistance, both parents (or one parent in single-parent households) must participate in an authorized work, education, or training activity, cooperate with child support enforcement, and meet income eligibility guidelines. The maximum income limit to be eligible for child care assistance is 47 percent of state median income at program entry and 67 percent or less of state median income at program exit. (For fiscal year 2013, 47 percent of state median income was $33,786, and 67 percent of state median income was $48,163 for a family of three.)

Children up to age 12 are eligible for child care assistance (up to age 14 for disabled children). During fiscal year 2012, there were an average of 1.81 children per family receiving MFIP child care assistance and 1.79 children per family receiving BSF child care assistance.

County agencies or their contractors must determine eligibility within 30 days of receiving a request for child care assistance. Direct reimbursement is the only method of receiving child care assistance.

What is the average annual subsidy a family receives?

In fiscal year 2013, the estimated average annual subsidy for a family receiving MFIP child care assistance was $13,275, and the estimated average annual subsidy for a family receiving BSF child care assistance was $9,890.

Maximum reimbursement rates paid for child care assistance are set by the legislature. However, maximum provider reimbursement rates have been frozen since 2003, with only a couple of increases since that time. The 2011 Legislature decreased provider reimbursement rates by 2.5 percent, effective October 31, 2011. The 2013 Legislature modified reimbursement rates effective February 3, 2014, and created a provider rate differential for child care providers that hold a three- or four-star quality rating under the Parent Aware quality improvement and rating system.

Are families required to pay for some child care expenses?

There is a family co-payment requirement based on family size and income. The maximum family co-payment is about 14 percent of gross monthly income. Families with incomes below 75 percent of the federal poverty level are exempt from making co-payments ($14,648 and below for a family of three in 2013).

How is child care assistance funded?

The child care assistance programs receive funding from a variety of sources, including the federal Child Care Development Fund (CCDF), federal Temporary Assistance for Needy Families (TANF) funds, the state general fund, and county funds.

Total estimated fiscal year 2013 annual direct service payments are $116.0 million for MFIP and transition year child care and $99.1 million for BSF child care assistance.

How many families receive child care assistance?

During fiscal year 2013, an estimated average of 8,736 families received MFIP child care assistance and 10,022 families received BSF child care assistance per month.

Not all families who apply for child care assistance receive it. MFIP child care is a forecasted, fully funded program, while BSF child care receives a capped allocation. As of March 31, 2013, there were 6,290 families on the waiting list for BSF child care assistance.

What is the child care quality rating system?

Minnesota has a voluntary child care and early learning program quality rating system called Parent Aware. The rating system is currently only available in certain areas of the state, but will be available to parents and providers statewide by 2015.

What are some potential legislative issues?

During previous legislative sessions, there were several proposals to consolidate the child care assistance programs into one program to reduce administrative and program complexity. However, none of these proposals have been passed by the legislature. There may be future attempts to consolidate the child care assistance programs.

In recent years, there have been several attempts to increase maximum provider rates due to the rate freeze that has been in effect since 2003. Maximum reimbursement rates continue to be below the previous level of the 75th percentile for similar care in a county or region.

For more information: See the House Research publications *Funding to Support Child Care Assistance*, December 2011, and *Minnesota Family Assistance*, November 2012.

HOUSE RESEARCH | Short Subjects

Joel Michael Updated: August 2013

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

For deaths in 2013, 31 states impose neither estate nor inheritance 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. In 2001 Congress 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 no longer impose estate or inheritance taxes (31 states for deaths in 2013). Tennessee's inheritance tax is scheduled to be eliminated for 2016 deaths. Minnesota continues to impose an estate tax.

Inheritance and estate taxes differ in the base used to compute 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.

Twelve states and the District of Columbia impose only estate taxes

For decedents dying in calendar year 2012, 12 states (Connecticut, Delaware, Hawaii, Illinois, Maine, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and Washington) and the District of Columbia impose only estate taxes. Two of these states (Delaware and Hawaii) had allowed their taxes to expire after Congress repealed the federal credit for state death taxes, but reenacted the taxes in 2010. In 2013, North Carolina repealed its estate tax, effective for deaths after December 31, 2012.

Exemption amounts under the state estate taxes vary, ranging from $5.25 million (two states) to $675,000 (New Jersey). The most common amount is $1 million (five states, including Minnesota). Top rates range from 7 percent to 19 percent with most states, like Minnesota, imposing a top rate of 16 percent.

Five states impose only inheritance taxes

Five states (Iowa, Kentucky, Nebraska, Pennsylvania, and Tennessee) impose only inheritance taxes. In 2012, Tennessee repealed its tax, effective for deaths after December 31, 2015. Indiana repealed its tax in 2013 effective for deaths after December 31, 2012.

The exemptions under state inheritance taxes vary greatly, ranging from $500 (Kentucky and New Jersey) for bequests to unrelated individuals to unlimited exemptions (Iowa and Kentucky) for bequests to lineal heirs, such as children or

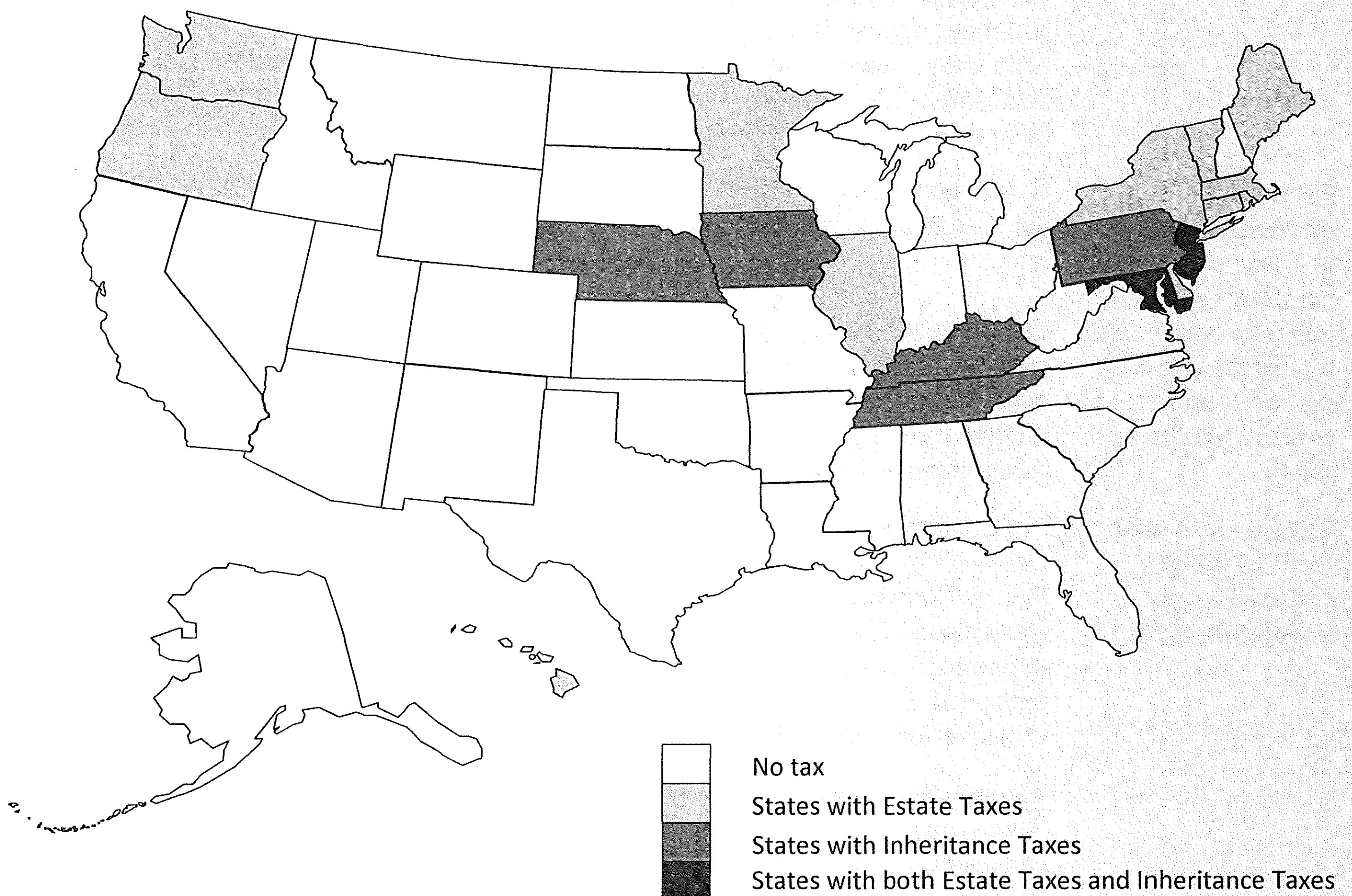
parents of the decedent. No states tax bequests to surviving spouses. Top tax rates range from 4.5 percent (Pennsylvania on lineal heirs) to 18 percent (Nebraska on collateral heirs). Tennessee's inheritance tax is calculated more like an estate tax (i.e., the tax does not vary based on the beneficiary).

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.

The map shows the states with estates and inheritance taxes for deaths in 2013.

State Estate and Inheritance Taxes



House Research Department

For more information: See the information brief *Survey of State Estate, Inheritance, and Gift Taxes*, December 2012.

HOUSE RESEARCH | Short Subjects

Joel Michael
Updated: August 2013

The Minnesota Estate Tax

The estate tax equals a percentage of the taxable estate

Minnesota imposes a tax on the estates of individuals who are residents of the state when they die or who own tangible property (typically real estate) in Minnesota when they die. The tax is imposed under a graduated rate schedule on the taxable estate. The taxable estate is generally the fair market value of the estate on the day the decedent died, less deductions (e.g., transfers to a surviving spouse and charitable bequests) and an exemption amount. *See the box for the exemption and rate amounts.*

Exemption Amount and Tax Rates

Exemption. The exemption amount is $1 million. Because transfers to surviving spouses are exempt, a $1 million exemption allows a married couple with a joint net worth of less than $2 million to avoid the tax if they structure transfers to trusts appropriately.

Tax rates. The tax rates range from 0.8 percent to 16 percent. The top rate applies to the amount of the taxable estate over $10,040,000. These rates are calculated on estate values over $40,000, not the $1 million exemption. Because no tax is due on estates of less than $1 million and because the tax cannot exceed the tax under pre-2001 federal law, some estates experience "marginal" rates (the rate of tax on increases in estate value) of up to 41 percent. However, average or effective rates can never exceed 16 percent.

The 2011 Legislature enacted an exclusion for qualifying small business property and farmland

Legislation passed in 2011 provided two special exclusions for qualifying small business property and homestead farmland, effective for decedents dying after June 30, 2011. (Legislation passed in 2013 significantly clarified the law.) The combined value of these exclusions cannot exceed $4 million, allowing a total exemption of $5 million when added to the basic $1 million exemption. The decedent or spouse must have owned the qualifying property for three years before the date of death and the heirs must continue to own and use the property in the business (or as a farm homestead for farm property) for three years after the date of death. Failure to do so triggers a recapture tax equal to 16 percent of the value of the property.

The Minnesota tax evolved as a creature of the federal estate tax

The rules under the estate tax are determined largely by reference to the rules under the federal estate tax. For the 16 years ending December 31, 2001, the Minnesota tax was directly linked to the federal estate tax as a "pickup" tax equal to the federal credit for state death taxes. As a pickup tax, the Minnesota tax imposed no additional tax burden on estates. Each dollar of state tax paid reduced federal tax by an equal amount. However, when Congress repealed the credit in 2001 (completely eliminating it for decedents dying after December 31, 2004), the legislature chose to continue imposing the estate tax under the rules in effect before the repeal of the federal credit. The 2013 Legislature also required gifts made within three years of death to be included in the estate; this only applies to gifts that must be reported under the federal gift tax (i.e., that are above the annual exemption, currently $14,000 indexed for inflation).

Few estates pay the tax; it is a progressive source of revenue

Fewer than 2 percent of estates pay the estate tax. The small number of estates paying tax results from the exemption amount and the fact that amounts left to surviving spouses are deductible. Decedents with taxable estates are, almost by definition, some of the most affluent individuals in the state. Most evidence also suggests that recipients of bequests from taxable estates also have above average income and assets. Based on Minnesota Department of Revenue's *Tax Incidence Study*, the tax is the most "progressive" source of state tax revenue.

The estate tax provides a modest, but volatile, source of general fund revenue

Revenues from the tax are deposited in the general fund. The Department of Management and Budget (February 2013 forecast) estimates that the tax will raise a little less than $170 million per year. *See the box for the last five years of collections.* Revenues from the tax are volatile, since they depend on the deaths of a few individuals. If one very wealthy individual dies, collections can soar. For example in August 2005, the Department of Revenue (DOR) received tax of $112 million from one estate (compared with estimated revenues for the year of $86 million and total collections of $73 million in the prior year). In other years, revenues may fall below estimates.

Estate Tax Revenues FY 2008-2012 (thousands)

Year	Revenue
2008	$115,498
2009	$130,196
2010	$148,977
2011	$161,202
2012	$165,277

Source: Minnesota Dept. of Revenue

DOR estimates that the 2013 addition of gifts made within three years of death will increase annual revenues by about $6 million.

Repeal of the federal credit creates an incentive for high net worth Minnesota residents to move to another state

The repeal of the federal credit creates an incentive for affluent, elderly Minnesotans to change their domiciles to a state without an estate tax. When Minnesota imposed only a pickup tax, the federal treasury bore the effective burden of the tax. As a result, Minnesota residents had no reason to change their domiciles to another state to avoid the tax. However, the 2001 repeal of the federal credit made the state tax a "real" tax that reduces the amount of property that can be left to heirs.

Affluent individuals may be willing to change their domiciles to avoid paying potentially multimillion-dollar state estate tax liabilities. The fact that many of these individuals have second homes in states without estate or inheritance taxes increases their ease of moving. Most states (31 in 2013) do not have estate or inheritance taxes. Several of these states also have no income tax (e.g., Florida, Nevada, South Dakota, and Texas), allowing individuals who change their domiciles to those states to avoid both taxes.

For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research short subject *Estate and Inheritance Taxation: An Overview of the States,* August 2013.

Colbey Sullivan and Nina Manzi Updated: August 2013

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of Minnesota Management and Budget (MMB) 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 2012 forecast provided the revenue and expenditure projections that the governor used in developing the budget for the fiscal year 2014-2015 biennium, which runs from July 1, 2013, to June 30, 2015. The November 2012 forecast also showed that the state was on track to finish the fiscal year 2012-2013 biennium with a balanced budget.

The February forecast modifies the preceding November's forecast with any new data that's available. The February 2013 forecast provided the revenue and expenditure projections that the legislature used in adopting a budget for the fiscal year 2014-2015 biennium. Following the February forecast, Governor Mark Dayton submitted modifications to the budget developed from the November forecast, which are called "supplemental budget recommendations." The February 2013 forecast also provided an update on the status of revenues and expenditures in the fiscal year 2012-2013 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 2013 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2014-2015 budget during the 2014 legislative session. The legislature will use the projections in the February 2014 forecast to ensure that the fiscal year 2014-2015 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 MMB 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 MMB must reduce allotments from that fund to avoid a deficit. As with general fund shortfalls, if the legislature is in session the governor would typically make recommendations to the legislature 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 MMB must allocate the surplus in priority order as provided in Minnesota Statutes, section 16A.152, subdivision 2:

1. to the cash flow account, until it reaches $350 million (currently satisfied)
2. to the budget reserve account, until it reaches $653 million (currently satisfied)
3. to increase the school aid payment schedule to 90 percent, in increments of one-tenth of 1 percent with any residual amount deposited in the budget reserve ($287 million outstanding)
4. to restore previous school aid reductions and reduce the property tax recognition shift accordingly ($587 million outstanding)
5. to restore the $15 million transferred in 2008 from the state airports fund to the general fund ($15 million outstanding)

If all these priorities have been met, the remaining surplus is reported in the forecast as a "positive unrestricted budgetary general fund balance."

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

What are recent uses of current biennium surpluses?

The November 2012 forecast projected a surplus of $1,330 million for the 2012-2013 biennium; $1,324 million was used to increase the school aid payment percentage from 64.3 percent to 82.5 percent, with the remaining $6 million deposited in the budget reserve. The February 2013 forecast projected an additional surplus of $295 million for the 2012-2013 biennium, with $290 million used to increase the school aid payment percentage to 86.4 percent, and the remaining $13 million deposited in the budget reserve.

Repayment priorities can change or be overriden in legislation. Laws 2013, chapter 116, provided for an accelerated increase of the school aid payment percentage, based on the forecasted balance for the 2012-2013 biennium at the close of fiscal year 2013, to be certified by the commissioner by September 30, 2013. As of July 2013, MMB has estimated the fiscal year 2013 surplus at $463 million. The actual balance, once certified, will reduce the $874 million outstanding education aid shift amount, and result in increased payments to schools several months sooner than would happen by waiting for the November 2013 forecast.

For more information: Contact legislative analyst Colbey Sullivan at 651-296-5047 or Nina Manzi at 651-296-5204. Also see the House Research publication *Unallotment: Executive Branch Power to Reduce Spending to Avoid a Deficit,* December 2010.

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HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: August 2013

Income Tax Terms: Deductions and Credits

What is a deduction?

A deduction reduces income tax liability by reducing taxable income. On the federal income tax return, taxpayers can claim various deductions that reduce adjusted gross income (sometimes called "above-the-line" deductions); taxpayers may also claim either the standard deduction or itemized deductions, which result in smaller federal taxable income.

Minnesota's income tax calculation starts with federal taxable income. On the state income tax return, taxpayers may claim various state deductions (sometimes called "subtractions"), which result in smaller state taxable income.

What federal deductions are allowed?

Businesses can deduct their ordinary and necessary expenses. In addition for tax year 2013, the federal income tax allows above-the-line deductions for various retirement account contributions, certain employee business expenses, student loan interest payments, Health Savings Account contributions, 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, higher education tuition, and educator classroom expenses. The federal income tax allows itemized deductions for state and local property taxes and either income or sales taxes, mortgage interest, charitable contributions, medical expenses in excess of 10 percent of income for taxpayers under age 65, and in excess of 7.5 percent for older taxpayers, casualty and theft losses in excess of 10 percent of income, and job expenses and miscellaneous expenses (most only allowed in excess of 2 percent of income).

What state subtractions are allowed?

Minnesota allows subtractions for K-12 dependent education expenses, most military pay, 50 percent of charitable contributions over $500 (for filers who do not claim federal itemized deductions only), up to $12,000 for low-income elderly and disabled taxpayers with low amounts of Social Security and nontaxable pensions, Job Opportunity Building Zone (JOBZ) income, organ donation expenses, gain on sale of farm property for insolvent taxpayers, foreign subnational income taxes, and national service education awards. Minnesota disallows the federal deductions for tuition and educator expenses.

Minnesota also allows subtractions for U.S. bond interest, railroad retirement benefits, and on-reservation earnings of enrolled tribal members, because federal law prohibits state taxation of these types of income.

Finally, Minnesota's income tax allows various subtractions to coordinate the calculation of taxable income with other features of the income tax. Minnesota requires itemizers to add back the amount of state income tax deducted at the federal level and allows a subtraction for amounts refunded in order to avoid twice

taxing the same income. Also, Minnesota does not conform to federal deductions for bonus depreciation, section 179 expensing, domestic production activities, income from the discharge of indebtedness, and net operating losses. Minnesota allows subtractions for amounts of these items that were included in Minnesota taxable income, but not federal taxable income, in earlier tax years.

How much are deductions worth?

The value of an income tax deduction equals the taxpayer's marginal rate times the amount of the deduction. A taxpayer whose income is too low to be subject to taxes does not benefit from a deduction, unless the law allows the unused deduction to be carried over to a later tax year.

In tax year 2013, federal marginal rates range from 10 percent to 39.6 percent, and state marginal rates from 5.35 percent to 9.85 percent. The graduated federal and state income tax rates make deductions worth more to high-income taxpayers than to low-income taxpayers. A taxpayer in the top federal and state brackets who claims a $1,000 deduction for moving expenses pays $396 less in federal taxes (39.6 percent of $1,000) and $98.50 less in state taxes (9.85 percent of $1,000). But a taxpayer in the bottom federal and state brackets who claims the same deduction pays $100 less in federal taxes (10 percent of $1,000), and $53.50 less in state taxes (5.35 percent of $1,000).

What is a credit?

Credits are subtracted directly from tax liability. Because credits are subtracted directly from liability, they are worth the same to all taxpayers with liability, regardless of income (i.e., it doesn't matter what tax rate bracket the taxpayer is in).

What is the difference between nonrefundable and refundable credits?

Nonrefundable credits only offset tax liability. Taxpayers with little or no tax liability do not benefit from nonrefundable tax credits.

Refundable credits, in contrast, fully benefit taxpayers regardless of their tax liability. For example, a taxpayer with $700 in tax liability who qualifies for a $1,000 refundable credit would receive a refund of $300. If the credit was nonrefundable, that taxpayer would only be able to "use" the $700 of the tax credit that offset liability.

What federal credits are allowed?

In tax year 2013, the federal income tax allows *nonrefundable* credits for foreign taxes paid, child and dependent care expenses, retirement contributions of low-income taxpayers, and residential energy efficient equipment. The federal income tax allows *refundable* credits for adoption expenses, certain health coverage expenses, and earned income of lower income filers. The federal child credit, for children age 17 and younger, and the American Opportunity credit, for post-secondary education expenses, are partially refundable.

What state credits are allowed?

In tax year 2013, Minnesota allows *nonrefundable* credits for marriage penalties resulting from the state's progressive rate structure (marriage credit), long-term care insurance premiums, and military retirement pay of low-income veterans. Minnesota also allows *refundable credits* for earned income of low-income filers (working family credit), dependent care expenses, and K-12 education expenses.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the income tax area on the House Research website for more information on tax credits.

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HOUSE RESEARCH | Short Subjects

Patrick McCormack Updated: August 2013

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 may be conducted by licensed establishments, nonprofits, and liquor stores

There are three statutorily acceptable methods for conducting a tasting:

(1) *Licensed establishments:* A bar, restaurant, taproom, or other holder of an on-sale intoxicating liquor license can hold a tasting as part of the normal operation of the establishment and would presumably charge a fee for either the event or each glass of wine, distilled spirits, or malt liquor served.

(2) *Nonprofits or charities:* A nonprofit or charity may conduct a tasting under section 340A.418. This section provides that:

- a wine or beer tasting is defined as an "event at which persons pay a fee or donation to participate, and are allowed to consume wine or malt liquor by the glass without paying a separate charge for each glass";
- these events can be no more than four hours in duration and receipts are to be dedicated to the charitable purpose;
- the charity or nonprofit must hold a temporary license or conduct the tasting on the premises of the holder of an existing on-sale license;
- no wine or malt liquor may be sold and no orders taken for off-premises consumption; and
- donations from and arrangements with wine or malt liquor wholesalers are permissible.

(3) *Exclusive liquor stores*: A broader range of tastings and classes may be held by an exclusive liquor store. These include tastings of wine, distilled spirits, and malt liquors. There are two ways that these stores can conduct such tastings:

- off-site, if those tastings are held at the premises of the holder of an on-sale license as specified under section 340A.419, subdivision 2, paragraph (a)
- on-site, if those tastings are held in classes conducted at the liquor store, under section 340A.419, subdivision 2, paragraph (f)

These tastings may not be accompanied by sales of the items, but may include the use of order forms where such items can be later purchased.

The existence of three separate methods of tastings, the differences in the kinds of liquor, and the ways that tastings can be conducted, may cause confusion. Local governments and the Department of Public Safety are the final arbiters of what tastings are allowable in a given jurisdiction.

Liquor stores, bars, licensed manufacturers, and farm wineries can offer 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)). In addition, breweries are allowed to open "taprooms," where beer brewed on the premises may be both sampled and served.

A number of off-sale licensees have begun to build both sampling and tastings into their business model, creating sampling stations open for multiple hours and days and conducting classes on- or off-site, with associated tastings. The law on tastings was clarified in 2012 to make such tastings legal (Minn. Stat. § 340A.419, subd. 2). This modification has the potential to change the nature of an off-sale business.

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 2008 law allows farm wineries to produce distilled spirits and to give 15-milliliter samples of each variety produced. A 2013 law allows microdistilleries to give samples of 15 milliliters per beverage, not to exceed 45 milliliters per visit.

Establishments can offer alcohol at 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. In addition, liquor stores and wine or malt liquor educators are allowed to conduct classes and serve alcohol at these classes.

Matt Burress Updated: August 2013

Municipal State-Aid Street System

The municipal state-aid street system is a collection of about 3,600 miles of key streets located in 147 Minnesota cities throughout the state. The system constitutes a bit under a quarter of all miles of city streets. Cities receive financial assistance from the state for construction and maintenance of those streets included in the system. Assistance comes from a portion of constitutionally dedicated, transportation-related taxes. Aid distribution is based on a statutory formula 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 2013 amount to $156.3 million.

Constitutional framework for 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 (with a portion of the latter dedicated to transit); (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 of each highway system. Minn. Const. art. XIV. State statutes further specify finance and policy provisions such as aid allocation formulas and requirements for cities to receive aid.

City eligibility based on population

For a city to be included in the state-aid system it must have a population over 5,000, a requirement under the Minnesota Constitution. Minn. Const. art. XIV, § 8. Population is determined by the last federal decennial census or most recent estimates. There are provisions for some special circumstances that include:

- an exception for Chisholm, whose population fell below the cutoff with the 2000 census but is permanently grandfathered in; and
- a four-year transition period of continued aid to a city that had been receiving assistance but whose population dropped below the cutoff in a census (which was established under a 2012 legislative change and applies to five cities for calendar years 2012-2015). Minn. Stat. § 162.09, subd. 4; Laws 2001, 1st spec. sess., ch. 8, art. 2, § 6; Laws 2002, ch. 364, § 29.

While smaller cities having a population under 5,000 are not eligible for aid from the MSAS fund, they are indirectly assisted through separate funding for 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.

Street system limitations

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 the

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.

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 future receipts. Apportionment amounts are released each January.

For calendar year 2013, total available MSAS funding is $156.3 million. Funds are distributed based on formulas and caps set in state law, consisting of:

- $149.4 million apportioned by formula as direct aid to cities;
- $3.1 million to an administrative account for MnDOT expenses in administering the state-aid program;
- $3.1 million to a disaster account for unforeseen events resulting in undue financial hardship; and
- $723,000 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:

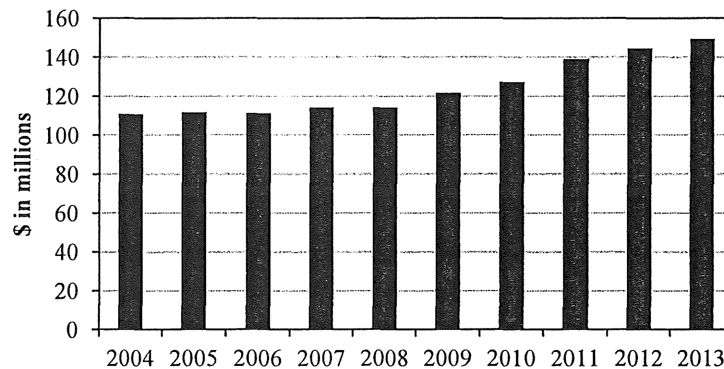
- **50 percent** is divided proportionally based on the population of each city (compared to the total for all municipal state-aid cities); and
- **50 percent** is divided proportionally based on the construction needs of each city, which is the amount the city needs to bring all its municipal state-aid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

Analysis of aid apportionment

Owing to the variety of cities with streets in the state-aid system, MSAS fund distributions vary. Calendar year 2013 direct aid apportionments to cities ranged from about $156,000 to nearly $13.6 million (and $25 to $87 on a per capita basis). The average was just over $1 million, with 54 cities receiving less than $500,000 a piece and 16 cities receiving over $2 million. Because of the weight of population in the aid formula, larger cities tend to receive greater allocations.

In recent years direct assistance has generally increased, as summarized below.

MSAS Direct Aid History
CY 2004-13



For more information: See the House Research publication *Highway Finance Overview*, January 2013.

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HOUSE RESEARCH | **Short Subjects**

Matt Burress **Updated: August 2013**

County State-Aid Highway System

System overview

The county state-aid highway system is a network of key highways under the jurisdiction of Minnesota's counties. It covers roughly 30,600 miles of roadway throughout all 87 counties, comprising over two-thirds of all county highway miles. Counties receive money from the state to assist in the construction, improvement, and maintenance of those highways included in the state-aid system.

Sources of revenue

State aid is provided through the County State-Aid Highway (CSAH) fund, which is established by the Minnesota Constitution. Revenue mainly comes from taxes on motor fuels, vehicle registration, vehicle sales, and vehicle leases. (This briefing does not discuss a CSAH fund "set-aside" that goes into town road, town bridge, and flexible highway accounts, some of which can also go 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 populations under 5,000. Minn. Stat. § 162.08, subd. 1. In general, the expenditure must 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 distributed by the Minnesota Department of Transportation (MnDOT) on a calendar-year basis. The amount is determined through a combination of actual tax receipts and estimated receipts. Total available funding is $519.1 million in calendar year 2013.

A portion is set aside for county highway-related purposes following statutory requirements. The deductions consist of: (1) MnDOT administrative costs, (2) a disaster account, (3) a research account, and (4) a state park roads account. Minn. Stat. § 162.06. Deductions for 2013 are $21.0 million, or 4.1 percent of total funding.

Direct aid in calendar year 2013 is $483.1 million. It is divided into two categories reflecting distinct revenue streams: the **apportionment sum** and the **excess sum**. Aid within each category is distributed through similar but separate statutory formulas. Minn. Stat. § 162.07.

Apportionment sum revenue and distribution formula

The apportionment sum revenue consists of available CSAH fund dollars for direct aid 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 a county's lane-miles in the system; 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 comprises additional revenue from a motor fuels tax increase enacted 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 in 2008)
- 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 that phased in for transportation purposes over fiscal years 2008-2012). Minn. Stat. § 162.07, subd. 1a.

Excess sum distribution formula

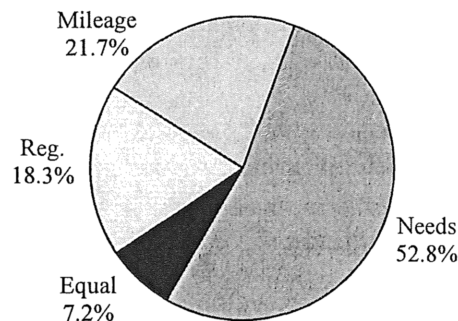
The formula distributes (1) 40 percent of the excess sum in proportion to each county's share of the total number of motor vehicles registered, and (2) 60 percent in proportion to each county's share of construction needs. Minn. Stat. § 162.07.

Analysis of formulas

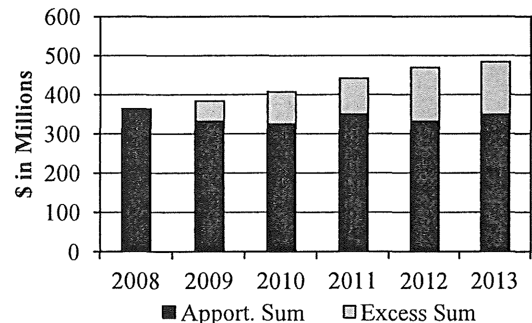
The excess sum was established as a second allocation formula in 2008 as part of legislation that increased funding for transportation purposes. Laws 2008, ch. 152. It was designed to address equity concerns in the statewide distribution of aid.

For 2013, the excess sum is $133.9 million or around 28 percent of the formula-based direct aid provided to counties (that is, excluding deductions). The portion of direct aid distributed via the excess sum formula has been increasing since it was introduced. (Note that the 2012 excess sum amount contains additional funds to correct a 2011 allocation that was too low.)

Direct Aid Components
CY 2013 ($483.1 million)



Historical Direct Aid
CY 2008-13



Motor vehicle lease tax

Also under 2008 legislation, a portion of revenue from a sales tax on motor vehicle leases is allocated to counties in the Twin Cities metropolitan area—excluding Hennepin and Ramsey. The formula-based distribution is proportional to the population of each county. Minn. Stat. § 297A.815. Funds in calendar year 2013 totaled $15.0 million. A change enacted in 2013 limits the counties to $9 million per year for the 2014 and 2015 distributions, with the additional revenue shifted to Greater Minnesota transit purposes.

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

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HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff **August 2013**

Aggregate Tax

Counties may impose aggregate taxes

Minnesota law authorizes counties to impose taxes on aggregate mined in the county. These taxes are often referred to as "gravel taxes." By law, the proceeds of the taxes (net of collection costs) are used for transportation and restoration of the mine sites.

Aggregate material includes a number of nonmetallic substances

For purposes of taxation, aggregate material is defined as a number of nonmetallic substances that include silica sand, gravel, limestone, and granite. Taconite tailings and some other material removed from taconite mines are also included in this category. This material must be measured or weighed after it has been extracted to determine the appropriate tax.

Thirty-five counties and a few towns impose aggregate taxes

Minnesota law explicitly authorizes 28 counties to impose aggregate taxes. Of these counties, all but four (i.e., 24 counties) imposed the tax in 2011. Of the expressly authorized counties Carlton, Mahnomen, Murray, and Pope did not impose the tax. The law also authorizes any other county to impose the tax, by vote of its board, after holding a public hearing and notifying the commissioner of revenue. Eleven counties impose the tax through this method. Thus, 35 counties imposed the tax in 2011. The map on the next page shows the counties. Special laws also authorize a few towns in St. Louis and Ottertail counties to impose aggregate taxes, as long as the county does not impose the tax.

The tax is imposed on the amount of aggregate excavated

State law sets the rate of the tax at 21.5 cents per cubic yard or 15 cents per ton; counties do not have discretion to set a lower rate. The tax is imposed when the material is taken from the extraction site or sold. If the aggregate is stored in a stockpile without being transferred on a public road, the tax is imposed either when the aggregate is sold, when transported from the stockpile site, or when it is used from the stockpile, whichever comes first.

A county board may exempt an operator that removed less than 20,000 tons or 14,000 cubic yards in the previous year.

The law limits the tax rate a county can impose to ten cents per cubic yard or seven cents per cubic ton, if the county borders two states and is not contiguous to a county imposing an aggregate tax. This limit expires on December 31, 2014, and currently applies to Rock County.

The taxes are apportioned among counties

If aggregate material is transported outside the county via a waterway, railway, or any other means besides a public road, the tax is to be apportioned equally between the county where the material is extracted and the county where the material is imported. If the receiving county is not in Minnesota, the county where the material was extracted receives the full amount of the tax.

Other fees are prohibited

A county, city, or town that receives aggregate tax proceeds is prohibited from imposing any additional host community fees on aggregate production.

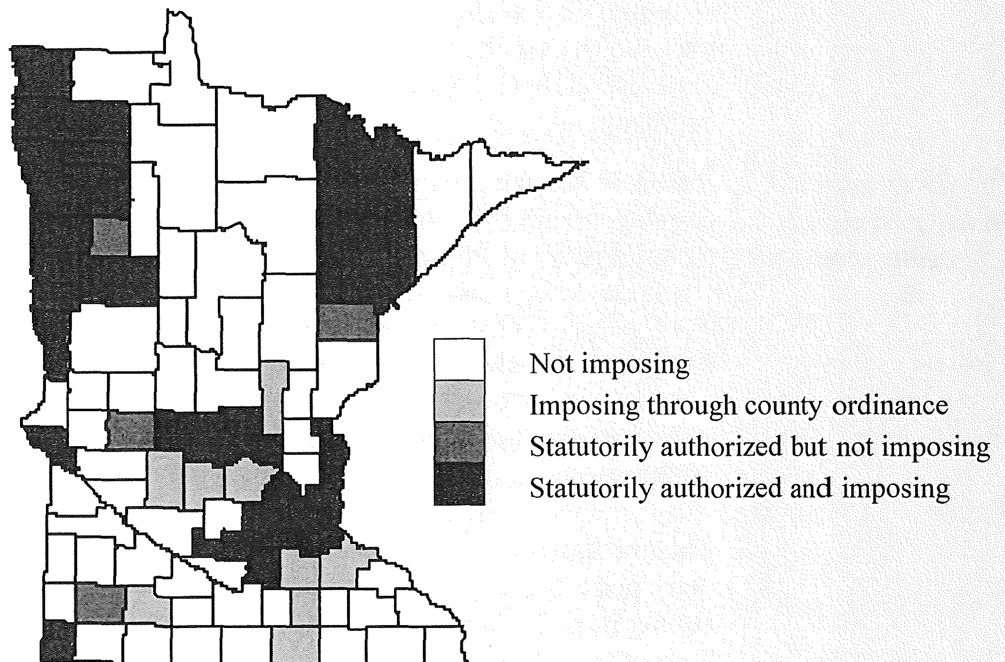
Proceeds of the tax are used for various purposes; about $5.7 million in revenues were collected in CY 2011

State law specifies how the revenues from the tax are to be used. The taxes are deposited into the county treasury and must be spent as follows:

- The county auditor may retain up to 5 percent of the total revenues as an administrative fee for administering the tax
- 42.5 percent of the remaining amount must be added to the county road and bridge fund for expenditure in maintenance, construction, and reconstruction of roads, highways, and bridges
- 42.5 percent of the remaining amount must be deposited in the general fund of the city or town in which the mine is located, or to the county where the mine is located in an unorganized town, to be expended for maintenance, construction, and reconstruction of roads, highways, and bridges
- 15 percent of the remaining funds must be put into a special reserve fund that is established for expenditures made related to the restoration of abandoned pits, quarries, or deposits located within the county

The Department of Revenue reports that $5.7 million in aggregate taxes were collected in calendar year 2011.

Counties Imposing Aggregate Taxes



For more information: Contact legislative analyst Andrew Biggerstaff at andrew.biggerstaff@house.mn.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi

Updated: August 2013

The Federal Child Tax Credit

What is the federal child tax credit?

Parents may claim a credit against federal income tax equal to $1,000 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 beginning in 2003. Like many provisions of EGTRRA, the expansion of the credit was scheduled to sunset after 2010, at which time it would have reverted to the $500 per child amount in effect in 1999. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUIRJCA) extended the $1,000 per-child amount through 2012, and the American Taxpayer Relief Act (ATRA) of 2012 made the $1,000 per child amount permanent.

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 exceeds $149,000; a single parent claiming the credit for one child will become ineligible when income exceeds $94,000.

Is the credit refundable?

The child credit is partly refundable; the refundable portion is referred to as the "additional child tax credit." In tax years 2009 through 2017, the additional child tax credit equals 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 $220 in 2013. They use $220 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 $220 as an offset to their tax liability and are paid the remaining $1,780 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:

- 15 percent 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 2001 law set the minimum amount at $10,000 and provided for it to increase annually for inflation; ATRA made the $10,000 as indexed for inflation permanent. The American Recovery and Reinvestment Act of 2009 temporarily reduced the indexed $10,000 to $3,000, not adjusted for inflation, for tax years 2009 and 2010 only; TRUIRJCA and ATRA extended the $3,000 threshold through 2017.

How much do Minnesotans claim?

In tax year 2011, 424,296 federal income tax returns filed by Minnesotans claimed $574 million in the nonrefundable portion of the federal child credit. The average amount claimed was $1,352. For the same year, 253,191 returns filed by Minnesotans claimed $348 million under the refundable additional child credit. Some of these returns also claimed the nonrefundable portion of the credit. The average additional child tax credit was $1,374.

How does Minnesota compare with other states?

Nationwide, 15.8 percent of all income tax returns claimed the child credit, compared with 16.3 percent in Minnesota. The average amount claimed nationwide was $1,208, compared with $1,352 in Minnesota. Since the credit is only partly refundable, the larger average amount claimed on Minnesota returns may result from Minnesotans having above-average incomes, and consequently more federal liability available to be offset by the child credit.

What is the effect of ATRA on Minnesota recipients of the federal child credit?

Some provisions extended by ATRA will expire after tax year 2017, including the provision that decreased the earned income threshold from $10,000, indexed for inflation since 2001, to $3,000, not adjusted for inflation.

Unless Congress extends this provision beyond 2017, in 2018 the portion of the credit that is refundable will revert to being the greater of:

- 15 percent of earned income over $10,000, indexed for inflation since 2001, or,
- for families with three or more children, payroll taxes in excess of the federal earned income tax credit.

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

HOUSE RESEARCH | **Short Subjects**

Bob Eleff

August 2013

2013 Solar Energy Legislation in Minnesota

In 2013, the Minnesota Legislature enacted a bill that contained several provisions designed to promote the growth of solar energy (Laws 2013, ch. 85). These provisions are summarized below.

1.5 Percent Solar Energy Standard for Public Utilities

Minn. Stat. § 216B.1691, subd. 2f. A new law requires Minnesota's public utilities to generate or procure sufficient electricity from solar sources so that by the end of 2020, at least 1.5 percent of the utility's retail electricity sales in the state are produced from solar energy. (In computing its standard, a utility must exclude retail sales to iron mining and processing facilities, paper mills, sawmills, and wood product manufacturers.) At least 10 percent of this energy must be generated by facilities with a capacity of 20 kilowatts or less. Public utilities must comply with this solar standard in addition to fulfilling the existing Renewable Energy Standard, which requires that at least 20 percent of electricity sales originate from renewable energy sources by 2020, and 25 percent by 2025 (for Xcel Energy, these percentages are 25 and 30, respectively.).

The state's public utilities are Xcel Energy, Minnesota Power, Otter Tail Power, Alliant Energy Interstate Power and Light, and Northwestern Wisconsin Electric Company. These utilities collectively account for two-thirds of the state's retail electricity sales.

Analysts estimate that compliance with the standard will increase solar capacity in the state by a factor of 30 from 2013 levels.

Solar Energy May Be Reimbursed at a New "Value of Solar" Rate

Minn. Stat. § 216B.164, subd. 10. The 2013 legislation gives public utilities a new option for paying solar generators for electricity sold to the utility in excess of the generator's consumption. Prior to the new law, generators were reimbursed at a rate they selected, based on either the utility's avoided costs as set by the Minnesota Public Utilities Commission (PUC) or the utility's average retail rate. Under the new law, a utility may choose to pay generators a price that reflects the value that solar energy represents to the utility, incorporating savings that accrue from avoiding construction of new power plants and transmission lines, reducing transmission and distribution line losses, etc. The PUC will establish a generic method that public utilities must use to annually calculate this "value of solar" rate, which, for the first three years, cannot be below the utility's average retail rate.

Xcel Energy's Solar Incentive Program

Minn. Stat. § 116C.7792. Beginning in 2014, Xcel Energy, which accounts for approximately half of Minnesota's retail electricity sales, must provide $5 million in financial incentives annually for five years to promote the installation of solar energy systems in its service area. Eligible systems must have a capacity of 20 kilowatts or less that generate no more than 120 percent of the customer's onsite annual electricity consumption. The incentive is paid for a period of ten years.

Xcel Energy's Community Solar Garden Program

Minn. Stat. § 216B.1641. A community solar garden sells electricity generated from solar energy to subscribers who purchase a given portion of its output. It allows access to solar energy by renters and property owners lacking sufficient capital to install their own solar systems or whose property may be shaded or otherwise unsuitable for a solar installation.

Xcel Energy must submit a plan to operate a community solar garden program to the PUC by September 30, 2013. Programs are to begin operating no later than 180 days following the commission's approval of the plan. Other utilities may also submit plans.

A community solar garden may be owned by a utility or any other entity. All energy generated by the facility, whose capacity is limited to one megawatt, is sold to the utility at the value of solar rate for distribution to subscribers. Subscriptions must represent at least 200 watts of capacity and may not exceed 120 percent of a subscriber's annual electricity consumption.

"Made in Minnesota" Solar Incentives

Photovoltaic (Minn. Stat. §§ 216C.411 to 216C.415). Beginning in 2014, $15 million annually for a period of ten years is allocated to owners who install solar photovoltaic devices with a capacity no greater than 40 kilowatts that have been certified by the Department of Commerce as manufactured in Minnesota. The incentive is financed from two sources: (1) each public utility annually contributes 5 percent of the minimum it is statutorily required to spend on energy conservation programs; and (2) the balance comes from Xcel Energy's Renewable Development Fund (Minn. Stat. § 116C.779, subd. 1).

The amount of the per-kilowatt-hour-generated incentive for each type of Minnesota-made photovoltaic device is determined by the Department of Commerce based on several factors, including the performance of the device, and may be revised annually. Payments run for ten years and are to be split evenly between residential and commercial properties.

Thermal (Minn. Stat. § 216C.416). Beginning in 2014, approximately $250,000 annually for a period of ten years is allocated by the Department of Commerce for rebates to owners of residential and commercial buildings who install solar thermal systems manufactured in Minnesota to heat or cool air or water. Maximum rebates are the lesser of 25 percent of the installed cost of the system or $2,500, $5,000, or $25,000, for single family, multifamily, and commercial properties, respectively. Rebates are to be allocated evenly between projects heating or cooling air and water. The rebates are funded from the incentive account established above for "Made in Minnesota" photovoltaic projects.

For more information: Contact legislative analyst Bob Eleff at 651-296-8961.

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HOUSE RESEARCH | Short Subjects

Danyell Punelli Updated: August 2013

MFIP Cases Reaching the 60-Month Time Limit

In 1996, the federal government reformed the welfare system with the Personal Responsibility and Work Opportunity Reconciliation Act. Included in the reform were 60-month time-limited benefits. The first cases reached these limits in 2002. This short subject summarizes data provided by the Minnesota Department of Human Services about the cases that have reached the time limit since 2002.

Cases reaching the 60-month time limit

As of December 2011, 17,044 Minnesota cases reached their 60-month time limit on or before that month.

- 71 percent of those cases were subsequently closed and ineligible for Minnesota Family Investment Program (MFIP) in December 2011
- 18 percent were granted an extension and received a cash portion of the grant
- 11 percent remained active on MFIP for other reasons, such as child-only cases, food-only cases, and cases using a banked month (child-only cases and food-only cases are not time limited)

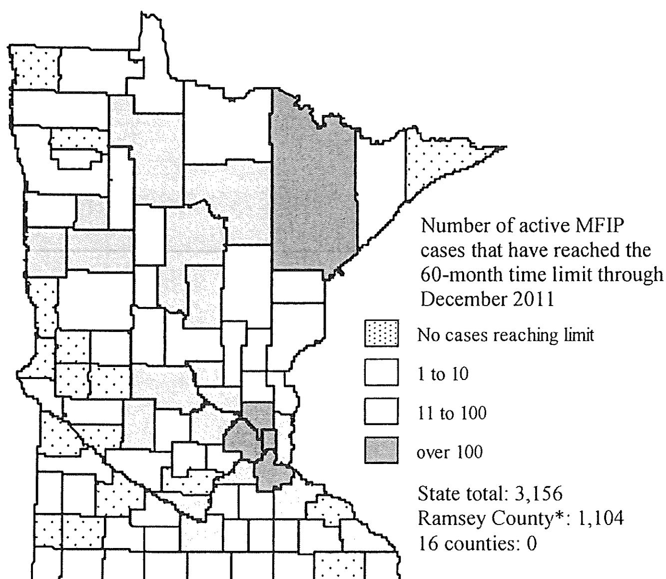
Who they are

Families reaching the 60-month time limit are more likely to be headed by an African American female who is 30 years of age or older, and families in which the family is eligible for family stabilization services.

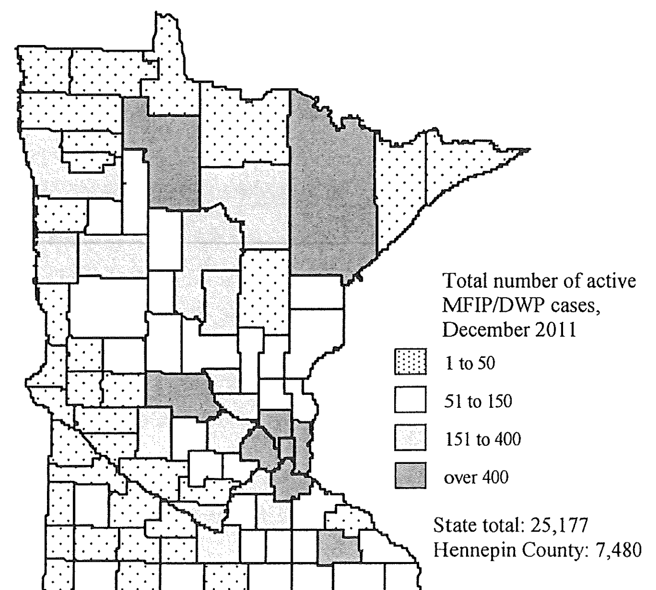
Where they live

Families living in Hennepin, Ramsey, and Anoka counties make up 74.9 percent of all cases that reached their 60-month time limit and were still active as of December 2011. Families living in these same three counties made up 56.9 percent of the total active MFIP and Diversionary Work Program (DWP) caseloads in December 2011.

Active MFIP Cases That Have Reached the 60-Month Time Limit Through December 2011



All Active MFIP and DWP Cases in December 2011



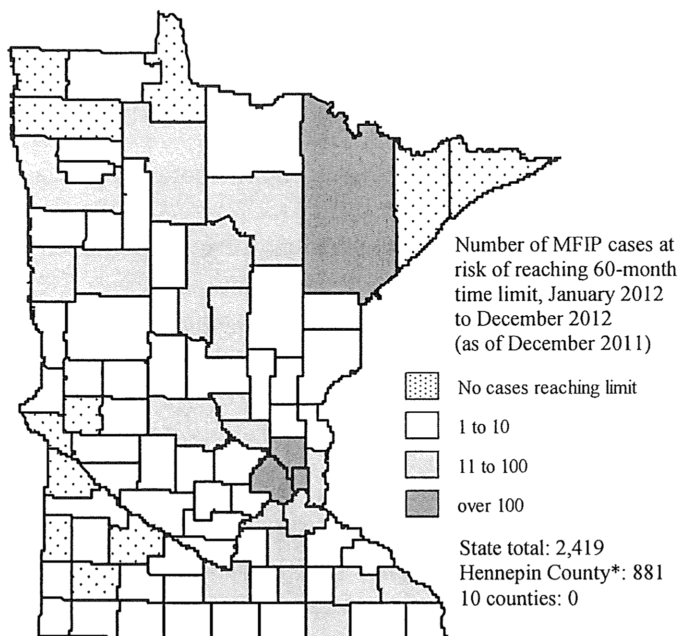
* Indicates county with the highest number of cases

Cases at risk of reaching the 60-month time limit by December 2012

There were 2,419 cases at risk of reaching the 60-month time limit by December 2012 (data through December 2011).

- 73.5 percent live in five counties within the state: Hennepin, Ramsey, St. Louis, Anoka, and Dakota
- 61.6 percent currently live in Hennepin or Ramsey County

Additional MFIP Cases at Risk of Reaching the 60-Month Time Limit by December 2012



* Indicates county with the highest number of cases

Data source: The data is from the Minnesota Department of Human Services (DHS). Parents at risk of reaching the 60-month time limit include all cases eligible since August 1997. These are the number of cases that have used over 48 months of their 60-month limit as of December 2011. This does not include any families that migrate into the state in future months with prior Temporary Assistance to Needy Families (TANF) months that will be counted toward the 60-month limit. The cases at risk of reaching the 60-month time limit are likely greater than the number of families that will reach the limit. Some of these families will leave welfare without using up all of their eligibility. Some parents may receive extensions. Still other parents will move into or leave the state. Parents entering the state may reach their welfare 60-month limit before December 2012 because of the number of months spent on TANF elsewhere.

For more information: Contact legislative analyst Danyell Punelli at 651-296-5058. Also see the House Research publications *Identifying Who Might Be Subject to the 60-Month Time Limit*, November 1999; *TANF Background*, January 2007; *The 60-Month Time Limit on TANF Assistance*, January 2002; *Factors Contributing to Longer Stays on Welfare: A Literature Review*, March 2002. See also the Minnesota DHS report *At the Time Limit: December 2007 Minnesota Family Investment Program Cases that Reached the 60-month Time Limit* (http://edocs.dhs.state.mn.us/lfserver/legacy/DHS-5092C-eng).

HOUSE RESEARCH | **Short Subjects**

Nina Manzi & Danyell Punelli **Updated: September 2013**

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 2011, Department of Revenue reports that 60,995 Minnesota returns claimed the credit. This is 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 2011, Minnesotans claimed $8.49 million of long-term care insurance credits. The average long-term care tax credit was $139 in tax year 2011. 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?

The following table includes all states that offered a long-term care insurance tax credit in 2011, 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 2011, and was provided by staff at state revenue departments and legislative offices.

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.

	Maximum credit	Credit rate*	Number of returns claiming the credit	Cost to the state for the credit
Colorado[1]	$150	25%	18,479 (est.)	$3.7 million (est.)
Maryland[2]	Varies by age: $320-$500	100%	5,729	$3.3 million
Minnesota	$100	25%	60,995	$8.49 million
Mississippi	$500	25%	2,500 (est.)	$1 million (est.)
Montana[3]	$5,000	Varies by income: 20% to 30%		
New York	None	20%	135,000	$75.3 million
North Carolina[4]	$350	15%	29,055 (est.)	$5.8 million
North Dakota[5]	$250	100%		
Oregon	$500	15%	34,450	$7.9 million
Virginia[6]	None	15%	3,939	$1.1 million

* The credit rate is the percentage of premiums allowed as a credit.
[1] Colorado's credit is income-limited; the maximum for joint filers is $150 per spouse.
[2] Maryland's credit can be claimed only once per person.
[3] 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.
[4] Data are for tax year 2010. North Carolina's credit is income-limited.
[5] North Dakota's credit is limited to long-term care plans that meet consumer protection criteria and provide inflation protection.
[6] Virginia's credit applies only to the first 12 months of premiums paid.

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House Research | **Short Subjects**

Joel Michael and Nina Manzi **Updated: September 2013**

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 credit took effect for tax year 2010 and expires 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 worth of at least $1 million (excluding the value of their homes) or annual income of at least $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 a small corporation exempt from registration may apply up to 30 days after making the investment. Investors (either individuals or funds) 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?

The credit only applies to investments in a qualifying small business that DEED certifies:

- Has its headquarters and 51 percent of its employees and payroll in Minnesota;
- Is engaged in a specified field of business involving proprietary technology or product;
- Has fewer than 25 employees;
- Pays most of its employees wages equal to at least 175 percent of the federal poverty guideline for a family of four;
- Has not been in operation for more than ten years (20 years for businesses

developing drugs or medical devices that require FDA approval); and
- Has not received more than $2 million in private equity investment.

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;
- Satisfy minimums of either $10,000 (individuals) 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.

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.

Has the demand for credits exceeded the limits?

Credit applications for tax year 2010 were about $4 million less than the limit. Under the law, the $4 million in unused credits carried over to tax year 2011. Applications for tax years 2011 through 2013 used up the full allocations and amount carried over before the end of the year, requiring DEED to reject applicants in all three years.

How many businesses and individuals benefited from the credits?

Calendar year:	2010	2011	2012
Number of businesses	67	113	117
Number in metro area	62	102	109
Percentage of $ in metro area	94%	80%	95%
Number of investors	267	758	656

The number of investors shown includes those investing via funds.

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. In addition, investors or funds that do not maintain their investment in the small business for at least three years must repay the credit.

What reporting requirements apply?

Investors, funds, and small businesses must annually report to DEED on their compliance with the law. DEED annually reports to the legislature. The law requires 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/Tax_Credits/Angel_Tax_Credit.aspx.

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 **September 2013**

Minnesota Research and Development Tax Credit

What is the Minnesota research and development credit?

Minnesota allows businesses conducting research and development to claim research credits against their corporate franchise taxes or individual income taxes (for pass-through tax entities, such as LLCs and S corporations). The credit's computations are based on definitions under the federal tax credit for increasing research activities, except the research must be done in Minnesota.

What is the policy rationale for the research credit?

There are two basic rationales for research credits:

- It is widely recognized that businesses under-invest in research and development, because some of benefits of research go to society generally and cannot be captured solely for the business and its owners. Others can copy or build on their research, siphoning off some of the benefit. Research credits, including the federal and Minnesota credits, are intended to help overcome this barrier by compensating for it and by providing incentives to do qualifying research.

- State credits, such as Minnesota's, have a general "economic development" purpose—that is, they also seek to encourage businesses to do more research in Minnesota to create jobs and other economic benefits for Minnesota residents. The credits help the state to compete for research investment by businesses. Some published academic research supports the view that state credits help to achieve this end.

What types of research expenses qualify?

Under the federal definition used by Minnesota, "qualifying research expenses" must be made to discover technological information that is applied to develop a new or improved business component (e.g., a product or process). The expenditures could be intended to improve quality, performance, reliability or similar. The expenditures typically are for wages of the business's employees, supplies purchased, or amounts paid to contractors to do research for the business. Expenditures on equipment do not qualify, but instead qualify for separate expensing benefits under federal and state tax law.

Is the credit incremental?

The federal definition of "qualified research expenses" is limited to the *increase* in research expenditures over a "base amount," making the credit an "incremental" credit. This base amount is expressed as a percentage of the business's gross receipts (Minnesota gross receipts for the Minnesota credit). The percentage is determined for each business based on the percentage its research spending was of its 1984-1988 gross receipts (for the businesses starting up after 1988, 3 percent is used) with a maximum of 16 percent. This incremental credit structure is intended to make the credit more cost effective in stimulating research by disallowing the

credit for the normal or basic research the business would otherwise do. For example, a business whose research is a constant percentage of its gross receipts would not be allowed the credit, because it had not increased its research "effort." However, the credit cannot exceed 50 percent of the business's research and many businesses' credits are determined under that rule, because their research is always well above their base amount. This typically occurs for Minnesota-based multistate businesses, because their base amounts are calculated using Minnesota gross receipts, a relatively low amount, while their Minnesota research often relates to their entire operations. Since these businesses qualify for a credit based on 50 percent of their research spending, their credits are really not incremental or dependent on increasing the relative amount of their research.

How is the credit computed?

The Minnesota credit has a two-tiered rate structure; a higher rate (10 percent) applies to the first $2 million of Minnesota qualified research expenses and a lower rate (2.5 percent) for the amount over that.

Is the credit refundable?

The credit is not refundable; it cannot exceed the liability for tax. (For three tax years, 2010 through 2012, the credit was refundable.) However, a unitary business (that is, a business with two or more corporations or other entities that are part of one business), may allocate the credit among its individual corporations to fully use the credit. If the credit still exceeds the liability for tax, it can be carried over and used to reduce taxes in later tax years (for up to 15 tax years).

How much does the credit reduce tax revenues?

The Minnesota Department of Revenue's (DOR) *Tax Expenditure Budget* (February 2012) estimated that for fiscal year 2014, $63.6 million in corporate franchise tax credits would be allowed and $8 million in individual income tax credits. These estimates do not, however, reflect the 2013 Legislature's repeal of the refundability of the credit. As a result, new estimates for the 2014 edition of the *Tax Expenditure Budget* are likely to be substantially lower. During the legislative session, DOR estimated that repeal of refundability would increase tax revenue by nearly $40 million per year.

How does Minnesota's credit compare to credits in other states?

Minnesota was the first state to enact a research and development credit in 1981. Most states with corporate taxes now have credits for some types of research expenditures. These credits vary considerably and it is difficult to generalize about them. Some states, like Minnesota, follow the basic federal credit. Other states use different—both more expansive or narrower—definitions of the types of research that qualify for their credits. Some states target their credits to specific types of businesses (e.g., high technology companies), while others follow the alternative, as well as the basic, federal research credit rules. Several states have credit rates that are higher than Minnesota's first tier (10 percent) rate and most allow rates higher than second tier (2.5 percent) rate. Finally, some state credits are not incremental, but rather apply to all qualifying research done in the state.

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HOUSE RESEARCH | Short Subjects

Andrew Biggerstaff

September 2013

Online Gambling: Federal Law

Federal law limits state authority over online gambling

Internet gambling has been historically regulated at the federal level. A number of overlapping federal laws restrict states' abilities to authorize and conduct Internet gambling operations. In April 2011, the U.S. Department of Justice (DOJ) shut down a number of Internet poker sites, asserting that these sites violated one of these federal laws, the Wire Act. However, later that same year, DOJ issued a memorandum opinion (discussed below) opining that some forms of Internet gambling do not violate the Wire Act.

Wire Act applies to telecommunication use for gambling

Originally passed to police illegal bookmaking operations associated with organized crime syndicates, the Wire Act was also used to prosecute online gambling operations. 18 U.S.C. § 1084. The law is focused on the use of interstate communications for the purpose of placing wagers.

Professional and Amateur Sports Protection Act governs sports betting

The Professional and Amateur Sports Protection Act is a complementary federal law aimed at ensuring the integrity of professional and collegiate sporting events by prohibiting states from authorizing wagering on those events. 28 U.S.C. § 3701-04. When the bill was under consideration by Congress, a handful of states already had sports wagering systems set up. The law grandfathered in these states, allowing them to continue their activity. Because of this, the constitutionality of this law has been called into question. New Jersey, one of the states that was allowed to grandfather in its sports betting system chose not to at the time, but recently has passed a law seeking to establish sports wagering and has brought federal suit to determine if the law is constitutional.

Interstate Horse Racing Act permits some interstate wagers on horse racing

The Interstate Horse Racing Act regulates wagers on horse racing. 15 U.S.C. § 3001-07. It was amended in 2000 to expressly allow pari-mutuel wagers transmitted between states by the use of phone or other electronic media. This law requires both the bettor and the betting operator to be in states that authorize betting on horse races. The World Trade Organization found this law to discriminate against off-shore betting operators, and the DOJ has asserted that the Wire Act prohibits all cross-border horse racing, but has never taken enforcement action associated with this.

Unlawful Internet Gaming Enforcement Act regulates gambling-related payments

In 2006 Congress passed the Unlawful Internet Gaming Enforcement Act (UIGEA). 31 U.S.C. § 5361. This law was aimed at regulating the payment processes associated with gambling, rather than gambling itself. For instance, it requires the Secretary of the Treasury and the Board of Governors of the Federal Reserve to establish regulations related to financial institutions transferring money associated with gambling. The UIGEA does not regulate bettors and betting operators, nor does it prohibit a direct arms-length transaction between the two. Ironically, the UIGEA expressly exempts gambling if a bettor and operator are in the same state, and it contains a number of other provisions that implicitly

authorize other forms of online gambling, such as fantasy games and games of skill.

The DOJ changed its view of state authority to permit online gambling

In December 2011, the DOJ issued a memorandum opinion interpreting the Wire Act. The first sentence of the opinion stated that interstate transmissions "of wire communications that do not relate to a 'sporting event or contest' fall outside the reach of the Wire Act." This is a drastic change in the DOJ's position. Less than one year after shutting down a number of online gambling sites through an injunction and by freezing bettors' assets, the DOJ seemingly concluded that states could authorize almost all forms of Internet gambling.

The gambling authorized by the DOJ opinion is unclear

It is not totally clear what types of gambling are authorized under the DOJ opinion. It is clear that any wager that is dependent on the outcome of a professional or amateur sporting event is still prohibited. However, all other types of Internet gambling are left in flux. For instance, states may now have the authority to authorize Internet poker or to conduct Internet poker operations themselves. Further, states are now likely able to sell lottery tickets online, even if those transmissions cross states lines.

Now that the Wire Act is not seen as a barrier to Internet gambling, it is also possible that states who do not wish to create online gaming infrastructure may still reap the benefits of the industry through regulatory fees and taxes. For instance, a state that does not wish to set up online poker may authorize the act of online poker and enter into a compact with a state that has an established online poker environment.

Some states acted quickly in response to the DOJ opinion

A handful of states took early action related to this guidance. Nevada quickly set up an online poker service. Delaware, New Jersey, and Nevada have already legalized Internet gambling. California, Massachusetts, and Illinois have considered laws of their own.

The future for state online gambling authority is unclear

It seems clear that the DOJ has given states far more latitude to create broad online gaming industries. The DOJ opinion does not have the force of law, but it is unclear whether others (beside DOJ) would have standing to file legal challenges to enforce federal law. While the DOJ has stated its acquiescence with online gaming, it could issue a new opinion clarifying, modifying, or refining its position that could materially affect states' authority. Absent a change in federal law, there is still some question as to the future of online gaming. However, it now seems that the federal government will allow states to explore this new economy without interference.

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HOUSE RESEARCH | Short Subjects

Nina Manzi and Steve Hinze

Updated: September 2013

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 17 percent of rent paid. 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 recent changes to the program?

The 2013 tax law expanded the program, by lowering the maximum threshold percentage for determining eligibility from 3.5 percent of income to 2.0 percent of income, in conjunction with reductions to the homeowner thresholds. It also increased the maximum refund to $2,000 for refunds based on rent paid in 2013.

For refunds based on rent paid from 1998 to 2008, the percentage of rent constituting property taxes equaled 19 percent. It was reduced to 15 percent for refunds based on rent paid in 2009 only under Gov. Tim Pawlenty's June 2009 unallotment, subsequently enacted into law. For refunds based on rent paid in 2010, the percentage returned to 19 percent. The 2011 tax law reduced the rate to 17 percent for refunds based on rent paid in 2011 and following years.

What are the maximums?

For refund claims filed in 2014, based on rent paid in 2013 and 2013 household income, the maximum refund is $2,000. Renters whose income exceeds $57,169 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, 2014, will be paid beginning in August 2014. The deadline for filing claims based on rent paid in 2013 is August 15, 2015; taxpayers filing claims after that date will not receive a refund.

What is the average refund and total amount paid?

Statewide Renter Property Tax Refunds, Filed in 2012
(based on 2011 incomes and rent paid in 2011, taxes assumed to equal 17% of rent paid)

	Number of returns	Total amount	Average per return
Under 65 years old	218,066	$123.2 million	$565
Senior/disabled	87,258	$54.1 million	$620
Total: all renters	305,324	$177.3 million	$581

How do refunds vary depending on income and property taxes?

The following table shows the refund amount for four 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 families paid monthly rent in 2013 of $736, the fair market rent for a one-bedroom apartment in the metro area. The families in Greater Minnesota paid monthly rent in 2013 of $528, 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 2014,
based on rent paid in 2013 and 2013 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	$1,501	$1,501	$1,077	$1,077
5	Statutory threshold percentage	1.4%	2.0%	1.4%	2.0%
6	Threshold % x income (3 x 5 = 6)	$210	$600	$210	$600
7	Property tax over threshold (4 – 6 = 7)	$1,291	$901	$867	$477
8	Copay percentage	15%	30%	15%	30%
9	Taxpayer copay amount (7 x 8 = 9)	$194	$270	$130	$143
10	Remaining tax over threshold (7 – 9 = 10)	$1,098	$631	$737	$334
11	Maximum refund allowed	$1,800	$1,650	$1,800	$1,650
12	Net property tax refund	$1,098	$631	$737	$334

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

HOUSE RESEARCH | Short Subjects

Nina Manzi & Steve Hinze

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Homestead Credit Refund Program

What is the homestead credit refund program?

The homestead credit refund is a state-paid refund that provides tax relief to homeowners whose property taxes are high relative to their incomes. The program was previously known as the homeowner's property tax refund program, or PTR, and sometimes popularly called the "circuit breaker." 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 2011 and 2013 tax laws both expanded the refund program. The 2011 changes increased the maximum refund for homeowners with incomes under about $37,000, and decreased the copayment percentage for most homeowners. The 2013 changes, effective for refunds based on taxes payable in 2014, lowered the maximum threshold percentage for determining eligibility from 3.5 percent of income to 2.0 percent of income for homeowners with household incomes from $19,530 to $65,049, and to 2.5 percent for those at higher income levels.

What are the maximums?

For refund claims filed in 2014, based on property taxes payable in 2014 and 2013 household income, the maximum refund is $2,580. Homeowners whose income exceeds $105,499 are not eligible for a refund.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR, which is filed separately from the individual income tax form. Claims filed before August 15, 2014, will be paid beginning in late September 2015; claims filed electronically may be paid a month earlier. The deadline for filing claims based on taxes payable in 2014 is August 15, 2015; taxpayers filing claims after that date will not receive a refund.

What is the average refund and total amount paid?

Statewide Homeowner Property Tax Refunds, Filed in 2012
(based on 2011 incomes and payable 2012 taxes, most recent data available)

	Number of returns	Total refund amount	Average per return
Under 65 years old	207,512	$170.2 million	$820
Senior/disabled	146,368	$123.3 million	$842
Total: all homeowners	353,880	$293.5 million	$829

How do refunds vary depending upon the filer's income and property tax?

The following table shows the refund calculations for four example families with different incomes—two families in the metro area and two 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 families have payable 2014 property taxes of $3,091, a typical amount for the metro. The families in Greater Minnesota have payable 2013 property taxes of $1,416, 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 2014,
based on taxes payable in 2014 and 2013 income

		Metro area		Greater Minnesota	
		Taxpayer #1	Taxpayer #2	Taxpayer #3	Taxpayer #4
1	Typical estimated market value of home	$223,500	$223,500	$147,600	$147,600
2	Gross income	$35,000	$75,000	$35,000	$75,000
3	Deduction for dependents	$10,530	$10,530	$10,530	$10,530
4	Household income (2 – 3 = 4)	$24,470	$64,470	$24,470	$64,470
5	Property tax	$3,091	$3,091	$1,416	$1,416
6	Threshold income percentage	2.0%	2.0%	2.0%	2.0%
7	Threshold % x income (4 x 6 = 7)	$489	$1,289	$489	$1,289
8	Property tax over threshold (5 – 7 = 8)	$2,602	$1,802	$927	$127
9	Statutory copay percentage	30%	40%	30%	40%
10	Taxpayer copay amount (8 x 9 = 10)	$780	$721	$278	$51
11	Remaining tax over threshold (8 – 10 = 11)	$1,821	$1,081	$649	$76
12	Maximum refund allowed	$2,580	$1,830	$2,580	$1,830
13	Net property tax refund	$1,821	$1,081	$649	$76

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

HOUSE RESEARCH | Short Subjects

Nina Manzi and Steve Hinze

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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?

Generally, 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. For refunds based on taxes payable in 2012 only, the refund percentage was 90 percent instead of 60 percent. The maximum refund is $1,000. The following example shows how the refund is calculated.

Payable 2013 Property Tax after Targeting Payable 2014 Property Tax	$1,600 $2,000
2014 tax increase (over 2013) Taxpayer pays first 12% of increase compared to previous year's tax, which must be at least $100 (12% x $1,600)	$400 $192
Remaining increase eligible for relief ($400 - $192 = $208)	$208
State pays 60% of excess over 12% increase up to a $1,000 maximum (60% x $208 = $125)	$125
Amount of 2014 increase paid by taxpayer ($400 - $125)	$275

The taxpayer's $400 increase (i.e., 25 percent) is reduced to an out-of-pocket property tax increase of $275 (i.e., 17.2 percent) as a result of the $125 refund.

The taxpayer pays the full $2,000 amount of the 2014 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 on form M1PR. The targeting refund is paid at the same time the regular homestead credit refund ("circuit breaker") is paid in late September.

Does targeting have any other restrictions?

No, unlike the homestead credit refund, the targeting refund is not tied to the taxpayer's household income. Under the homestead credit 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 homestead credit refund due to income restrictions are eligible for the targeting refund.

What are statewide amounts?

The table below shows the statewide amount, with a breakdown for the metro and the 80 nonmetro counties, for the past four years.

The amounts paid out for the targeting program decreased substantially from $6.1 million in 2009 to about $3.2 million in 2012. The changes from one year to the next generally track changes in property taxes on homesteads. From 2011 to 2012, homestead property taxes increased on average in Greater Minnesota and remained relatively constant in the metro area.

Targeting Refunds, Filed 2009 – 2012 (dollars in thousands)

	Filed 2009	Filed 2010	Filed 2011	Filed 2012
Total Metro	$3,750	$1,024	$1,211	$570
Total Nonmetro	$2,338	$1,310	$691	$2,696
State	$6,088	$2,334	$1,902	$3,266

Some taxpayers (e.g., those who typically don't qualify for the homestead credit 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 2012, just over 27,000 homeowners claimed refunds based on their property tax increase from payable 2011 to 2012. The average refund amount was $121.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR, the homestead credit 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, 2014, will be paid beginning in late September 2014. The deadline for filing claims based on taxes payable in 2014 is August 15, 2015; taxpayers filing claims after that date will not receive a refund. Forms are available online at DOR's website, under "Forms and Instructions" (www.revenue.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.revenue.state.mn.us. Also see the House Research Short Subject *Homestead Credit Refund Program*, September 2013, and the Information Brief *Targeting*, December 2012.

HOUSE RESEARCH | **Short Subjects**

Janelle Taylor & Jim Cleary **Updated: September 2013**

Transporting Firearms in Motor Vehicles

General Limits on Transporting Firearms within a Motor Vehicle

Minnesota Statutes, section 97B.045, prohibits transporting a firearm in a motor vehicle unless the firearm is unloaded and either (1) fully secured in a gun case expressly made for that purpose, where the case is zipped, snapped, buckled, tied, or otherwise fastened, or (2) in the closed trunk of the motor vehicle. Minnesota law does not require that the gun case be locked.

Exception for Handguns with Permit to Carry

The law provides an exception for a handgun being carried under the terms of a valid permit to carry (i.e., in accordance with Minnesota Statutes, section 624.714). A person with a valid permit to carry a pistol may transport one or more pistols in a motor vehicle whether as a driver or a passenger, irrespective of whether the handgun is cased or uncased, is loaded or unloaded, or is concealed or being carried openly, and whether it is kept on the person or elsewhere in the vehicle, and whether the person is inside or outside the vehicle. When the handgun is left stored in any condition within a vehicle, "constructive possession" applies.

Disabled Hunter Exception

None of the restrictions in Minnesota Statutes, section 97B.045, regarding the transportation of firearms, apply to a disabled person if:

- the person possesses a permit for disabled hunters issued under Minnesota Statutes, section 97B.055, subdivision 3; and
- the firearm is not loaded in the chamber until the vehicle is stationary, or is a hinge-action firearm with the action open until the vehicle is stationary.

A 2009 law repealed a third condition that required the disabled person to be participating in a hunt sponsored by a nonprofit organization or to be hunting on land owned or leased by the disabled person. (Laws 2009, ch. 176, art. 2, § 39)

Exception for Longguns When Hunting or at a Shooting Range

In 2009, the law was amended to also allow an uncased, unloaded rifle or shotgun to be transported in a motor vehicle, without any requirement for a permit to carry a pistol, in the following situations:

- while at a shooting range, as defined under Minnesota Statutes, section 87A.01, subdivision 3, where the person has received permission from the lawful owner or possessor of the range to discharge firearms
- while lawfully hunting on private or public land, including possessing a valid hunting license (if required)
- while traveling to or from a site where the person intends to hunt lawfully that day or has hunted lawfully that day

The rifle or shotgun, whether cased or uncased, must still remain unloaded while being transported in a motor vehicle in these situations. (Laws 2009, ch. 176, art. 2, § 40) The original 2009 law required that the rifle or shotgun remain cased

when the vehicle was within any area where the discharge of a firearm is prohibited by ordinance. In 2011 the law was amended to repeal that requirement. (Laws 2011, 1st spec. sess., ch. 2, art. 5, § 41.)

Limitations on Hunting and Shooting Range Exception

There are some limitations to the exceptions for transporting firearms for hunting and while on a shooting range. A rifle or shotgun must be unloaded and either cased or in a closed trunk while being transported in a motor vehicle:

- within Anoka, Hennepin, and Ramsey counties;
- within the boundary of a city with a population of 2,500 or more;
- on school grounds; and
- as regulated under statutes governing game refuges, shining of artificial lights, and use of night vision devices.

Penalty for a Violation

A violation of Minnesota's firearms transportation law is a misdemeanor, punishable by up to 90 days in jail and a $1,000 fine.

Firearms Ineligibility Not Affected

A person's status under federal and Minnesota law as a firearms-prohibited person, if applicable, is not affected by the new or the previous firearms transportation law. A firearms-prohibited person continues to be prohibited from possessing any firearm in any manner, including for the purpose of transporting it.

Key Definitions in Game and Fish Law

For purposes of Minnesota Statutes, section 97B.045, and other game and fish laws, certain key terms are defined as follows:

- "Motor vehicle" means a self-propelled vehicle, or a vehicle propelled or drawn by a self-propelled vehicle, that is operated on a highway, on a railroad track, on the ground, in the water, or in the air (Minn. Stat. § 97A.015, subd. 32)
- "Hunting" means "taking" birds or mammals. "Taking" is further defined as pursuing, shooting, killing, capturing, trapping, snaring, angling, spearing, or netting wild animals, or placing, setting, drawing, or using a net, trap, or other device to take wild animals. Taking includes attempting to take wild animals and assisting another person in taking wild animals. (Minn. Stat. § 97A.015, subds. 26 and 47)
- "Possession" means both actual and constructive possession and control of the things referred to. (Minn. Stat. § 97A.015, subd. 36)

For more information: Contact legislative analyst Janelle Taylor at janelle.taylor@house.mn or Jim Cleary at jim.cleary@house.mn.

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HOUSE RESEARCH | Short Subjects

Randall Chun **Updated: October 2013**

Medical Assistance: An Overview

Medical Assistance (MA), the state's Medicaid program, is a federal-state program that pays for health care services for low-income individuals. The program is administered 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. This short subject describes the eligibility criteria that will be in effect for MA on January 1, 2014.

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, persons with disabilities, and adults without children.
- Meet program income and any applicable asset limits. 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	275	None
Children 19 through 20	133	None
Pregnant women	275	None
Parents and caretakers	133	None, unless on spenddown
Aged, blind, or disabled	100	$3,000 for one/$6,000 for two/$200 each additional
Adults without children	133	None

* 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 133 percent of FPG for families and children and 75 percent of FPG for individuals who are aged, blind, or disabled. There is no spenddown for adults without children.

- 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 and other 2013 session changes

The 2013 Legislature increased the income limit for adults without children from 75 percent to 133 percent of FPG, and increased the income limit for parents and caretakers and children ages 19 and 20 from 100 percent to 133 percent of FPG, effective January 1, 2014. This was an optional Medicaid expansion allowed under the federal Affordable Care Act (ACA). The legislature also implemented a number of Medicaid eligibility changes required by the ACA, including using modified adjusted gross income (MAGI) and a standard 5 percent income disregard when determining eligibility for parents and caretakers, children, and adults without children, and eliminating the asset requirement for parents and caretakers. The legislature also increased the MA income limit for children ages two through 18 from 150 percent to 275 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 home and community-based "waivered services" not normally covered by Medicaid that are intended to allow 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).

Funding and expenditures

In state fiscal year 2012, total state and federal MA expenditures for services were $8.241 billion. The federal share of MA costs is determined by a formula based on state per capita income. In most fiscal years, the federal government has paid 50 percent of the cost of MA services, with Minnesota responsible for the remaining 50 percent.

Recipients

During state fiscal year 2012, an average of 738,511 individuals were eligible for MA services each month. As of July 2013, 507,608 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 or MNsure, the state's health insurance exchange.

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

HOUSE RESEARCH | Short Subjects

Pat Dalton

October 2013

Township LGA

Township LGA will be paid for the first time since 2001

A new local government aid (LGA) program for townships was enacted in the 2013 session, and the first payments will be made beginning in 2014. The original LGA program enacted in 1971 provided aid to all local governments but over the years, the program became a city aid program only. The last LGA payment made to townships under the old program was in 2001.

Aid payment is based on geographic size, population, and percent of agricultural property

The amount received by each township is based on three factors:

- Town area factor: the most recent estimate of the acreage in the township, up to 50,000 acres. The estimate may come from the U.S. Bureau of the Census, the State Land Management Information Center, or the secretary of state
- Population factor: the square root of the most recent population estimate for the township
- Agricultural property factor: the ratio of the adjusted net tax capacity of all agricultural property in the township to the adjusted net tax capacity of all other property located in the township, up to a maximum factor of eight. "Agricultural property" includes homestead and nonhomestead agricultural land, rural vacant land, and noncommercial seasonal recreational property (i.e., cabins), but it does not include managed forest land or tax-exempt natural resource land.

Total aid is limited to $10 million annually

The formula will distribute $10 million annually to organized townships in the state. The actual formula for each towns aid is:

$$Aid = X\% \quad of \left(\begin{matrix} agricultural \\ property \\ factor \end{matrix} \times \begin{matrix} town\ area \\ factor \end{matrix} \times \begin{matrix} population \\ factor \end{matrix} \times .0045 \right)$$

where $X\%$ is the percentage needed so the total paid to all townships does not exceed $10 million. For payments made in 2014, the percentage paid is 91.4 percent.

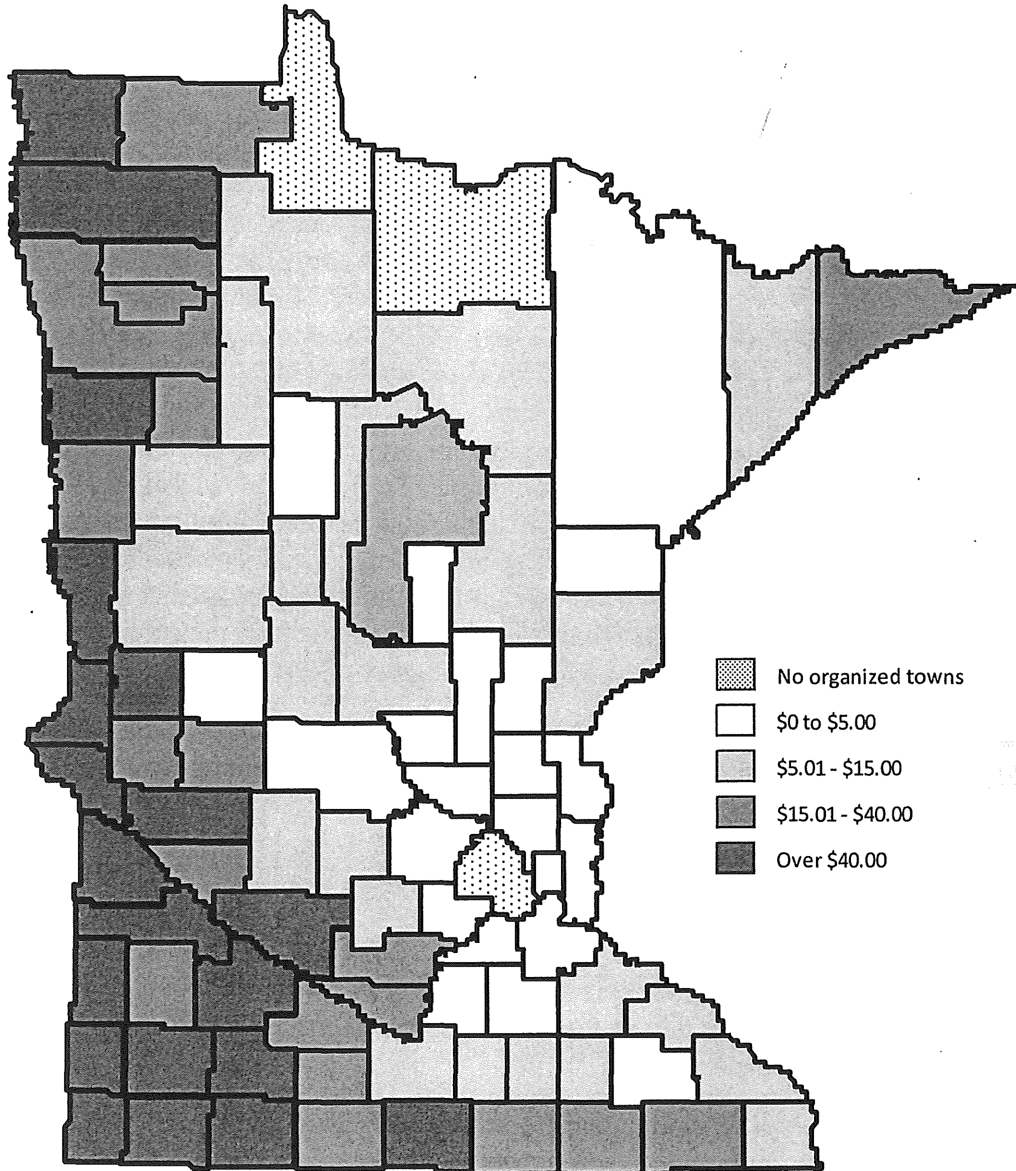
Formula favors organized, agriculture-based townships

The formula tends to provide more aid per capita to townships that have a large amount of land meeting the definition of "agricultural property" used here. Townships with large amounts of other property such as residential, commercial, or forest property will get less aid per capita. The town aid is limited to organized townships; no aid is paid to counties for providing township services to unorganized townships in the state. Because of this, payments tend to be highest in the western and southwestern counties in the state.

No town aid is paid in three counties

No township aid is paid in Hennepin, Koochiching, or Lake of the Woods counties. This is because either the entire county is incorporated into cities (Hennepin County) or the county only has *unorganized* townships (Koochiching and Lake of the Woods counties).

Average 2014 Town LGA per capita by County
(based on organized township population)



For more information: Contact legislative analyst Pat Dalton at 651-296-4472.

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HOUSE RESEARCH | Short Subjects

Nina Manzi & Joel Michael

Updated: October 2013

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 due to 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 (110 percent if adjusted gross income exceeds $150,000), 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?

For calendar year taxpayers, income tax returns are due by April 15 following the close of the tax year, but there is no late filing penalty if the return is filed by 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 3 percent for 2010 through 2014.

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 joel.michael@house.mn.

Randall Chun Updated: October 2013

MinnesotaCare: An Overview

MinnesotaCare is a federal-state program that provides subsidized health care coverage to low-income individuals. The program is administered by the Department of Human Services (DHS); counties have the option of processing applications and determining eligibility.

Note: *The following text describes the program as it will exist beginning January 1, 2014.*

Eligibility

Effective January 1, 2014, most MinnesotaCare enrollees will be parents and caretakers, children ages 19 to 20, and adults without children.

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

- Have gross income that is greater than 133 percent of the federal poverty guidelines (FPG) ($15,282 for a household of one) but does not exceed 200 percent of FPG ($22,980 for a household of one). Exceptions to these income limits are made for certain children under age 19 and legal noncitizens, who are not eligible for MA.
- Not be eligible for Medical Assistance (MA). This requirement has the effect of shifting the vast majority of pregnant women and children from MinnesotaCare to MA.
- Not have access to subsidized health coverage that, as defined in the federal Affordable Care Act (ACA), is affordable (the employee pays no more than 9.5 percent of income for self-only coverage) and provides minimum value (pays for at least 60 percent of medical expenses on average).
- Not have minimum essential health coverage (defined in the ACA as coverage under Medicare, Medicaid and other government programs, employer-sponsored coverage, individual market coverage, and other specified coverage).
- Be a resident of Minnesota. Enrollees must meet the residency requirements of the MA program.

Covered services

Parents and caretakers and adults without children are covered for most, but not all, services covered under MA. Covered services include physician care, hospitalization, prescription drugs, therapy services, and a wide range of other health care services. 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.

Children ages 19 and 20, and certain children under age 19, receive coverage for a broader range of services than adults.

Premiums and cost-sharing	Enrollees age 21 and older pay monthly, per-person premiums based on a sliding scale. Persons under age 21 are not charged premiums. Adult enrollees are subject to copayments and other cost-sharing for specified services.
Provider reimbursement	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.
MinnesotaCare as Basic Health Program	Under the ACA, states have the option of operating a basic health program to provide health coverage to persons with incomes greater than 133 percent but not exceeding 200 percent of FPG, beginning January 1, 2015. The 2013 Legislature directed DHS to seek federal approval to operate MinnesotaCare as a basic health program. The legislature also made changes in MinnesotaCare eligibility, covered services, and service delivery that are consistent with federal requirements for a basic health program; many of these changes are effective January 1, 2014.
Expenditures and funding	In fiscal year 2012, the MinnesotaCare program paid $549 million for medical services provided to enrollees. Forty-eight percent of this cost was paid for by the state, 44 percent by the federal government, and 8 percent by enrollees through premium payments (this last category also includes enrollee cost-sharing). The state receives federal funding at the MA match rate for health care services provided to enrollees under a federal waiver, and is seeking reauthorization of this waiver for the period January 1, 2014 through December 31, 2017. The state receives federal funding at an enhanced match rate (under the Children's Health Insurance Program) for children under age 21 with incomes greater than 133 percent of FPG. State funding for MinnesotaCare and other health care access initiatives is provided by a tax of 2 percent on the gross revenues of health care providers and a tax of 1 percent on the premiums of nonprofit health plan companies. The tax on health care provider revenues is scheduled to sunset January 1, 2020. Prior to that date, the Commissioner of Management and Budget is required to reduce the rate of the tax on health care provider revenues if certain financial criteria are met.
Recipients	As of July 2013, 131,979 individuals were enrolled in the MinnesotaCare program. Seventy percent of these enrollees were parents, children, or pregnant women.
Application procedure	MinnesotaCare applications can be obtained by calling the Department of Human Services (1-800-657-3672) or MNsure, the state's health insurance exchange (1-855-366-7873). Applications are also available at county human services agencies and other locations.

For more information: See the House Research information brief *MinnesotaCare*.

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HOUSE RESEARCH | **Short Subjects**

Danyell A. Punelli

November 2013

Community First Services and Supports (CFSS)

What are community first services and supports?

The Community First Services and Supports (CFSS) program was created by the 2013 Legislature (see Laws 2013, chapter 108, article 7, section 49) and will replace the Personal Care Assistance (PCA) program. CFSS will be available statewide to eligible individuals to provide assistance and support to persons with disabilities, the elderly, and others with special health care needs living independently in the community.

How does CFSS differ from the PCA program?

CFSS is intended to be more accessible and flexible than the PCA program. CFSS will facilitate transition out of institutional care, prevent or delay future admissions, and support community living. CFSS will assist participants to recover and/or gain skills to increase and maintain community stability, use technology or home modifications to decrease the need for human assistance when appropriate, avoid the use of inappropriate services, and increasingly direct their own services. CFSS will allow for testing of innovative models of coordinating services for children receiving services across home, school, and community.

CFSS changes the structure of fiscal support entities under the PCA program to support people hiring and directing their own staff. CFSS includes a budget model that allows participants to exercise more responsibility and control over the services and supports described and budgeted within the CFSS service-delivery plan. An agency-provider model is available for participants who are unable to direct their own services.

Who will be eligible for CFSS?

CFSS is available to a person who meets one of the following criteria:

- is a recipient of Medical Assistance (MA)
- is a recipient of the alternative care program
- is a MA waiver recipient (elderly waiver, developmental disabilities waiver, brain injury waiver, community alternative care waiver, or community alternatives for disabled individuals waiver)
- has medical services identified in a participant's individualized education program and is eligible for MA special education services

In addition to meeting the eligibility criteria above, a person must also:

- require assistance and be determined dependent in one activity of daily living (ADL) or Level I behavior based on an assessment;
- not be a family support grant recipient; and
- live in the person's own apartment or home (not a hospital or institutional setting).

What services will be provided?	CFSS services include: • assistance with ADLs, including eating, toileting, grooming, dressing, bathing, mobility, positioning, and transferring; • assistance with instrumental activities of daily living (IADLs), such as meal planning, preparation, and cooking; shopping for food, clothing, or other essential items; laundry; housecleaning; assistance with medications; managing finances; communicating needs and preferences during activities; arranging supports; and assistance with traveling around and participating in the community; • assistance with health-related procedures and tasks that can be delegated or assigned by a state-licensed health care or mental health professional and performed by a support worker; • assistance to acquire, maintain, or enhance the skills necessary for the participant to accomplish ADLs, IADLs, or health-related procedures and tasks; • expenditures for items, services, supports, or environmental modifications, or goods, including assistive technology; • observation and redirection for behavior symptoms when there is a need for assistance; • back-up systems or mechanisms, such as the use of pagers or other electronic devices, to ensure continuity of the participant's services and supports; • transition costs for participants moving out of an institution and into the community; and • services provided by a support specialist that are chosen by the participant.
Who will provide CFSS services?	CFSS will be provided by support specialists and support workers who will be employed by agency providers or the participant. Support workers must enroll with the Department of Human Services, complete a background study, and meet all other requirements. Agency providers must be MA-enrolled health care program providers and meet all applicable provider standards and requirements, including compliance with background study requirements, reporting maltreatment of minors and vulnerable adults, and providing the participant with service-related rights.
How will CFSS be funded?	CFSS will be a federal-state funded service, with 50 percent paid with federal MA funds and 50 percent paid with state general funds.
When will CFSS become effective?	CFSS is effective upon federal approval but no earlier than April 1, 2014. The services will begin 90 days after federal approval or April 1, 2014, whichever is later.

For more information: Contact legislative analyst Danyell Punelli at 651-296-5058.

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Mark Shepard

Updated: November 2013

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 who is required to register with the Campaign Finance and Public Disclosure Board to lobby Minnesota state government. A "principal" is an entity that hires lobbyists or that spends more than $50,000 in a year to influence official action. 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 651-539-1187 to verify if the individual or entity is a lobbyist or principal. 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. The board could also make a public finding that there has been a violation.

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:

- 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

The following are excluded from the gift ban:

- 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 or beverage given at a reception, meal, or meeting if: (1) the reception, meal, or meeting is held away from the recipient's place of work by an organization before whom the recipient appears to make a speech or answer questions as part of a program; or (2) the recipient is a member or employee of the legislature and an invitation to attend the reception, meal, or meeting was provided to all members of the legislature at least five days prior to the date of the event
- 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 family member, unless the gift is given on behalf of someone outside the family

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

Mark Shepard

Updated: November 2013

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 or 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.

The 2013 Legislature passed legislation increasing the governor's salary by 3 percent on January 1, 2015, and by 3 percent on January 1, 2016. Laws 2013, ch. 142, art. 6, §12. Salaries of the other constitutional officers are a specified percentage of the governor's salary, so salaries of the other constitutional officers also will increase by 3 percent in 2015 and 3 percent in 2016. Laws 2001, 1st spec. sess., ch. 10, art. 1, §2.

Officer	% of Governor's Salary	2013 Salary	2015 Salary	2016 Salary
Governor	---	$120,303	$123,912	$127,629
Attorney General	95%	$114,288	$117,716	$121,248
State Auditor	85%	$102,258	$105,326	$108,485
Secretary of State	75%	$90,227	$92,934	$95,722
Lt. Governor	65%	$78,197	$80,543	$82,959

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 must 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 4 percent, and took effect in July 2013 as required under a 2013 law. The same law provided an additional 3 percent increase on July 1, 2014. Laws 2013, ch. 86, art. 3, § 12. Annual salaries for various judges are as follows:

Official	2013 Salary	2014 Salary
Supreme Court, chief	$167,002	$172,012
Supreme Court, justice	$151,820	$156,375
Court of Appeals, chief	$150,206	$154,712
Court of Appeals, justice	$143,054	$147,346
District Court, chief	$141,003	$145,233
District Court, judge	$134,289	$138,318

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.

The 2013 Legislature proposed a constitutional amendment regarding how legislators' salaries are determined. That amendment will be voted on at the 2016 general election. Laws 2013, ch. 124. If the amendment is adopted, salaries for legislators will be established by a newly created council appointed by the governor and by the chief justice of the Supreme Court.

The compensation council's role in establishing salaries

Separate from the new council proposed in the constitutional amendment to be voted on in 2016, the legislature has previously established a 16-member compensation council to assist it in establishing the compensation of constitutional officers, judges, and legislators. Minn. Stat. § 15A.082. A compensation council is appointed in January of each odd-numbered year. The council must make its recommendations to the legislature by March 15 of that 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. If the constitutional amendment is adopted by the voters in 2016, the new council created in the constitution will set salaries for legislators, and the compensation council currently created in law will recommend salaries for constitutional officers and judges.

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 website: www.commissions.leg.state.mn.us/lcer/officialssalaries.htm.

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

Colbey Sullivan

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Biofuel Use Mandates

What is a biofuel?

A biofuel is a transportation fuel derived from plants or other renewable biological resources. The most widely used biofuels are ethanol produced from corn and biodiesel produced primarily from soybean oil. Ethanol is a substitute for gasoline; biodiesel is a substitute for diesel fuel. In contrast, gasoline and diesel are referred to as "fossil fuels" because they are created by processing nonrenewable petroleum. A biofuel-blended fuel is a fossil fuel mixed with biofuel.

Researchers and companies are actively developing new biofuels and new feedstocks for ethanol and biodiesel. In May 2012, a company opened the first commercial-scale biobutanol plant in Luverne.

What is a biofuel use mandate?

A biofuel use mandate is a law that requires transportation fuel suppliers and retailers to sell biofuel-blended fuel. As the result of Minnesota's biofuel mandates, in general all motorists who fuel up in Minnesota purchase biofuel-blended fuel. Regular gasoline and diesel are not typically available at gas stations.

How do the biofuel use mandates work?

Minnesota has two biofuel use mandates—one for gasoline and another for diesel fuel. Both laws require fuel blenders to incorporate a specific amount of biofuel in nearly every gallon of transportation fuel sold in the state.

What is the requirement for gasoline?

Prior to July 1, 2013, state law required a 10 percent blend of ethanol in nearly every gallon of gasoline. This blend of 10 percent ethanol and 90 percent gasoline is commonly referred to as "E10." As the result of a law enacted during the 2013 legislative session, fuel sellers now have an option—they may sell either E10 or gasoline blended with 10 percent biobutanol, cellulosic ethanol, or any other biofuel approved by the U.S. Environmental Protection Agency (EPA) as a gasoline substitute.

By law, the E10 option could change if the EPA authorizes greater ethanol blends. In that case, fuel sellers who choose the ethanol option would be required to sell E15, E20, or any other blend approved by EPA for use in all light-duty vehicles. However, if EPA allows the use of new ethanol blends only in certain vehicles, the law's ethanol option will remain at E10. For example, EPA recently approved E15. However, the ethanol mandate did not increase correspondingly because EPA authorized E15 use only in 2001 and newer vehicles.

What is the requirement for diesel?

The biodiesel mandate law currently requires a 5 percent blend of biodiesel ("B5") in most diesel fuel sold in Minnesota. Unlike ethanol, the EPA has already approved all diesel-biodiesel blends. The law called for an increase to B10 on May 1, 2012, and B20 on May 1, 2015. However, these target dates are subject to change based on certain conditions specified in the law. For example, the

scheduled increase from B5 to B10 in May of 2012 did not happen because executive branch agencies—as required by law and in consultation with nongovernmental stakeholders—determined that certain regulatory and supply issues were not sufficiently resolved. However, in the September 30, 2013, issue of the State Register, the same agencies posted notice that the statutory conditions had now been met. By law, the mandate will increase from B5 to B10 270 days after the announcement, or June 27, 2014. At that time, the B10 mandate will be in effect except for the months of November through March, when the mandate level will temporarily revert to B5 due to concerns about B10's performance in cold weather.

The law also authorizes the executive branch to suspend the use mandate for a limited period of time if there is not enough biodiesel fuel available or if the wholesale price of biodiesel is so high relative to diesel fuel that the mandate would cause economic hardship for gas stations and other diesel fuel sellers who may lose business to competitors located outside of the state.

What exemptions exist?

The legislature granted specific exemptions from the mandate for certain vehicles, equipment, and fuels. The exemptions reflect stakeholder concerns about the suitability of biofuel-blended fuels for their vehicles or other gasoline- or diesel-powered equipment. For a list of exemptions, see the table below.

Biofuel Mandates, Implementation Dates, and Exemptions

	Diesel	**Gasoline**
Mandate Level	5 percent biodiesel per gallon, scheduled to increase incrementally to a maximum of 20 percent in 2015 and thereafter	Option of 1) the highest ethanol blend approved by the U.S. EPA for all vehicles, or 2) 10 percent of another EPA-approved biofuel
Initial Implementation	2005	2003*
Exemptions	Nuclear plants, trains, off-road mining and logging equipment, Coast Guard boats and certain boats subject to Coast Guard inspection. Number 1 diesel fuel is exempt entirely during the months of October to March due to cold-weather performance concerns	Aircraft, resorts, marinas, houseboat companies, recreational vehicle manufacturers, riparian landowners, motor sport racing events, collector vehicles, off-road vehicles, motorcycles, boats, snowmobiles, and small engines

*The legislature required E10 use statewide in 2003. From 1997 to 2003, the law effectively required E7.7 statewide.

For more information: For mandate compliance information, contact the Minnesota Department of Commerce, Weights and Measures Division, at 651-215-5821. For more detail on the mandates, see the following reports from the Minnesota Department of Agriculture: *Legislative Report on Ethanol – Review of E20* (January 2011) and *Biodiesel Annual Report to the Legislature* (January 2013), available at www.mda.state.mn.us/renewable.aspx. For legislative issues, contact legislative analyst Colbey Sullivan at 651-296-5047.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi & Joel Michael

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Minnesota Individual Alternative Minimum Tax

What is the alternative minimum tax?

The federal and state alternative minimum taxes (AMT) 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 current structure of the two taxes (as alternative, rather than add-on, 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 require taxpayers to compute a tentative liability under a second tax structure. This second tax structure, the AMT, has a broader tax base (due to fewer deductions, exemptions, and credits) and lower rates than the regular tax. If the tentative tax is higher than the taxpayer's regular tax liability, the taxpayer pays the difference. In effect, the AMT takes away part of the benefit of tax preferences that lowered the regular tax.

Who pays the AMT?

AMT filers fall into three main groups:

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

How are the federal and state AMTs different?

The federal and state AMTs have two major differences.

- The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not.
- The Minnesota AMT has one flat rate, while the federal tax has two rates.

How are the Minnesota regular tax and AMT different?

The Minnesota AMT uses a broader tax base than the regular tax does and applies a single 6.75 percent rate against that base. The following table outlines the parameters of the Minnesota regular and alternative minimum tax.

Comparison of Minnesota's Regular Income Tax and AMT
($ amounts are for the 2014 tax year)

Feature	Regular Tax	AMT
Tax base	Federal adjusted gross income	Federal adjusted gross income
Rules carried over from federal AMT that add to tax base		Less generous depreciation rules Incentive stock options Depletion Intangible drilling costs Tax-exempt interest from private activity bonds
Standard deduction	$10,350 (married joint) $6,200 (single) $9,100 (head of household)	$72,220 for married joint (phased out for income from $150,000 to $438,880) $54,160 for single and head of household (phased out for income from $112,500 to $329,140)
Personal exemptions	$3,950 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%; 9.85%	6.75% (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 $16.6 million in tax year 2014, from about 8,000 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.

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 cash 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 excludes recovery of amounts that were included in FAGI when the contributions 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, SIMPLE, and other retirement contributions; nontaxable employee fringe benefits; deductible 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 2013, $250 of teacher classroom expenses and up to $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 2011, the most recent year for which data is available, 60 percent of Minnesotans claimed the standard deduction and 40 percent itemized.

How much is the standard deduction?

In tax year 2014, the standard deduction is as follows:

- $12,400 for married couples filing joint returns
- $6,200 for married couples filing separate returns
- $9,100 for head of household filers
- $6,200 for single filers

What itemized deductions are allowed?

In tax year 2014 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 and health insurance premiums in excess of a percentage of FAGI (7.5 percent for filers age 65 and older, 10 percent for all others)
- 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 2014, the personal and dependent exemptions are $3,950 each. A family of four qualifies for four exemptions, totaling $15,800.

Are there limits on deductions and exemptions?

The federal American Taxpayer Relief Act of 2012 (ATRA) revived and made permanent the limitation on itemized deductions and phaseout of personal and dependent exemptions for taxpayers with incomes over a threshold.

The 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 FAGI over the applicable thresholds. But they are always guaranteed 20 percent of the deductions, no matter how high their FAGIs are.

ATRA also provides 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.

ATRA increased the income thresholds at which the limitation of itemized deductions and the phaseout of personal and dependent exemptions take effect, relative to prior federal law. It also provided for the limitation and the phaseout to begin at the same income thresholds; under prior law the deduction limitation began at a lower income level than did the exemption phaseout. The table shows the income thresholds for the itemized deduction limitation and the personal and dependent exemption phaseout in effect in tax year 2014. The income thresholds are adjusted annually for inflation.

Tax year 2014	Itemized deduction limit and personal and dependent exemption phaseout begins at
Married joint filers	$305,050
Married separate filers	$152,525
Single filers	$254,200
Head of household filers	$279,650

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 2013.

HOUSE RESEARCH | Short Subjects

Joel Michael and Nina Manzi

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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 library debts
- Governmentally owned hospitals and Regions Hospital
- Agencies responsible for child support enforcement
- Agencies that administer low-income housing programs
- Licensed ambulance services

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 $11,850 and $22,400 for care provided in 2012, 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.

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

Some types of refunds are subject to recapture

Revenue recapture applies to the following:

- Individual income tax refunds
- Property tax refunds
- Sustainable forest incentive 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 $78 million was recaptured in 2012

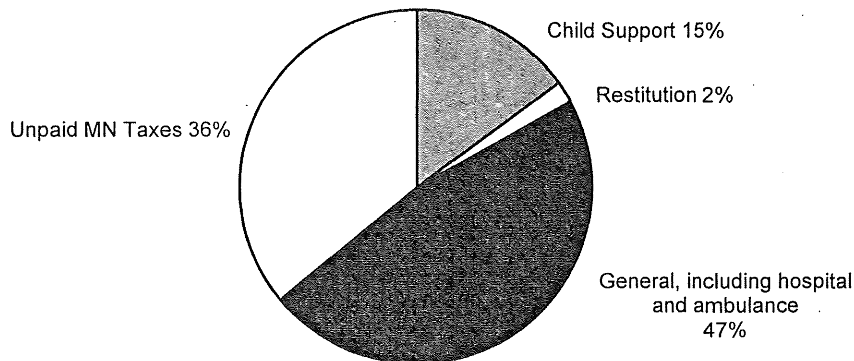
The table to the right shows the number of revenue recapture offsets and amount of refunds offset for calendar years 2008 to 2012.

The graph below shows the percentage of revenue recapture amounts and tax debts offset for calendar years 2008 to 2012 by four of the major types of debts for which the law sets priorities.

Revenue Recapture Amounts CY2008-2012

	Number of Offsets	Amount of Recapture
2008	230,911	$87,756,822
2009	216,623	$72,845,049
2010	226,754	$78,173,924
2011	193,629	$63,231,794
2012	231,085	$78,408,559

2011 and 2012 data exclude offsets for unpaid state taxes. In 2012, there were 134,547 offsets for $33,837,705 in unpaid state taxes.
All years exlude amounts offset to satisfy federal debts.
Source: DOR



For more information: See www.revenue.state.mn.us/collections/Pages/Revenue_Recapture.aspx for more information, or contact the Department of Revenue at 651-556-3037; or email at revenue.recapture@state.mn.us.

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