State of Minnesota

Tax Expenditure Budget

Fiscal Years 2000-2003

Minnesota Department of Revenue
Tax Research Division

Questions relating to this report and requests
for additional copies may be directed to:

Minnesota Department of Revenue
Tax Research Division
Mail Station 2230
St. Paul, Minnesota 55146-2230
Telephone: (651) 296-3425

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STATE OF MINNESOTA

TAX EXPENDITURE BUDGET

FISCAL YEARS 2000 - 2003

A REPORT TO THE MINNESOTA LEGISLATURE

STATUTORY REQUIREMENT: MINNESOTA STATUTES, SECTION 270.067

Minnesota Department of Revenue
Tax Research Division

February 2000

MINNESOTA Department of Revenue
Commissioner's Office

February 2000

To The Members of the Legislature of the State of Minnesota:

It is my pleasure to submit to you the 2000 Minnesota Tax Expenditure Budget, as required by Minnesota Statutes, Section 270.067. The purpose of the report is to facilitate a regular, comprehensive legislative review of state and local tax expenditures that provide preferential tax treatment for certain types of taxpayers or activities. The Tax Expenditure Budget enables the Legislature to review tax expenditures as part of the budget process.

This report contains information essential for evaluating Minnesota's state and local tax system. The information is provided for a better understanding of the current tax system and as a basis for making future tax policy decisions.

Minnesota Statutes, Section 3.197, specifies that a report to the Legislature must include the cost of its preparation. The approximate cost of preparing this report was $100,000.

Sincerely,

Matthew G. Smith
Commissioner

PREFACE

This report is the seventh tax expenditure budget prepared and submitted as required by Minnesota Statutes, Section 270.067. It reflects Minnesota law after changes enacted in the 1999 legislative session.

The tax expenditure budget covers all state taxes and all local taxes that are applied statewide. Fees are not included. Only taxes that contain tax expenditure provisions are included in the report.

The main purpose of the tax expenditure budget is to provide information on which sound policy decisions can be made. The report also can be used as a reference source because it contains an explanation and history for each provision, as well as the fiscal impact. Many provisions also contain the number of taxpayers who are affected by the provision.

An essential starting point for using this report is the main introduction, beginning on page 1. The main introduction includes background information on tax expenditure reporting, describes the conceptual basis for determining whether a provision is a tax expenditure, and explains how the fiscal impacts of tax expenditure provisions are measured.

Following the main introduction is a summary list which contains the item number, name, year enacted, and fiscal impact of each tax expenditure provision. An item number is assigned to each tax expenditure provision, and the provisions are numbered consecutively within each tax. The item number is the key used to identify and locate provisions throughout this report.

The report is organized into chapters, with one chapter for each tax. Each chapter contains descriptive information on the tax and detailed information on each tax expenditure provision in that tax. Tax expenditure estimates are provided for fiscal years 2000 through 2003.

The Appendix to Chapter 1 contains distributional information by income category for the individual income tax and for selected tax expenditures in that tax. The Appendix to Chapter 4 contains similar information for selected items in the sales and use tax.

SUMMARY

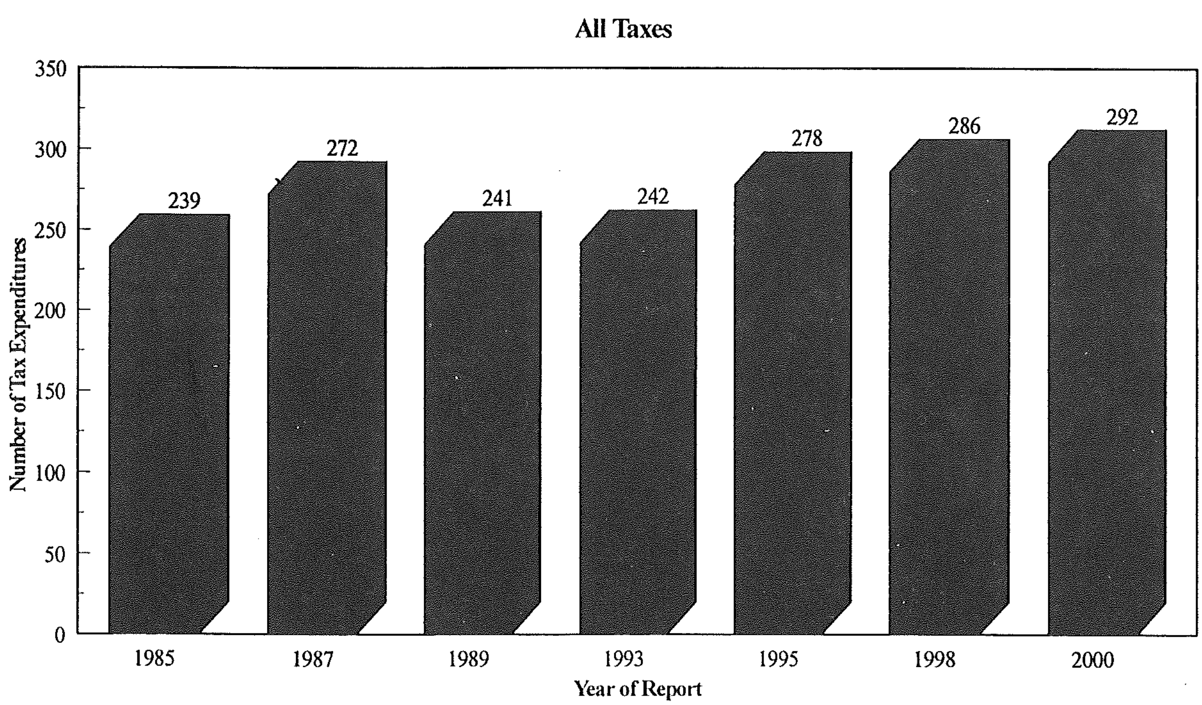
The 2000 Minnesota Tax Expenditure Budget contains 292 separate tax expenditure provisions, compared to 286 in the 1998 report. The net increase of six items tells only part of the story. Twenty-two items were added due to law changes, six of which were to conform to changes in federal law. Eight items were added to the individual income tax, and ten items were added to the general sales and use tax. Sixteen provisions were deleted for various reasons, including repeal, expiration, or no activity. In some cases, provisions were combined, such as the sales tax exemptions for replacement and other capital equipment.

The graph below shows the total number of tax expenditure provisions in each of the Minnesota reports published to date. The year of the report reflects the picture at the beginning of the legislative session for that year. The next page contains similar graphs by tax type.

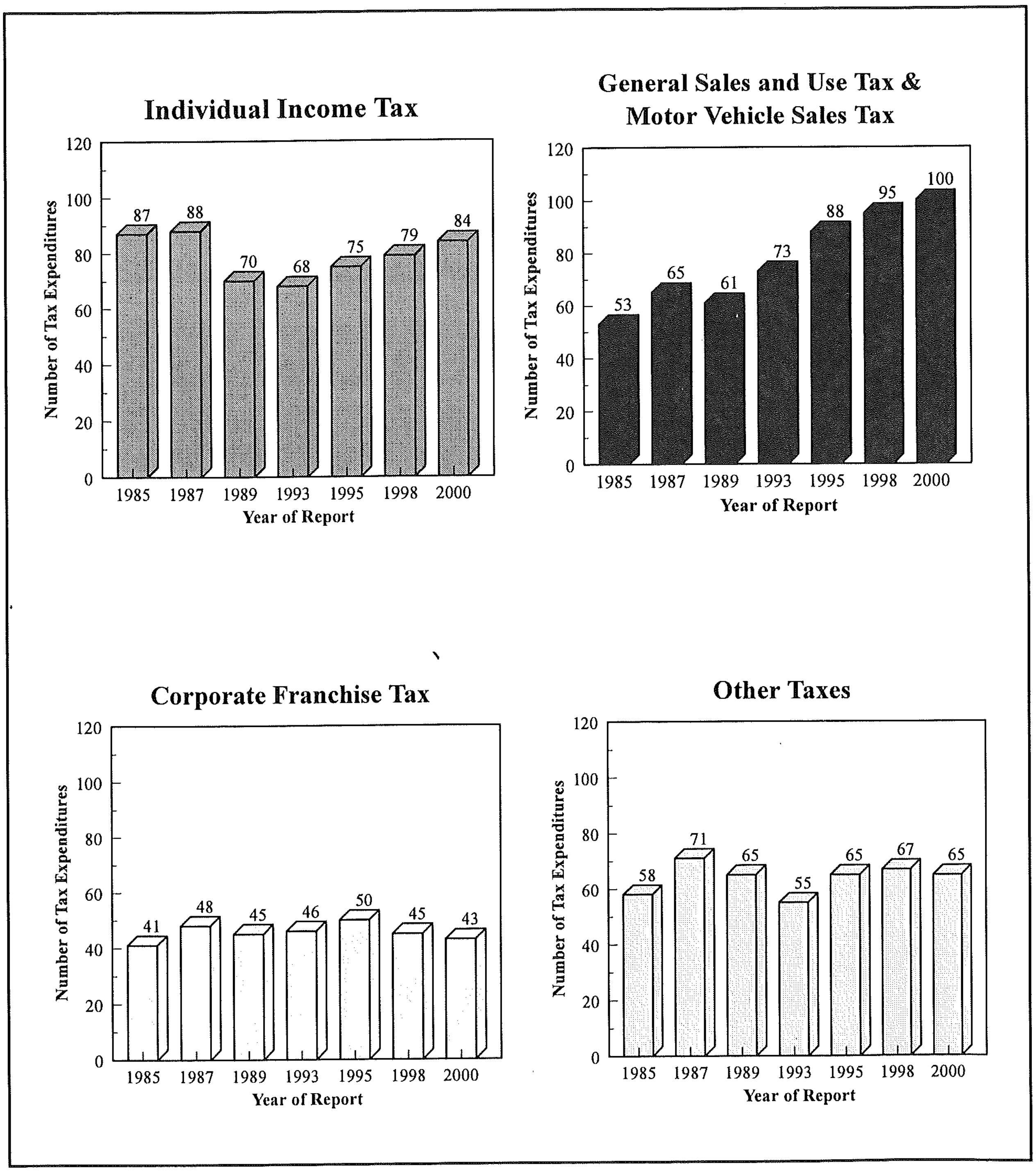
Some trends are evident in the time period covered by the seven Minnesota tax expenditure reports. Not all areas of the tax system have experienced the same level of activity, but notable are the individual income tax and the sales taxes. The pattern in each tax area has been different, and changes in the individual income tax reflect conformity to federal law changes in addition to state choices.

For the individual income tax, the decrease between the 1987 and 1989 reports resulted from federal and state tax reform measures enacted in 1987. However, provisions added over the time period covered by the last three reports have brought the number back to almost the level of the 1987 report.

The number of tax expenditures in the general and motor vehicle sales taxes has nearly doubled since the first report in 1985. Between the 1985 and 2000 reports, a net of 53 tax expenditures were added to Minnesota's tax system. The two sales taxes accounted for 47 of the 53 new provisions.



Summary (Con't)



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INTRODUCTION TO THE TAX EXPENDITURE BUDGET

The Tax Expenditure Concept

The term "tax expenditure" may appear to be a contradiction. "Tax" means money coming into the government; "expenditure" means money going out. How can money be coming in and going out at the same time?

With a tax expenditure, the money does not come in and then go out again; it does not come in at all. The reason it does not come in is that the law has provided for an exemption, deduction, credit, reduced rate, or other mechanism which lowers the amount of tax revenue.

A tax expenditure is like a direct expenditure in that it can be used for public policy goals. A tax expenditure may be enacted either to encourage a certain activity or to limit the tax burden on taxpayers in a certain situation.

For example, government can encourage home ownership by providing grants or other assistance to homeowners and, in fact, does facilitate home buying through its financing programs. Home ownership is also encouraged and subsidized through tax expenditures - the itemized deductions for property taxes and home mortgage interest.

A tax expenditure is different from a direct expenditure in that it does not need to be re-enacted. Unless a sunset date is placed on a tax expenditure provision, it could continue indefinitely, whereas direct expenditures must be appropriated for each budget period.

Not only does a tax expenditure not require re-enactment, its fiscal impact is not usually reviewed after it becomes law. When net revenues are forecast, most tax expenditures have already been excluded from the base. The fiscal impact of an existing provision may not be estimated unless a proposal is made to change or repeal it.

The Purpose of the Tax Expenditure Budget

The tax expenditure budget provides information that is not part of the regular budget so that all aspects of government programs can be reviewed. For each provision in the comprehensive list of tax expenditures the report includes the legal citation, explanation, history, and estimates of the impact of the provision on tax revenues for fiscal years 2000 through 2003.

The purpose of the tax expenditure budget is to provide information. No conclusions are drawn nor are recommendations made regarding whether a provision should be continued, repealed, expanded, or restricted.

Minnesota Statutes, Section 270.067, was enacted in 1983 and required a tax expenditure budget to be submitted as a supplement to the governor's biennial budget. In 1996 the law was changed so that the report is due in each even-numbered year, rather than at the same time as the governor's biennial budget, which occurs in the odd-numbered years. Due to this difference in timing, the report is no longer identified in law as a supplement to the governor's budget.

Introduction

The preparation of this tax expenditure budget involves more than simply listing every exemption, deduction, credit, etc., that is contained in the tax system. A conceptual framework governs the preparation of the report. Each provision is evaluated not subjectively according to its purpose or effectiveness but objectively against a list of criteria. Every effort is made to eliminate value judgments.

Tax Expenditure Criteria

Seven criteria have been established to determine if a provision is a tax expenditure. Some of the criteria are taken directly from the authorizing statute; some are based on concepts used in the preparation of federal tax expenditure reports; and others are based on what is believed to be a logical application of the tax expenditure concept. A provision must meet all the criteria in order to be a tax expenditure.

A provision is a tax expenditure if it:

- has an impact on a tax that is applied statewide;
- confers preferential treatment;
- results in reduced tax revenue in the applicable fiscal years;
- is not included in the budget as an expenditure;
- is included in the defined tax base for that tax;
- is not subject to an alternative tax; and
- can be amended or repealed by a change in state law alone.

The first four criteria are based on the statute requiring the tax expenditure budget.

The tax expenditure budget is required by statute to include every state tax and every local tax that is applied statewide. For example, local taxes that are imposed by only one municipality or only in some counties are not included in the report.

Preferential treatment is a key concept in determining tax expenditures, and a key word in the authorizing statute is "certain". Minnesota Statutes, Section 270.067, Subd. 6(1) (emphasis added):

> "Tax expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for *certain* persons, types of income, transactions, or property that results in reduced tax revenue.

If a provision is not preferential, it is not a tax expenditure. For example, the personal exemption for the individual income tax is not preferential because each person receives the same amount of exemption. Likewise, the graduated rate structure of the individual income tax is not a tax expenditure because each taxpayer with the same amount of tax base pays at the same rate.

In the statute quoted above, a requirement is that the provision ". . . results in reduced tax revenue". A provision that would otherwise qualify is not considered a tax expenditure if it is not being used or is not likely to be used during fiscal years 2000 through 2003.

The federal law (Congressional Budget Act of 1974, Public Law 93-344) that requires a list of tax expenditures to be included with the federal budget includes in its definition of tax expenditures ". . . provisions of the Federal tax laws which allow . . . a deferral of liability". Although the Minnesota law does not mention deferral of liability, this concept has been adopted in the preparation of the report.

A deferral of liability involves the time value of money and affects primarily the individual income and corporate franchise taxes. A deferral can result either from postponing the time when income is recognized for tax purposes or from accelerating the deduction of expenses. In the year in which either of these is done, taxable income is lower than it would be otherwise, although an adjustment may be made in a future year. The effect of the deferral of liability is the same as an interest-free loan for the taxpayer.

Some provisions of tax law are similar to tax expenditures, but they are not considered tax expenditures because they are already listed separately on the spending side of the budget. Many of the property tax relief provisions fit this pattern. For Minnesota budget purposes, revenues are reduced by the total amount of refundable income tax credits. These credits are therefore included in this report.

The tax base for each tax must be clearly defined so that exceptions to that base can be identified. Some tax provisions help to define the base; others are exceptions to the base. The defined base for each tax is explained in the chapter introduction to that tax. The tax base for each tax is the conceptual framework used for this report and is not necessarily the same as an ideal tax base. The determination of the tax base included a review of the statutes, history of the tax, and other pertinent literature.

In some instances, one tax may be imposed in place of another tax, and it would not be reasonable for a taxpayer or activity to be subject to both taxes. Therefore, the exemption from one tax is not considered a tax expenditure if the alternative tax is imposed.

The application of the alternative tax concept for this report was limited to these situations:

- The income from taconite and iron mining is subject to the occupation tax in lieu of the corporate franchise tax.
- The purchase of a motor vehicle is subject to the separate motor vehicle sales tax (Chapter 5) in lieu of the general sales and use tax (Chapter 4).
- A number of taxes are imposed in lieu of the general property tax, including the motor vehicle registration tax and the taconite production tax.
- Noncommercial aircraft are taxed under the aircraft registration tax, whereas commercial airflight property is taxed under the airflight property tax.

However, if a taxpayer can elect to be taxed under an alternative tax that is lower, then the alternative tax provision is considered to be a tax expenditure, measured as the difference between the two taxes. The election to be taxed under the tree growth tax rather than the general property tax is an example of an alternative tax that is preferential (Item 13.09).

The biennial budget contains only items which can become law upon action by both houses of the Minnesota Legislature and the governor. Likewise, the tax expenditure budget contains only items which can be changed or repealed by the concurring actions of the Legislature and the governor. Therefore, provisions that are contained in the Minnesota Constitution, federal law, or the United States Constitution are not included in the tax expenditure budget.

Measuring the Fiscal Impact of Tax Expenditures

The fiscal impact of a tax expenditure is intended to measure what is being "spent" through the tax system on that one provision. It is not necessarily the same as the amount of revenue that would be gained by repeal. This distinction is important.

For the tax expenditure budget, each provision is estimated in isolation, and other provisions in that tax and in other taxes are held constant. The secondary impact of that provision on other provisions is not taken into account. Because the estimates measure the impact of the provision as it exists and not what would happen if it were repealed, no change in taxpayer behavior is assumed.

In contrast to the tax expenditure estimates, estimating the repeal of a provision would take into account interactions within a tax or between taxes and may include changes in taxpayer behavior. If two or more provisions in a tax were repealed at the same time, the combined impact of repealing the provisions would be estimated, rather than estimating each provision separately.

The methodology used to estimate tax expenditures can produce misleading results if the estimates for two or more provisions are combined. Depending upon the situation, the combined impact of two or more provisions could be more or less than the total of the provisions estimated separately.

When two or more tax expenditures in a tax overlap, it is important to understand how this situation is treated in the tax expenditure estimates. When one provision is estimated, all other provisions are assumed to remain unchanged.

The sales tax exemptions for food and for purchases by school districts illustrate this point. When the exemption for food is estimated, purchases by school districts would still be exempt and are not included in the estimate. When the exemption for purchases by school districts is estimated, purchases of food are excluded. Therefore purchases of food by school districts are not included in either estimate. If the two exemptions were repealed together, the estimate of repeal would include the overlap and would be larger than the sum of the two exemptions estimated separately.

The estimates for provisions that result in deferral of tax are the net impact for that year. For example, the expensing of depreciable business property is estimated for a given year as the net of accelerated deductions taken that year and deductions not taken because they were expensed in an earlier year.

The precision of the estimates varies with the source of the data and with the applicability of the data to the tax expenditure provision. Data from Minnesota tax returns were used whenever possible. Other sources included federal tax expenditure estimates, data from federal tax returns, and other data for Minnesota and the nation.

TAX EXPENDITURE SUMMARY LIST

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
INDIVIDUAL INCOME TAX						
Federal Exclusions						
1.01	Employer-Provided Meals and Lodging	1933	$5,100,000	$5,300,000	$5,500,000	$5,800,000
1.02	Rental Value of Parsonages	1945	2,100,000	2,300,000	2,400,000	2,600,000
1.03	Employer-Provided Dependent Care	1982	13,300,000	14,400,000	15,700,000	17,000,000
1.04	Employee Awards	1987	800,000	800,000	800,000	800,000
1.05	Employer Pension Plans	1933	435,800,000	435,200,000	434,600,000	436,300,000
1.06	Contributions by Employers for Medical Insurance Premiums and Medical Care	1933	407,500,000	432,700,000	460,000,000	490,600,000
1.07	Employer-Paid Accident and Disability Premiums	1955	1,300,000	1,300,000	1,400,000	1,500,000
1.08	Employer-Paid Group Term Life Insurance Premiums	1933	11,100,000	11,700,000	12,200,000	12,800,000
1.09	Cafeteria Plans	1975	28,700,000	31,300,000	33,800,000	36,400,000
1.10	Employer-Paid Transportation Benefits	1985	22,700,000	23,100,000	23,500,000	23,900,000
1.11	Medical Savings Accounts	1997	100,000	100,000	100,000	100,000
1.12	Employer-Provided Adoption Assistance	1997	500,000	500,000	100,000	*
1.13	Employer-Provided Educational Assistance	1979	1,400,000	100,000	0	0
1.14	Miscellaneous Employee Fringe Benefits	1985	36,200,000	38,400,000	40,600,000	43,400,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
1.15	Income Earned Abroad by U.S. Citizens and Foreign Housing Costs	1933	$9,900,000	$10,900,000	$11,400,000	$12,400,000
1.16	Certain Allowances for Federal Employees Abroad	1945	600,000	600,000	600,000	600,000
1.17	Benefits and Allowances to Armed Forces Personnel	1933	7,300,000	7,400,000	7,600,000	7,700,000
1.18	Veterans' Benefits	1933	13,600,000	14,000,000	14,400,000	14,800,000
1.19	Military Disability Pensions	1933	400,000	400,000	400,000	400,000
1.20	Workers' Compensation Benefits	1933	39,700,000	39,300,000	38,900,000	38,500,000
1.21	Special Benefits For Disabled Coal Miners	1971	*	*	*	*
1.22	Social Security Benefits	1939	147,300,000	155,000,000	163,700,000	173,300,000
1.23	Medicare Benefits	1965	102,600,000	110,500,000	120,300,000	130,900,000
1.24	Foster Care Payments	1987	200,000	200,000	200,000	200,000
1.25	Public Assistance	1933	2,800,000	2,700,000	2,700,000	2,700,000
1.26	Scholarship and Fellowship Income	1955	5,700,000	5,900,000	6,200,000	6,600,000
1.27	Educational Individual Retirement Accounts	1998	2,900,000	3,200,000	3,600,000	3,900,000
1.28	Qualified State Tuition Plans	1997	100,000	200,000	400,000	500,000
1.29	Certain Agricultural Cost-Sharing Payments	1979	300,000	300,000	300,000	300,000
1.30	Discharge of Indebtedness Income for Certain Farmers	1987	1,100,000	900,000	800,000	600,000
1.31	Investment Income on Life Insurance and Annuity Contracts	1933	129,700,000	133,600,000	138,000,000	142,500,000
1.32	Interest on General Obligation State and Local Government Bonds	1933	26,900,000	27,900,000	28,900,000	30,000,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
1.33	Interest on Nonguaranteed State and Local Government Bonds	1933	$27,900,000	$29,000,000	$30,000,000	$31,100,000
1.34	Capital Gains on Home Sales	1998	114,900,000	118,400,000	122,000,000	125,600,000
1.35	Capital Gains at Death	1933	72,000,000	77,200,000	83,100,000	87,700,000
1.36	Capital Gains on Gifts	1933	6,800,000	7,500,000	8,100,000	8,800,000
1.37	Permanent Exemptions from Imputed Interest Rules	1985	900,000	900,000	1,000,000	1,000,000
1.38	Like-Kind Exchanges	1933	1,700,000	1,700,000	1,700,000	1,700,000
1.39	Special Rules for Magazine, Paperback, and Record Returns	1979	*	*	*	*
1.40	Energy Conservation Subsidies Provided by Public Utilities	1993	100,000	100,000	100,000	100,000
Federal Deductions						
1.41	Depreciation	1959	70,400,000	71,200,000	70,300,000	69,800,000
1.42	Expensing Depreciable Business Property	1983	1,600,000	2,400,000	3,200,000	1,900,000
1.43	Excess of Percentage Over Cost Depletion	1933	800,000	800,000	800,000	800,000
1.44	Five-Year Amortization of Business Organizational and Start-Up Costs	1977	1,700,000	1,700,000	1,700,000	1,700,000
1.45	Seven-Year Amortization of Reforestation Expenditures	1981	*	*	*	*
1.46	Expensing of Research and Development Costs	1955	100,000	100,000	100,000	100,000
1.47	Expensing of Magazine Circulation Expenditures	1951	100,000	100,000	100,000	100,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
1.48	Expensing of Exploration and Development Costs	1933	*	*	*	*
1.49	Cash Accounting and Expensing for Agriculture	1933	$12,300,000	$13,500,000	$14,600,000	$15,400,000
1.50	Expensing of Multiperiod Agricultural Production Costs	1933	1,200,000	1,300,000	1,300,000	1,400,000
1.51	Expensing of Multiperiod Timber Growing Costs	1933	1,200,000	1,300,000	1,300,000	1,400,000
1.52	Special Rules for Mining and Solid Waste Reclamation Reserves	1985	*	*	*	*
1.53	Cash Accounting Other than Agriculture	1933	600,000	600,000	600,000	600,000
1.54	Installment Sales	1933	1,900,000	2,100,000	2,200,000	2,400,000
1.55	Completed Contract Rules	1933	100,000	100,000	100,000	100,000
1.56	Employee Stock Ownership Plans	1975	300,000	300,000	300,000	300,000
1.57	Individual Retirement Accounts	1975	81,900,000	86,500,000	93,800,000	102,400,000
1.58	Keogh Plans	1963	26,800,000	27,300,000	28,400,000	30,000,000
1.59	Interest on Education Loans	1998	1,000,000	1,200,000	1,500,000	1,600,000
1.60	Per Diem Amounts Paid to State Legislators	1959	*	*	*	*
1.61	Treatment of Clean-Fuel Vehicles	1993	100,000	100,000	100,000	100,000
Federal Personal Deductions						
1.62	Additional Standard Deduction for the Elderly and Blind	1987	13,000,000	13,500,000	14,300,000	14,700,000
1.63	Medical and Dental Expenses	1933	20,100,000	21,400,000	23,000,000	23,800,000
1.64	Real Estate Taxes	1933	93,300,000	100,400,000	107,100,000	110,500,000
1.65	Other Taxes	1933	12,100,000	12,600,000	13,200,000	13,700,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
1.66	Interest on Home Mortgages	1933	$268,700,000	$294,100,000	$317,000,000	$329,600,000
1.67	Charitable Contributions	1933	126,700,000	133,700,000	140,800,000	145,800,000
1.68	Casualty and Theft Losses	1933	1,300,000	1,300,000	1,400,000	1,400,000
Minnesota Subtractions						
1.69	K-12 Education Expenses	1955	17,500,000	18,300,000	19,300,000	20,200,000
1.70	Charitable Contributions for Nonitemizers	1999	3,100,000	3,500,000	3,700,000	4,000,000
1.71	Income of the Elderly or Disabled	1988	2,400,000	2,100,000	1,800,000	1,600,000
1.72	Self-Employed Health Insurance	1988	8,400,000	9,200,000	9,700,000	10,600,000
1.73	Urban Homestead Program	1995	2,000,000	2,000,000	2,000,000	2,000,000
1.74	Youth Works Postservice Benefits	1997	*	*	*	*
1.75	Disposition of Farm Property	1985	100,000	100,000	100,000	100,000
Preferential Computation						
1.76	Five-Year Averaging of Lump Sum Distributions	1975	900,000	*	*	*
Credits						
1.77	Credit for Income Tax Paid to Other States	1959	64,700,000	71,200,000	78,300,000	86,100,000
1.78	Marriage Credit	1999	46,200,000	48,400,000	50,900,000	52,900,000
1.79	Credit for Long-Term Care Insurance	1997	1,500,000	1,700,000	1,800,000	2,000,000
1.80	Credit for Increases in Property Taxes on Cabins	1997	100,000	0	0	0

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
1.81	Child and Dependent Care Credit	1977	$12,000,000	$12,000,000	$12,000,000	$12,000,000
1.82	Working Family Credit	1991	87,000,000	89,000,000	91,100,000	93,200,000
1.83	K-12 Education Credit	1997	20,000,000	24,000,000	28,800,000	31,700,000
1.84	Employer Tax Credits (Enterprise Zones)	1983	100,000	100,000	100,000	100,000
CORPORATE FRANCHISE TAX						
Exempt Organizations						
2.01	Credit Unions	1937	4,600,000	4,900,000	5,200,000	5,600,000
2.02	Insurance Companies Domiciled in Retaliatory States	1989	26,000,000	26,000,000	26,800,000	27,300,000
2.03	Smaller Mutual Property and Casualty Insurance Companies	1989	200,000	200,000	300,000	300,000
Federal Exclusions						
2.04	Permanent Exemptions from Imputed Interest Rules	1985	100,000	100,000	100,000	100,000
2.05	Investment Income on Life Insurance and Annuity Contracts	1933	4,900,000	5,000,000	5,100,000	5,300,000
2.06	Like-Kind Exchanges	1933	1,500,000	1,500,000	1,500,000	1,500,000
2.07	Special Rules for Magazine, Paperback, and Record Returns	1979	100,000	100,000	100,000	100,000
2.08	Alternative Computation for Small Property and Casualty Companies	1989	*	*	*	*
Federal Deductions						
2.09	Depreciation	1959	95,500,000	96,700,000	98,600,000	99,700,000
2.10	Expensing Depreciable Business Property	1983	1,800,000	2,400,000	2,500,000	2,000,000
2.11	Excess of Percentage Over Cost Depletion (Mining Occupation Tax)	1989	900,000	900,000	700,000	700,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
2.12	Amortization of Organizational and Start-up Costs	1955	$200,000	$200,000	$200,000	$200,000
2.13	Expensing of Research and Development Costs	1955	8,700,000	9,800,000	10,200,000	10,900,000
2.14	Expensing of Magazine Circulation Expenditures	1951	100,000	100,000	100,000	100,000
2.15	Expensing for Removal of Barriers to the Handicapped and Elderly	1987	100,000	100,000	100,000	100,000
2.16	Expensing of Exploration and Development Costs	1967	800,000	900,000	1,000,000	1,100,000
2.17	Cash Accounting and Expensing for Agriculture	1933	400,000	400,000	500,000	500,000
2.18	Expensing of Multiperiod Agricultural Production Costs	1933	100,000	100,000	100,000	100,000
2.19	Expensing of Multiperiod Timber Growing Costs	1933	800,000	900,000	1,000,000	1,100,000
2.20	Special Rules for Mining and Solid Waste Reclamation Reserves	1987	100,000	100,000	100,000	100,000
2.21	Cash Accounting Other than Agriculture	1933	100,000	100,000	100,000	100,000
2.22	Installment Sales	1933	1,700,000	1,800,000	1,900,000	2,000,000
2.23	Completed Contract Rules	1933	700,000	700,000	700,000	700,000
2.24	Employee Stock Ownership Plans	1984	4,400,000	4,700,000	4,900,000	5,000,000
2.25	Capital Construction Funds of Shipping Companies	1987	*	*	*	*
2.26	Unpaid Property Loss Reserves of Property and Casualty Insurance Companies	1989	2,200,000	2,200,000	2,200,000	2,300,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
2.27	Special Treatment of Life Insurance Company Reserves	1989	$900,000	$900,000	$1,000,000	$1,000,000
2.28	Treatment of Small Life Insurance Companies	1989	100,000	100,000	100,000	100,000
2.29	Treatment of Clean-Fuel Vehicles	1993	400,000	400,000	400,000	300,000
Apportionment						
2.30	Weighted Apportionment	1939	118,100,000	116,600,000	132,000,000	137,300,000
2.31	Throwback Sales	1973	23,000,000	23,000,000	26,900,000	28,000,000
2.32	Single-Factor Apportionment for Mail Order Companies	1985	4,500,000	4,400,000	3,800,000	3,900,000
Minnesota Subtractions						
2.33	Dividend Received Deduction	1947	76,000,000	75,000,000	76,100,000	79,200,000
2.34	Charitable Contributions	1933	10,300,000	10,200,000	10,300,000	10,700,000
2.35	Foreign Source Income	1988	51,700,000	51,100,000	51,800,000	53,900,000
2.36	Disposition of Farm Property	1985	*	*	*	*
Credits						
2.37	Research and Development Credit	1981	16,700,000	16,500,000	16,700,000	17,400,000
2.38	Credit for Tax Paid to Other States	1999	0	0	0	1,800,000
2.39	Employer Tax Credits (Enterprise Zones)	1983	400,000	400,000	400,000	*
2.40	Aircraft Maintenance and Engine Repair Facilities Job Credit	1991	2,100,000	2,100,000	2,100,000	0
2.41	Job Training Program Credit	1997	200,000	200,000	200,000	100,000
2.42	Credit for Gross Premiums Tax (Insurance Companies)	1937	13,800,000	13,000,000	13,000,000	13,400,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
2.43	Credit for Guaranty Association Assessments	1994	$500,000	$400,000	$300,000	$300,000
ESTATE TAX						
Preferential Valuation						
3.01	Special Use Valuation	1979	200,000	300,000	300,000	300,000
Exclusions						
3.02	Life Insurance Proceeds	1979	5,600,000	6,200,000	6,900,000	7,700,000
3.03	Annuities	1979	*	*	*	*
3.04	Social Security Benefits	1979	*	*	*	*
Deductions						
3.05	Marital Deduction	1979	46,500,000	49,400,000	52,500,000	55,700,000
3.06	Charitable Gifts	1979	17,100,000	18,100,000	19,100,000	20,200,000
GENERAL SALES AND USE TAX						
Exemptions - Particular Goods and Services						
4.01	Food Products	1967	397,000,000	408,500,000	421,000,000	434,900,000
4.02	Clothing and Wearing Apparel	1967	382,800,000	401,100,000	420,900,000	443,600,000
4.03	Drugs and Medicines	1967	95,200,000	104,200,000	114,000,000	124,900,000
4.04	Therapeutic and Prosthetic Devices	1967	6,400,000	6,800,000	7,200,000	7,700,000
4.05	Prescription Eyeglasses	1967	8,900,000	9,300,000	9,800,000	10,400,000
4.06	Baby Care Products	1967	400,000	400,000	400,000	400,000
4.07	Feminine Hygiene Items	1981	2,500,000	2,600,000	2,700,000	2,900,000
4.08	Caskets and Burial Vaults	1967	5,100,000	5,100,000	5,100,000	5,100,000
4.09	Publications	1967	43,000,000	44,300,000	45,600,000	47,000,000
4.10	Textbooks Required for School Use	1973	6,600,000	6,900,000	7,100,000	7,400,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
4.11	Personal Computers Required for School Use	1994	$100,000	$100,000	$100,000	$100,000
4.12	Motor Fuels	1967	234,400,000	248,600,000	258,900,000	272,800,000
4.13	Residential Heating Fuels	1978	84,600,000	91,800,000	98,600,000	104,500,000
4.14	Residential Water Services	1979	18,500,000	18,900,000	19,500,000	20,100,000
4.15	Sewer Services	1967	21,700,000	22,200,000	22,800,000	23,500,000
4.16	Used Manufactured Homes	1984	500,000	500,000	600,000	600,000
4.17	Selected Services	1967	905,800,000	953,000,000	1,006,300,000	1,062,300,000
4.18	YMCA, YWCA, and JCC Membership Dues	1987	1,500,000	1,500,000	1,600,000	1,600,000
4.19	Cross Country Ski Passes for Public Trails	1988	*	*	*	*
4.20	Personal Property Brought into Minnesota	1967	7,200,000	7,300,000	7,400,000	7,600,000
4.21	De Minimis Use Tax Exemption for Individuals	1996	100,000	100,000	100,000	100,000
4.22	Capital Equipment	1984	149,000,000	150,700,000	158,100,000	165,000,000
4.23	Accessory Tools	1973	6,900,000	6,900,000	7,000,000	7,100,000
4.24	Special Tooling	1984	4,500,000	4,600,000	4,700,000	4,800,000
4.25	Resource Recovery Equipment	1984	200,000	300,000	200,000	200,000
4.26	Used Motor Oil	1988	200,000	200,000	300,000	300,000
4.27	Taconite Production Materials	1971	*	*	*	*
4.28	Wind Energy Conversion Systems	1992	500,000	400,000	300,000	400,000
4.29	Air Cooling Equipment	1992	200,000	300,000	400,000	*
4.30	Airflight Equipment	1967	10,300,000	10,300,000	9,500,000	9,000,000
4.31	Large Ships	1992	100,000	100,000	100,000	100,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
4.32	Repair and Replacement Parts for Ships and Vessels	1990	$200,000	$200,000	$200,000	$200,000
4.33	Petroleum Products Used by Transit Systems	1992	600,000	600,000	600,000	600,000
4.34	Petroleum Products used in Passenger Snowmobiles	1993	*	*	*	*
4.35	Logging Equipment	1984	600,000	700,000	700,000	700,000
4.36	Farm Machinery	1981	16,400,000	18,800,000	18,900,000	19,000,000
4.37	Repair and Replacement Parts for Farm Machinery	1985	7,000,000	7,000,000	7,000,000	7,000,000
4.38	Petroleum Products Used to Improve Agricultural Land	1985	*	*	*	*
4.39	Farm Conservation Program Items	1991	300,000	300,000	300,000	300,000
4.40	Used Farm Tires	1994	*	*	*	*
4.41	Horses	1994	900,000	900,000	900,000	900,000
4.42	Prizes at Carnivals and Fairs	1999	100,000	100,000	100,000	100,000
4.43	Television Commercials	1999	1,000,000	1,100,000	1,100,000	1,200,000
4.44	Advertising Materials	1973	6,400,000	6,800,000	7,100,000	7,500,000
4.45	Court Reporter Documents	1997	600,000	600,000	700,000	700,000
4.46	Certain Interstate Telephone Service	1987	8,400,000	9,000,000	9,500,000	10,000,000
4.47	Metropolitan Public Safety Radio Systems	1997	1,100,000	1,900,000	1,700,000	900,000
4.48	Packing Materials	1973	*	*	*	*
4.49	Property for Business Use Outside Minnesota	1967	*	*	*	*

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
4.50	Automatic Fire-Safety Sprinkler Systems	1992	$900,000	$800,000	$700,000	$700,000
4.51	Building Materials for Residences of Disabled Veterans	1971	*	*	*	*
4.52	Chair Lifts, Ramps, and Elevators in Homesteads	1989	*	*	*	*
4.53	Ambulances Leased to Licensed Ambulance Services	1990	*	*	*	*
4.54	Firefighters' Personal Protective Equipment	1994	600,000	600,000	700,000	700,000
4.55	Parts and Accessories to Make Motor Vehicles Handicapped Accessible	1993	700,000	700,000	700,000	700,000
Exemptions - Sales to Particular Groups						
4.56	Certain Sales to Local Governments	1967	58,300,000	59,000,000	59,800,000	60,500,000
4.57	Sales to Nonprofit Organizations	1967	58,700,000	59,700,000	60,800,000	62,000,000
4.58	Sales to Veterans' Organizations	1980	200,000	200,000	300,000	300,000
4.59	Duluth Entertainment Convention Center	1995	400,000	200,000	0	0
4.60	Minneapolis Convention Center	1998	1,200,000	1,200,000	0	0
4.61	St. Paul RiverCentre Arena	1998	1,300,000	300,000	0	0
4.62	Earle Brown Heritage Center	1998	*	*	0	0
4.63	Lake Superior Center	1997	500,000	100,000	0	0
4.64	Science Museum of Minnesota	1997	100,000	0	0	0
4.65	Agricultural Processing Facility	1999	0	400,000	200,000	0
4.66	Biomass Electrical Generating Facility	1999	500,000	*	0	0

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
4.67	Biosolids Processing Equipment and Facilities	1998	$1,400,000	$1,000,000	$700,000	$600,000
4.68	Business Incubator and Industrial Park Facility	1997	*	0	0	0
4.69	District Heating and Cooling Facility	1997	200,000	200,000	0	0
4.70	Soybean Processing Facility	1998	*	200,000	1,000,000	200,000
Exemptions - Sales by Particular Groups						
4.71	Isolated or Occasional Sales	1967	22,100,000	22,800,000	23,800,000	24,900,000
4.72	Institutional Meals	1967	33,300,000	33,900,000	34,500,000	35,200,000
4.73	Fundraising Sales by Nonprofit Organizations	1985	4,800,000	4,900,000	5,000,000	5,000,000
4.74	Candy Sales by Certain Organizations	1984	*	*	*	*
4.75	Minnesota Amateur Sports Commission Events	1994	*	*	*	*
4.76	Admission to Charitable Golf Tournaments	1994	*	*	*	*
4.77	Admission to School-Sponsored Events	1985	700,000	700,000	700,000	700,000
4.78	Admission to Artistic Events	1980	4,100,000	4,200,000	4,200,000	4,300,000
4.79	Sacramental Wine Sold by Religious Organizations	1991	*	*	*	*
Reduced Sales Price						
4.80	Price Reduced by Value of Trade In	1967	4,900,000	3,000,000	3,100,000	3,300,000
4.81	New Manufactured Homes	1984	3,900,000	4,200,000	4,700,000	5,200,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
Reduced Rates						
4.82	Tax Paid to Other States	1967	$3,600,000	$3,700,000	$3,800,000	$3,900,000
MOTOR VEHICLE SALES TAX						
Exemptions						
5.01	Vehicles Acquired by Inheritance	1971	2,400,000	2,500,000	2,600,000	2,600,000
5.02	Vehicles of Persons Moving into Minnesota	1971	8,400,000	8,500,000	8,700,000	8,800,000
5.03	Transfers Between Joint Owners	1971	2,900,000	3,000,000	3,100,000	3,200,000
5.04	Transfers Between Family Members	1971	17,100,000	17,600,000	18,100,000	18,500,000
5.05	Transfers in Divorce Proceedings	1974	400,000	400,000	400,000	400,000
5.06	Corporate and Partnership Transfers	1975	800,000	800,000	800,000	800,000
5.07	Sales to Disabled Veterans	1971	*	*	*	*
5.08	Ambulances Purchased by Private Ambulance Services	1990	*	*	*	*
5.09	Bookmobiles	1994	*	*	*	*
5.10	Vehicles Used in Automotive Training Programs	1988	100,000	100,000	100,000	100,000
5.11	Vehicles Donated to Exempt Organizations	1997	100,000	100,000	100,000	100,000
5.12	Ready-Mixed Concrete Trucks	1998	600,000	600,000	600,000	600,000
5.13	Town Road Maintenance Vehicles	1998	200,000	200,000	200,000	200,000
Reduced Purchase Price						
5.14	Federal Excise Taxes	1983	1,000,000	1,000,000	1,000,000	1,000,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
5.15	Price Reduced by Value of Trade in	1971	$83,300,000	$90,200,000	$97,600,000	$105,500,000
5.16	Handicapped-Accessible Modifications	1992	200,000	200,000	200,000	200,000
Preferential Computations						
5.17	Flat Taxes on Older Cars and Collector Vehicles	1985	15,800,000	16,100,000	16,400,000	16,700,000
Credit						
5.18	Credit for Taxes Paid to Other States	1971	2,300,000	2,300,000	2,400,000	2,400,000
HIGHWAY FUELS EXCISE TAXES						
Exemptions						
6.01	Transit Systems Receiving State Financial Assistance	1977	2,700,000	2,700,000	2,700,000	2,700,000
6.02	Motor Vehicles Not Requiring Registration (Special Fuels)	1951	600,000	600,000	600,000	600,000
6.03	Reciprocal Agreements for Out-of-State Purchases	1961	*	*	*	*
ALCOHOLIC BEVERAGE TAXES						
Exemptions						
7.01	Consumer Purchases Made Out of State	1947	100,000	100,000	100,000	100,000
7.02	Home Production and Use	1957	*	*	*	*
7.03	Sales to Food Processors and Pharmaceutical Firms	1988	*	*	*	*

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
7.04	Consumption on Brewery Premises	1941	*	*	*	*
7.05	Wine for Tasting and Testing	1934	*	*	*	*
7.06	Wine for Sacramental Purposes	1937	*	*	*	*
7.07	Shipments of Wine for Personal Use	1993	*	*	*	*
Credit						
7.08	Small Brewers' Credit	1985	$200,000	$200,000	$200,000	$200,000
CIGARETTE AND TOBACCO TAXES						
Exemption						
8.01	Consumer Purchases Made Out of State	1949	2,700,000	2,700,000	2,700,000	2,700,000
MORTGAGE REGISTRY TAX						
Exemptions						
9.01	Certain Persons and Organizations	1907	600,000	600,000	600,000	600,000
DEED TRANSFER TAX						
Exemptions						
10.01	Deeds Partitioning Property of Co-Owners	1984	100,000	100,000	100,000	100,000
10.02	Deeds of Distribution by Personal Representatives	1975	*	*	*	*
10.03	Deeds for Cemetery Lots	1961	100,000	100,000	100,000	100,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
10.04	Exchange of Permanent School Fund Lands	1991	*	*	*	*
10.05	Mortgage or Lien Foreclosure Sales	1993	$800,000	$900,000	$1,000,000	$1,000,000
10.06	Decree of Marriage Dissolution	1997	100,000	100,000	100,000	100,000
LAWFUL GAMBLING TAXES						
Exemptions						
11.01	Bingo at Certain Organizations	1985	*	*	*	*
11.02	Bingo at Fairs and Civic Celebrations	1984	*	*	*	*
11.03	Infrequent Bingo Occasions	1984	*	*	*	*
11.04	Smaller Raffles	1984	*	*	*	*
11.05	Raffles by Certain Organizations	1984	300,000	300,000	300,000	300,000
11.06	Lawful Gambling Under Certain Conditions	1986	700,000	700,000	700,000	700,000
INSURANCE PREMIUMS TAXES						
Exemptions						
12.01	Fraternal Benefit Socities	1907	3,900,000	4,000,000	4,100,000	4,200,000
12.02	Farmers' Mutual and Township Mutual Fire Insurance Companies (Fire Marshal Tax)	1915	200,000	200,000	200,000	200,000
12.03	Minnesota Comprehensive Health Insurance Plan Premiums	1976	1,000,000	1,000,000	1,000,000	1,000,000
Exemptions/Reduced Rate						
12.04	Health Maintenance Organizations and Nonprofit Health Service Plan Corporations	1971	57,400,000	43,400,000	31,100,000	32,400,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
Reduced Rates						
12.05	Smaller Mutual Property and Casualty Insurance Companies	1988	$4,900,000	$5,000,000	$5,200,000	$5,400,000
Credit						
12.06	Credit for Guaranty Association Assessments	1994	3,400,000	2,600,000	2,200,000	2,100,000
PROPERTY TAX						
Exemptions						
13.01	Exempt Real Property	1851	945,500,000	942,600,000	998,900,000	1,038,900,000
13.02	Limited Market Value	1993	17,700,000	25,000,000	32,700,000	43,100,000
13.03	Certain Improvements to Older Homes	1993	6,200,000	8,600,000	11,900,000	16,400,000
Preferential Valuations						
13.04	Classification System	1913	N/A	N/A	N/A	N/A
13.05	Green Acres Treatment of Agricultural Land	1967	14,900,000	17,600,000	20,800,000	24,600,000
13.06	Open Space Property	1969	4,300,000	5,200,000	5,300,000	5,400,000
13.07	Metropolitan Agricultural Preserves Land	1980	2,700,000	2,900,000	3,100,000	3,300,000
13.08	Tax Increment Financing	1947	290,900,000	297,600,000	308,300,000	319,400,000
Preferential Computations						
13.09	Auxiliary Forest Tax and Tree Growth Tax	1927	1,100,000	1,200,000	1,200,000	1,300,000

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
Credits						
13.10	Taconite Homestead Credit	1969	$14,700,000	$14,700,000	$14,700,000	$14,700,000
13.11	Power Line Credit	1979	100,000	100,000	100,000	100,000
13.12	Agricultural Preserves Credit	1980	300,000	300,000	300,000	300,000
13.13	Conservation Tax Credit	1986	200,000	200,000	200,000	200,000
AIRFLIGHT PROPERTY TAX						
Preferential Computation						
14.01	Commuter Airlines	1969	100,000	100,000	100,000	100,000
Preferential Valuations						
14.02	Quiet Aircraft	1987	300,000	200,000	200,000	200,000
14.03	Certain Airlines	1987	1,100,000	1,100,000	1,100,000	1,100,000
MOTOR VEHICLE REGISTRATION TAX						
Exemptions						
15.01	Local Government Vehicles	1921	5,600,000	5,800,000	6,000,000	6,200,000
15.02	School Buses	1933	500,000	500,000	500,000	500,000
15.03	Nonresident Military Personnel	1967	100,000	100,000	100,000	100,000
15.04	Medal of Honor Recipients and Former Prisoners of War	1983	100,000	100,000	100,000	100,000
15.05	Disabled Veterans	1941	*	*	*	*
15.06	Nonprofit Charities	1987	*	*	*	*
15.07	Driver Education Programs at Nonpublic High Schools	1990	*	*	*	*

		Year Enacted	Fiscal Year Impact 2000	2001	2002	2003
15.08	Ambulances Owned by Private Ambulance Services	1990	$100,000	$100,000	$100,000	$100,000
Preferential Computation						
15.09	Privately-Owned Buses Used for Student Transportation	1971	400,000	400,000	400,000	400,000
Credit						
15.10	Physically Disabled Persons	1975	300,000	300,000	300,000	300,000
AIRCRAFT REGISTRATION TAX						
Exemption						
16.01	Civil Air Patrol Aircraft	1957	*	*	*	*
16.02	Maximum Tax For Agricultural Aircraft	1999	*	*	*	*

CHAPTER 1: INDIVIDUAL INCOME TAX

Collections and History

Fiscal year 1999 net collections from the individual income tax were $5.3 billion, which was 43.6% of total state revenue. All revenue from this tax goes into the state general fund.

The State of Minnesota enacted an income tax for both individuals and corporations in 1933, twenty years after the federal income tax was adopted. One graduated rate schedule applied to both taxes, and it was divided into $1,000 increments, with the lowest rate at 1% on the first $1,000 of taxable income and the highest rate at 5% on taxable income over $10,000.

Although many changes were made to the individual income tax over the years, the structure of the tax remained basically the same from 1933 to 1985. Major changes were made in two areas in 1985: the joint income of married couples and the deductibility of the federal income tax.

Prior to 1985, one rate schedule applied to all filers, so that the income of each person was treated the same, regardless of marital status. Two-income married couples usually filed separately, even though they filed a joint federal return. In 1985 a married-joint schedule was added, and the election to file jointly or separately was required to be the same as on the federal return. Other provisions were changed so that they are based on the joint income of the couple rather than on the income of each taxpayer.

A deduction for federal income taxes was allowed until 1985, when the deduction was made an option, with a schedule of higher tax rates used if federal tax was deducted. In 1987 the deduction for federal income tax was eliminated, as part of another wave of broad changes to the individual income tax.

Whereas the 1985 tax changes involved a significant reduction in individual income tax revenues, the combined effect of the 1987 changes was revenue neutral. The 1987 changes to the individual income tax occurred in three major areas: federal conformity and simplification; 1986 federal tax reform; and rate structure.

Federal adjusted gross income had been the starting point for the Minnesota tax, but in 1987 the starting point was changed to federal taxable income. The Minnesota standard deduction and personal credits were replaced with the federal standard deduction and personal exemptions. Some of the adjustments to income were repealed. Using federal taxable income continued the trend toward closer conformity to federal itemized deductions, with the exceptions now being adjustments to federal taxable income.

Minnesota also adopted nearly all of the landmark changes contained in the federal tax reform act of 1986, most of which took effect in tax year 1987. Since 1987, Minnesota has adopted most of the federal changes that affect the determination of federal taxable income.

Both the number of tax brackets and the range of tax rates were reduced dramatically in 1987. Prior to 1985 there were twelve tax rates, from 1.6% to 16%. Since 1988 there have been only three tax rates. In 1999 the tax rates were reduced from 6%, 8%, and 8.5% to 5.5%, 7.25%, and 8%.

Tax Base

In order to be a tax expenditure, a provision must be included in the defined tax base for that tax. For this study, the tax base for the individual income tax is defined to be income from all sources less expenses that are reasonable and necessary to generate that income. If an expense is reasonable and necessary to generate income, it is not considered a tax expenditure.

An all-encompassing definition of income would include gifts and bequests. For purposes of this study, gifts and bequests that are voluntary and unconditional are not considered income, and, therefore, their exclusion is not considered a tax expenditure. Payments to which the recipient is entitled due to meeting specified requirements, such as social security, workers compensation, and public assistance, are considered income, and the exclusion of that income is a tax expenditure.

Computation of the Tax

The computation of the Minnesota individual income tax starts with federal taxable income. The definition of federal taxable income in Minnesota tax law references the Internal Revenue Code as of a specified date. If federal legislation is enacted which affects the computation of federal taxable income, a state law change is required to adopt the federal changes, generally by updating the reference to the Internal Revenue Code.

Minnesota has adopted the federal personal exemptions and standard deduction without any modifications. Minnesota also adopts the federal itemized deductions, but state income taxes are added back on the Minnesota return. The estimates for the itemized deductions take into account the incremental benefit of the deduction over the standard deduction for those taxpayers who would lose the benefit of itemizing by the loss of that one deduction.

The tax brackets are increased annually by the increase in the United States Consumer Price Index and for tax year 1999 are as follows:

	5.5%	7.25%	8%
Married Joint	$1 - $25,220	$25,221 - $100,200	Over $100,200
Married Separate	$1 - $12,610	$12,611 - $50,100	Over $50,100
Single	$1 - $17,250	$17,251 - $56,680	Over $56,680
Head of Household	$1 - $21,240	$21,241 - $85,350	Over $85,350

An alternative minimum tax (AMT) on tax preference items is imposed to the extent that it exceeds the regular tax computed from the above rate schedule. The Minnesota AMT is similar to the federal AMT and is 6.5% of Minnesota alternative minimum taxable income. The benefits to a taxpayer of a number of the deductions shown as tax expenditures are lower because part or all of these items must be added back in computing alternative minimum taxable income.

The tax expenditures are shown generally in the order in which they occur in the computation of the tax. The Minnesota individual income tax is computed as follows for tax year 1999:

	Income from all sources
minus:	federal exclusions
equals:	federal gross income
minus:	federal deductions
equals:	federal adjusted gross income
minus:	federal standard deduction or itemized deductions
minus:	federal personal exemptions
equals:	federal taxable income
plus:	Minnesota additions, including:
	- non-Minnesota state and municipal bond interest
	- federal itemized deduction for state income taxes
	- capital gains portion of a lump sum distribution
minus:	Minnesota subtractions, including:
	- U.S. bond interest
	- dependent K-12 education expenses
	- charitable contributions for nonitemizers
	- income of elderly and disabled (up to specified limits)
	- state income tax refunds included in federal taxable income
	- railroad retirement income
	- payments by the self-employed for health insurance not deducted federally
equals:	Minnesota taxable income
times:	graduated rates of 5.5%, 7.25%, and 8%
equals:	gross tax
plus:	alternative minimum tax
plus:	tax on lump sum distribution from a pension plan
minus:	nonrefundable credits, including:
	- credit for income tax paid to other states
	- marriage credit
	- long-term care insurance credit
	- alternative minimum tax carryover credit
equals:	Minnesota income tax
minus:	refundable credits
	- dependent care credit
	- working family credit
	- K-12 education credit
equals:	net individual income tax payable

FEDERAL EXCLUSIONS

1.01 EMPLOYER-PROVIDED MEALS AND LODGING

Internal Revenue Code, Sections 119 and 132(e)(2)
Minnesota Statutes, Section 290.01, Subd. 19

Section 119 of the Internal Revenue Code allows an employee to exclude from federal gross income the value of meals and lodging furnished by the employer for the employer's convenience on the business premises. To qualify, the lodging must be required as a condition of employment, such as for a live-in housekeeper or an apartment resident manager. This provision does not cover instances in which an employee is reimbursed by the employer for amounts previously spent on meals and lodging.

Also excluded is the fair market value of meals provided to employees at a subsidized eating facility operated by the employer. The facility must be located on or near the employer's business, and revenue from the facility must equal or exceed the facility's direct operating costs.

These exclusions were first allowed in 1918 by federal regulation. Section 119 was enacted in 1954. The exclusion of meals at employer-provided facilities was enacted in 1984. This provision was last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$5,100,000	$5,300,000	$5,500,000	$5,800,000

1.02 RENTAL VALUE OF PARSONAGES

Internal Revenue Code, Section 107
Minnesota Statutes, Section 290.01, Subd. 19

Section 107 of the Internal Revenue Code provides that the gross income of a minister of the gospel does not include any housing allowance that is part of compensation. The exclusion applies whether it is the rental value of a home furnished to the minister or a cash housing allowance paid as part of compensation. Ministers receiving cash housing allowances may also claim itemized deductions for mortgage interest and real estate taxes on their residences.

This exclusion was enacted federally in 1921 and adopted by Minnesota in 1945.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,100,000	$2,300,000	$2,400,000	$2,600,000

1.03 EMPLOYER-PROVIDED DEPENDENT CARE

Internal Revenue Code, Section 129
Minnesota Statutes, Section 290.01, Subd. 19

Employer-provided dependent care assistance is excluded from the employee's income if the assistance is provided through a formal, written plan. The amount excluded from an employee's income cannot exceed $5,000 during a tax year. The assistance provided may not discriminate in favor of employees who are highly compensated, shareholders, owners, or their dependents. The amount excluded cannot exceed the employee's earned income; amounts exceeding earned income are taxable.

If the taxpayer makes direct payments for child or dependent care, this exclusion does not apply, but the taxpayer may be eligible for the child and dependent care credit (Item 1.81).

This provision was enacted in 1981 and was last changed in 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$13,300,000	$14,400,000	$15,700,000	$17,000,000

1.04 EMPLOYEE AWARDS

Internal Revenue Code, Sections 74(c) and 274(j)
Minnesota Statutes, Section 290.01, Subd. 19

Certain employee awards are excluded from gross income. To qualify, the award must be tangible personal property and must be given for either length of service or safety achievement. Limits on the size of the business deduction taken by the business giving the award determine the size of the award that is excluded. In general, the exclusion is limited to $400. If the employer has an established written plan which does not discriminate in favor of highly-compensated employees, the exclusion for each employee may be up to $1,600.

Employee awards were first specifically excluded by statute in the federal Tax Reform Act of 1986.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$800,000	$800,000	$800,000	$800,000

1.05 EMPLOYER PENSION PLANS

Internal Revenue Code, Sections 401-407, 411, 415, and 457
Minnesota Statutes, Section 290.01, Subd. 19

Employer contributions to an employee's qualified pension plan are excluded from the employee's income. The current-year earnings derived from such contributions, as well as those from contributions made by the employee, are also excluded. The employee's contribution is also excluded from income for specific types of plans, including 401(k) plans, certain government plans, tax-sheltered annuities, and deferred compensation.

The tax expenditure is actually a deferral of income and not an exclusion because pension income which was not previously taxed must be included in income when disbursements are received. The estimates show the fiscal impact of excluding current-year pension contributions and earnings from taxable income, net of all taxed pension income disbursed in that year.

The federal exclusion was enacted in 1921, and the Minnesota exclusion was enacted in 1933. Various changes were enacted over the years, primarily affecting the requirements for a qualified plan. The last changes were made in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$435,800,000	$435,200,000	$434,600,000	$436,300,000

1.06 CONTRIBUTIONS BY EMPLOYERS FOR MEDICAL INSURANCE PREMIUMS AND MEDICAL CARE

Internal Revenue Code, Sections 105 and 106
Minnesota Statutes, Section 290.01, Subd. 19

All employer contributions to health insurance plans which provide compensation for sickness and injury are excluded from the employee's income. Payments from such plans may be excluded to the extent that they are based on the nature of the injury or illness or the cost of medical care and are not based on the period the employee is absent from work.

Employer contributions for medical insurance premiums and medical care have never been subject to taxation. In 1996 the provisions were extended to include long-term care insurance.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$407,500,000	$432,700,000	$460,000,000	$490,600,000

1.07 EMPLOYER-PAID ACCIDENT AND DISABILITY PREMIUMS

Internal Revenue Code, Sections 105 and 106
Minnesota Statutes, Section 290.01, Subd. 19

Premiums paid by an employer to an employee accident and disability plan are excluded from the gross income of the employee.

This provision was enacted in 1954.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,300,000	$1,300,000	$1,400,000	$1,500,000

1.08 EMPLOYER-PAID GROUP TERM LIFE INSURANCE PREMIUMS

Internal Revenue Code, Section 79
Minnesota Statutes, Section 290.01, Subd. 19

Group term life insurance premiums paid by an employer on behalf of an employee may be excluded from the employee's federal gross income. However, this exclusion applies only to premiums paid for insurance coverage of $50,000 or less; premiums for coverage in excess of $50,000 must be included in an employee's gross income. In order for the premiums to qualify for the exclusion, the plan must meet certain requirements including nondiscrimination rules.

In 1920 a federal administrative legal opinion was issued authorizing this exclusion. In 1954, when the Internal Revenue Code was revised, the provision was codified as Section 79 and was last changed in 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$11,100,000	$11,700,000	$12,200,000	$12,800,000

1.09 CAFETERIA PLANS

Internal Revenue Code, Section 125
Minnesota Statutes, Section 290.01, Subd. 19

Section 125 of the Internal Revenue Code allows an employee to choose to receive a combination of nontaxable fringe benefits or receive all or part of the value of the fringe benefits as taxable compensation. The value of a combination of fringe benefits chosen by the employee is excluded from federal gross income. The nontaxable benefits that may be offered by a plan include the following: group term life insurance; accident or health benefits; dependent care assistance; and 401(k), profit sharing, or stock bonus plans. If the plan discriminates in favor of highly compensated or key employees, all benefits paid to those particular employees are taxable.

This exclusion was enacted in 1974 and was first allowed in 1978. It was last changed in 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$28,700,000	$31,300,000	$33,800,000	$36,400,000

1.10 EMPLOYER-PAID TRANSPORTATION BENEFITS

Internal Revenue Code, Section 132
Minnesota Statutes, Section 290.01, Subd. 19

Certain employer-provided transportation benefits are excluded from the employee's income. The exclusion applies to transit passes, parking, and transportation in a commuter vehicle between the employee's residence and place of employment. The maximum exclusion from an employee's income for parking is $175 per month, and the maximum exclusion for the combined amount of transit passes and transportation in a commuter vehicle is $65 per month.

These benefits were first excluded by statute in 1984. The provision was last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$22,700,000	$23,100,000	$23,500,000	$23,900,000

1.11 MEDICAL SAVINGS ACCOUNTS

Internal Revenue Code, Sections 106 and 220
Minnesota Statutes, Section 290.01, Subd. 19

Medical savings accounts (MSA) are available only to self-employed individuals and employees of a small employer (not over 50 employees) who are covered by a high-deductible health plan. The maximum annual contribution to an MSA is 65% of the deductible for the high-deductible plan for individual coverage and 75% for family coverage.

Contributions by an individual to an MSA are deductible, and employer contributions are excluded from the gross income of the employee. Earnings on the MSA are not taxed prior to distribution. Distributions from an MSA for medical expenses are not taxable.

Medical savings accounts were enacted in 1996 as a limited program for accounts established in 1997 through 2000, not to exceed 750,000 taxpayers. MSAs established during those four years continue after that time, and contributions can be made in subsequent years. The provisions were last changed in 1997.

The national MSA limit of 750,000 has not been reached. The Internal Revenue Service has estimated that fewer than 45,000 MSA returns will be filed for 1999, which makes it likely that fewer than 1,000 MSA returns will be filed by Minnesota taxpayers.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

1.12 EMPLOYER-PROVIDED ADOPTION ASSISTANCE

Internal Revenue Code, Section 137
Minnesota Statutes, Section 290.01, Subd. 19

Amounts paid by an employer to an employee for adoption assistance are excluded from the employee's income. The exclusion is limited to $5,000 for the adoption of a child ($6,000 for a child with special needs).

This exclusion was enacted federally in 1996 and was adopted by Minnesota in 1997. It expires after December 31, 2001.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$500,000	$500,000	$100,000	*

*Less Than $50,000

1.13 EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

Internal Revenue Code, Section 127
Minnesota Statutes, Section 290.01, Subd. 19

An employee may exclude from gross income amounts paid by the employer for educational assistance, including tuition, fees, and books. The maximum exclusion is $5,250 per year.

This exclusion was first enacted in 1978 and was effective through the end of 1983. The provision has been renewed a number of times over the years, but it has not been made permanent. In 1998 Minnesota adopted the extension of the exclusion through May 31, 2000. At the time of this report, Minnesota has not had the opportunity to adopt the federal extension through December 31, 2001.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,400,000	$100,000	$0	$0

1.14 MISCELLANEOUS EMPLOYEE FRINGE BENEFITS

Internal Revenue Code, Section 132
Minnesota Statutes, Section 290.01, Subd. 19

In addition to Items 1.01 through 1.13, certain other employee benefits may be excluded from income. The exempt benefits include: employee discounts, up to specified limits; no-additional-cost service; and de minimis fringe benefits for which the value of the property or service provided is so small as to make accounting for it unreasonable or administratively impractical.

The status of employee benefits not specifically exempted by statute was uncertain prior to the enactment of Section 132 of the Internal Revenue Code in 1984. Any benefit not specified as exempt by in the Internal Revenue Code is considered taxable compensation. This provision was last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$36,200,000	$38,400,000	$40,600,000	$43,400,000

1.15 INCOME EARNED ABROAD BY U.S. CITIZENS AND FOREIGN HOUSING COSTS

Internal Revenue Code, Section 911
Minnesota Statutes, Section 290.01, Subd. 19

A United States citizen or resident whose principal residence is in a foreign country and who is either present overseas for eleven out of twelve consecutive months or is a bona fide resident of a foreign country may exclude the income which is earned in a foreign country up to a maximum of $74,000 in 1999. This exclusion does not apply to federal employees or members of the Armed Forces. (See Item 1.16 for a provision relating to federal employees.)

The taxpayer may also exclude any employer-paid foreign housing costs above a floor amount equal to 16% of step 1 salary at the GS-14 level. A deduction of an equal amount is allowed if the foreign housing costs are paid by the taxpayer. The combined income and housing exclusion or deduction may not exceed the taxpayer's total foreign earned income for that year.

Income earned abroad by United States citizens was excluded without limitation from federal gross income in 1926. The deduction for foreign housing costs was enacted in 1979. The exclusion was limited to $70,000 in 1986. In 1997 the maximum exclusion was increased to $72,000 in 1998 and is increased by $2,000 per year until it reaches $80,000 in 2002.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$9,900,000	$10,900,000	$11,400,000	$12,400,000

1.16 CERTAIN ALLOWANCES FOR FEDERAL EMPLOYEES ABROAD

Internal Revenue Code, Section 912
Minnesota Statutes, Section 290.01, Subd. 19

Federal civilian employees who work abroad are allowed to exclude from income certain allowances that are generally linked to the cost of living and are not eligible for the foreign income exclusion (Item 1.15).The allowances eligible for exclusion include housing, education, and travel, and they are defined by reference to specific federal legislation, including the Foreign Service Act of 1980 and the Central Intelligence Act of 1949. Also excluded are cost-of-living allowances received by federal employees stationed in U.S. possessions, Hawaii, and Alaska, and certain allowances received by members of the Peace Corps.

The federal exclusion was enacted in 1943 and was last amended in 1988.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$600,000	$600,000	$600,000

1.17 BENEFITS AND ALLOWANCES TO ARMED FORCES PERSONNEL

Internal Revenue Code, Sections 112 and 134
Minnesota Statutes, Section 290.01, Subd. 19

Section 112 of the Internal Revenue Code excludes all combat pay for military personnel who serve in a combat zone designated by an executive order. No dollar limit applies to the exclusion for enlisted personnel, but the limit for commissioned officers is equal to the highest rate of basic pay at the highest pay grade applicable to enlisted personnel.

Under Section 134 of the Internal Revenue Code, the value of in-kind benefits provided to military personnel and the cash payments given in lieu of the benefits are excluded from gross income. These benefits include allowances for housing and overseas cost of living, medical and dental benefits, group term life insurance, professional education, and dependent education.

The exclusion of benefits and allowances to Armed Forces personnel was first enacted in 1942. The exclusion of meals, quarters, and cash allowances was codified in 1986. In 1996 the limit on the exclusion for combat pay of commissioned officers was increased from $500 per month.

About 11,000 Minnesota residents are active duty members of the Armed Forces.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$7,300,000	$7,400,000	$7,600,000	$7,700,000

1.18 VETERANS' BENEFITS

38 United State Code 3101
Minnesota Statutes, Section 290.01, Subd. 19

All benefits administered by the Veterans Administration are excluded from a taxpayer's federal gross income. Benefits are paid in three categories: compensation for service-connected disability or death; pensions for non-service-connected disability or death; and vocational rehabilitation, education, and training assistance (including what is commonly referred to as GI Bill benefits).

VA benefits have never been taxed, having first been excluded from federal gross income in 1917.

Approximately 40,000 Minnesota veterans receive exempt veterans' benefits.

	Fiscal Year Impact			
	2000	2001	2002	2003
Disability Compensation	$12,400,000	$12,800,000	$13,200,000	$13,600,000
Pensions	600,000	600,000	600,000	600,000
Education and Training	600,000	600,000	600,000	600,000
Total - State General Fund	$13,600,000	$14,000,000	$14,400,000	$14,800,000

1.19 MILITARY DISABILITY PENSIONS

Internal Revenue Code, Sections 104(a)(4) and 104(b)
Minnesota Statutes, Section 290.01, Subd. 19

Retired military personnel who have at least a 30% disability may receive a pension from the Department of Defense based on either the number of years in service or their percent disability, whichever would produce a larger pension. The amount of pension which is or would be awarded to the retiree based on percent disability is excluded from federal gross income.

The exclusion is restricted to qualified pensions. For retirees who entered military service on or before September 24, 1975, qualified pensions include pensions awarded for personal injury and illness resulting from active service in the armed forces of any country. For retirees who entered service after September 24, 1975, only pensions awarded for combat-related injuries qualify.

Military disability pensions were fully excluded from income until the exclusion was limited in 1976.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$400,000	$400,000	$400,000

1.20 WORKERS' COMPENSATION BENEFITS

Internal Revenue Code, Section 104(a)(1)
Minnesota Statutes, Section 290.01, Subd. 19

All workers' compensation benefits are excluded from income. Workers' compensation benefits include replacement of lost earnings, payments of injury-related medical costs, compensation for permanent disabilities, and certain expenses related to injury or death.

Workers' compensation benefits were first excluded from federal taxation in 1918 and from Minnesota taxation in 1933 when the Minnesota individual income tax was enacted.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$39,700,000	$39,300,000	$38,900,000	$38,500,000

1.21 SPECIAL BENEFITS FOR DISABLED COAL MINERS

Internal Revenue Code, Section 104(a)(1)
30 United States Code 801 and 924(c)
Revenue Ruling 72-400
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Benefits provided by certain federal programs to coal miners totally disabled as a result of pneumoconiosis (black lung disease), and to widows and dependents of coal miners who died as a result of pneumoconiosis, are excluded from federal gross income.

Disability payments for black lung disease were first specifically excluded from federal gross income in 1969.

About 50 Minnesotans received these benefits in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

1.22 SOCIAL SECURITY BENEFITS

Internal Revenue Code, Section 86
Minnesota Statutes, Section 290.01, Subd. 19

All or a portion of a recipient's social security benefits may be excluded from taxable income, depending upon income. The tax expenditure measures the exclusion of nontaxable social security benefits, net of the recovery of previously-taxed employee contributions.

Social Security benefits are not taxable if the recipient's modified adjusted gross income is less than $25,000 for single or $32,000 for married-joint returns. For taxpayers with income between $32,000 and $44,000 for married-joint (between $25,000 and $32,000 for single), up to 50% of social security benefits are taxable. Above that income level, up to 85% of benefits are taxable.

For purposes of determining taxable social security benefits, modified adjusted gross income is adjusted gross income plus federally tax-exempt interest plus one-half of social security benefits. The calculation is done in two steps. The first step is equal to the smaller of: 50% of social security benefits; $6,000 for married-joint or $4,500 for single; or 50% of modified adjusted gross income in excess of the first threshold of $32,000 for married-joint or $25,000 for single.

If modified adjusted gross income is above the second threshold of $44,000 for married-joint or $34,000 for single, the second step is calculated equal to the smaller of: 85% of social security benefits; or the result of the first step plus 85% of modified adjusted gross income above the second threshold.

*Less Than $50,000

Prior to 1984, social security benefits were not subject to federal or Minnesota income tax. The federal taxation of a portion of social security benefits was enacted in 1983. In 1985 Minnesota adopted the federal treatment. The inclusion of a larger portion of benefits in taxable income was enacted federally in 1993 and adopted by Minnesota in 1994.

In 1997 approximately 716,000 people in Minnesota received social security benefits.

	Fiscal Year Impact			
	2000	2001	2002	2003
Retired Workers	$108,300,000	$113,800,000	$120,100,000	$127,100,000
Disability Benefits	15,600,000	16,900,000	18,300,000	19,900,000
Benefits for Dependents and Survivors	23,400,000	24,300,000	25,300,000	26,300,000
Total - State General Fund	$147,300,000	$155,000,000	$163,700,000	$173,300,000

1.23 MEDICARE BENEFITS

Revenue Ruling 70-341
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Medicare benefits are excluded from income, including benefits paid under the basic hospital insurance program and the supplementary medical insurance program. The basic Medicare program is financed by a portion of the social security payroll taxes on employees, employers, and the self-employed. The supplementary program is a voluntary program financed through individual premiums and matching federal contributions. The tax expenditure measures exclusion of benefits attributable to employer contributions through the payroll tax and federal contributions to the supplemental program; it does not include the recovery of previously-taxed contributions made by the recipient.

Medicare benefits have never been taxed although the exclusion has not been specified in the statutes. A federal revenue ruling in 1970 upheld the exclusion of these benefits.

In 1997 approximately 639,000 people in Minnesota received Medicare benefits.

	Fiscal Year Impact			
	2000	2001	2002	2003
Hospital Insurance	$67,200,000	$70,300,000	$74,300,000	$78,700,000
Supplementary Medical Insurance	35,400,000	40,200,000	46,000,000	52,200,000
Total - State General Fund	$102,600,000	$110,500,000	$120,300,000	$130,900,000

1.24 FOSTER CARE PAYMENTS

Internal Revenue Code, Section 131
Minnesota Statutes, Section 290.01, Subd. 19

Qualified foster care payments are excluded from the income of the foster care provider. The exclusion is limited to payments for no more than five foster care individuals over age eighteen, but this limitation does not apply to payments for foster children under that age.

This provision was enacted in 1977. Prior to 1986, foster care payments that exceeded documented expenses were included as income, but detailed record keeping is no longer required. In 1996 the exclusion was also extended to foster care payments made for qualifying adults.

Minnesota has 3,300 licensed adult foster care and 5,300 licensed child foster care households.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

1.25 PUBLIC ASSISTANCE

Numerous Revenue Rulings
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Public assistance benefits are excluded from federal gross income. The programs through which benefits are paid include the Minnesota Family Investment Program (replaced Aid to Families with Dependent Children), General Assistance, Emergency Assistance, Minnesota Supplemental Aid, and Supplemental Security Income. Only a portion of the benefits would be subject to the income tax because the income of some recipients would be below the income tax filing requirements.

Although theoretically the tax expenditure includes benefits received both in cash and in kind, such as food stamps, the estimates reflect only cash payments.

This exclusion has no direct statutory basis. During the 1930's the Internal Revenue Service issued a series of Revenue Rulings on the definition of federal gross income which explicitly exclude these benefits.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,800,000	$2,700,000	$2,700,000	$2,700,000

1.26 SCHOLARSHIP AND FELLOWSHIP INCOME

Internal Revenue Code, Section 117
Minnesota Statutes, Section 290.01, Subd. 19

Section 117 of the Internal Revenue Code excludes from income scholarships, fellowships, and grants based on financial need given to degree candidates to cover tuition, fees, and related expenses, including books and supplies.

This exclusion was first allowed in 1954. Prior to 1986, scholarship money to cover room and board and money paid to nondegree students (up to $300 per month) were also excluded.

Approximately 150,000 Minnesota students receive scholarship, fellowship, or grant money that qualifies for the exclusion.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$5,700,000	$5,900,000	$6,200,000	$6,600,000

1.27 EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS

Internal Revenue Code, Section 530
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may establish an education individual retirement account for the purpose of paying qualified higher education expenses of a named beneficiary. Annual contributions to an account cannot exceed $500 and cannot be made after the beneficiary reaches age eighteen. The maximum contribution is reduced for taxpayers with income over $95,000 ($150,000 for a joint return).

Earnings on funds in the account are not included in income until the funds are distributed. Distributions used for qualified higher education expenses of the beneficiary are excluded from income.

This provision was enacted federally in 1997 and adopted by Minnesota in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,900,000	$3,200,000	$3,600,000	$3,900,000

1.28 QUALIFIED STATE TUITION PLANS

Internal Revenue Code, Section 529
Minnesota Statutes, Sec. 290.01, Subd. 19

Under a qualified state tuition plan, a taxpayer may make contributions to an account that is established for the sole purpose of meeting qualified higher education expenses of a designated beneficiary. The earnings on the account are not taxed until they are distributed, and then they are included in the income of the beneficiary, not the contributor.

The tax status of state tuition plans was clarified at the federal level in 1996 when Section 529 was added to the Internal Revenue Code. These provisions were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$200,000	$400,000	$500,000

1.29 CERTAIN AGRICULTURAL COST-SHARING PAYMENTS

Internal Revenue Code, Sections 126 and 1255
Minnesota Statutes, Section 290.01, Subd. 19

Agricultural cost-sharing payments may be excluded in whole or in part from income if three conditions are met: the United States Secretary of Agriculture certifies that the payment serves to conserve soil and water resources, improve forests, or provide a habitat for wildlife; the Internal Revenue Service determines that the improvement does not substantially increase the annual income from the property; and the payment is for a capital expense. No deductions, depreciation, amortization, or depletion may be claimed with respect to any such amount excluded from income.

Payments from four federal programs currently qualify for the exclusion: the Agricultural Conservation Program, the Rural Clean Water Program, the Forestry Incentive Program, and the Water Bank Program. The Minnesota Soil and Water Conservation Cost Share Program is the only state program that qualifies.

This exclusion was enacted in 1978 and was last changed in 1980.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$300,000	$300,000	$300,000	$300,000

1.30 DISCHARGE OF INDEBTEDNESS INCOME FOR CERTAIN FARMERS

Internal Revenue Code, Sections 108(g) and 1017
Minnesota Statutes, Section 290.01, Subd. 19

Generally the amount of any debt forgiveness must be included in the debtor's gross income unless the debt is discharged in a title II bankruptcy case or when the debtor is insolvent. A solvent farmer may be treated as insolvent and the canceled debt excluded from income if at least 50% of the taxpayer's average annual gross receipts for the previous three years comes from farming. A reduction must be made to the taxpayer's basis in the property and to the taxpayer's tax attributes, including net operating losses, capital losses, and certain credit carryovers. The exclusion cannot exceed the sum of the reduction in basis and reduction in tax attributes. The net effect is that the income is deferred rather than excluded

The income exclusion for solvent farmers was enacted in 1986. Prior to that time, a similar provision applied to qualified business indebtedness, not just farming.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,100,000	$900,000	$800,000	$600,000

1.31 INVESTMENT INCOME ON LIFE INSURANCE AND ANNUITY CONTRACTS

Internal Revenue Code, Sections 72, 101, 7702, and 7702A
Treasury Regulation 1.451-2
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Investment income earned on life insurance and annuity contracts is not included in the recipient's gross income as it accumulates. For a life insurance policy, the exclusion applies to what is commonly referred to as "inside build-up" of investment income. When the premiums paid by the policyholder exceed the cost of insurance, the excess premiums are invested by the company, and investment income is credited to the policy.

If the policy is surrendered before the death of the policyholder, the excess of the cash surrender value over the premiums paid is included in income. In this situation, the income is deferred rather than excluded. Policy proceeds paid because of the death of the insured are excluded from the gross income of a beneficiary, and that investment income is never taxed.

An annuity is an investment contract sold by a life insurance company in which the owner makes a deposit in either a lump sum or installment payments in exchange for regular payments for a lifetime or for a specified number of years. The income is not included in the gross income of the owner as it accumulates but is deferred until payments are made from the contract to the annuitant.

These exclusions have been in effect since 1933 and were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$129,700,000	$133,600,000	$138,000,000	$142,500,000

1.32 INTEREST ON GENERAL OBLIGATION STATE AND LOCAL GOVERNMENT BONDS

Internal Revenue Code, Section 103
Minnesota Statutes, Section 290.01, Subd. 19 and Subd. 19a(1)

Interest received or accrued from all state and municipal general obligation bonds is excluded from income. This tax expenditure measures the impact of excluding the interest from bonds which are backed by the full faith and credit of the government which issues them. The impact of the interest exclusion for nonguaranteed bonds is estimated separately in Item 1.33.

For Minnesota tax purposes, the exclusion is restricted to interest from bonds issued by the State of Minnesota or by local units of government in Minnesota. Interest from other states which was excluded from federal income is added back to arrive at Minnesota taxable income.

Minnesota exempted interest from Minnesota state and local bonds when the income tax was enacted in 1933. When the state began adopting the federal definition of gross income in 1961, the add-back provision was included in the statutes to maintain the intent and effect of the 1933 law. These provisions were recodified in 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$26,900,000	$27,900,000	$28,900,000	$30,000,000

1.33 INTEREST ON NONGUARANTEED STATE AND LOCAL GOVERNMENT BONDS

Internal Revenue Code, Sections 103 and 141-150
Minnesota Statutes, Section 290.01, Subd. 19 and 19a(1)

Interest received from nonguaranteed state and local government bonds is excluded from federal gross income. For Minnesota income tax purposes, the exclusion is restricted to interest from bonds issued by the State of Minnesota or by Minnesota local government units. Any interest from non-Minnesota state or local governments is added back to determine Minnesota taxable income. In contrast to Item 1.32, this provision covers the exclusion of interest from nonguaranteed bonds.

The interest exclusion applies to several types of bonds, including exempt facility bonds, small-issue bonds, qualified mortgage bonds, qualified student loan bonds, and qualified redevelopment bonds.

Federal law imposes an annual volume limitation by state on the total amount of these bonds that can be issued. The limitation for each state is the greater of $50 per resident or $150 million through calendar year 2002. The limits are increased annually after 2002. Also exempt from taxation but not subject to the overall volume limitation are qualified bonds of 501(c)(3) nonprofit organizations and bonds for government-owned airports, docks, wharves, and certain solid waste disposal facilities. Other limitations apply to certain types of bonds including those subject to and exempt from the overall state volume limitation.

Minnesota exempted interest from Minnesota state and local bonds when the income tax was enacted in 1933. When the state began adopting the federal definition of gross income in 1961, the add-back provision was included in the statutes to maintain the intent and effect of the 1933 law. A 1968 federal law restricted the tax-free status given interest of industrial revenue bonds to those issued for specific purposes. In 1984 a federal law was enacted which limits by state the total amount of certain types of state and local bonds which may be issued, and the volume limitations were last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$27,900,000	$29,000,000	$30,000,000	$31,100,000

1.34 CAPITAL GAINS ON HOME SALES

Internal Revenue Code, Section 121
Minnesota Statutes, Section 290.01, Subd. 19

All or a portion of the gain from the sale of a taxpayer's principal residence may be excluded from income. The gain is excluded if, during the five years prior to the sale, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. The maximum exclusion is $250,000. For a married couple filing a joint return, the maximum exclusion is $500,000 if either spouse owned the property and both spouses used the property as their principal residence.

The exclusion is not allowed if the taxpayer excluded the gain from another such sale in the previous two years. Therefore the exclusion is allowed each time a taxpayer who meets the eligibility requirements sells a residence, but not more than once every two years.

The exclusion in its current form was enacted federally in 1997 and adopted by Minnesota in 1998. It replaced two previous provisions. The deferral of the gain from the sale of the taxpayer's principal residence when the seller bought another home of equal or greater value was enacted in 1951 and repealed in 1997. The one-time exclusion of the gain, up to a specified amount, from the sale of the taxpayer's principal residence for taxpayers age 65 or older (later age 55 or older) was enacted in 1964, expanded several times, and repealed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$114,900,000	$118,400,000	$122,000,000	$125,600,000

1.35 CAPITAL GAINS AT DEATH

Internal Revenue Code, Sections 1001, 1014, 1040, 1221, and 1222
Minnesota Statutes, Section 290.01, Subd. 19

When property is transferred because of the death of the owner, the heir's basis in the property is the value of the asset at the time of the decedent's death rather than the original cost of the asset. Therefore, the appreciation of the asset occurring during the decedent's lifetime is excluded from gross income. The fiscal impact measures the exclusion against the taxation of the gain at the time of transfer at death.

The exclusion of capital gains at death was enacted federally in 1921. A similar provision was incorporated into the original Minnesota income tax law in 1933.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$72,000,000	$77,200,000	$83,100,000	$87,700,000

1.36 CAPITAL GAINS ON GIFTS

Internal Revenue Code, Sections 1001, 1015, 1221, and 1222
Minnesota Statutes, Section 290.01, Subd. 19

The taxation of the capital gain on an asset is deferred when it is given as a gift. The recipient's basis in the property is the same as the giver's basis, but the gain is not reported as income until the property is sold by the recipient. The deferral is considered a tax expenditure because a gain is generally recognized when an asset is transferred.

This provision was enacted federally in 1921 and by Minnesota in 1933.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$6,800,000	$7,500,000	$8,100,000	$8,800,000

1.37 PERMANENT EXEMPTIONS FROM IMPUTED INTEREST RULES

Internal Revenue Code, Sections 483, 1274, and 1274A
Minnesota Statutes, Section 290.01, Subd. 19

The Internal Revenue Code generally requires that debt instruments bear a market rate of interest at least equal to the average rate on outstanding Treasury securities of comparable maturity. If the instrument does not, a market rate is imputed to it for tax purposes. The imputed interest must be included in the income of the recipient and is deducted by the payer.

Several exceptions exist to the imputed interest rules: debt associated with the sale of property when the total sales price does not exceed $250,000; the sale of farms or small businesses by individuals when the sales price does not exceed $1 million; and the sale of a personal residence. Debt instruments for amounts not exceeding $2.8 million that are given in exchange for real property may not have imputed to them an interest rate exceeding 9%. The $2.8 million maximum is indexed annually for inflation.

Imputed interest rules and exemption from the rules were first effective in 1984 and were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$900,000	$900,000	$1,000,000	$1,000,000

1.38 LIKE-KIND EXCHANGES

Internal Revenue Code, Section 1031
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain from the sale or exchange of property is recognized as income for tax purposes. However, the gain from a like-kind exchange is not recognized at the time of exchange if both the relinquished and the received property are held for productive use in a trade or business or for investment. The recognition of the gain is deferred until the received property is sold or otherwise disposed. In order for the gain to qualify for deferral, the exchange must be concluded within specified time limits. This provision does not cover stock in trade or other property held primarily for sale, or stock, bonds, notes, or other securities.

Tax-free exchanges of like-kind property were allowed federally in 1921 and by Minnesota in 1933. These provisions were last amended in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,700,000	$1,700,000	$1,700,000	$1,700,000

1.39 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

Internal Revenue Code, Section 458
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer who distributes magazines, paperbacks, and sound recordings and who uses the accrual method of accounting may elect to exclude from gross income for the taxable year the income attributable to the qualified sale of any magazine, paperback, or sound recording which is returned to the taxpayer before the end of the merchandise return period, even though the merchandise return period extends into the next taxable year.

A sale of such merchandise is a qualified sale if the merchandise is not resold and the taxpayer has a legal obligation to adjust the sales price if it is not resold. The excludable amount is the amount by which the price is adjusted. Separate rules govern how the excludable income is distributed over time for magazines and for paperbacks and records.

Section 458 of the Internal Revenue Code was enacted in 1978.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

1.40 ENERGY CONSERVATION SUBSIDIES PROVIDED BY PUBLIC UTILITIES

Internal Revenue Code, Section 136
Minnesota Statutes, Section 290.01, Subd. 19

Residential customers may exclude from gross income subsidies provided by public utilities for the purchase or installation of an energy conservation item.

Section 136 was enacted as part of the Comprehensive National Energy Policy Act of 1992. As originally enacted, a partial exclusion was allowed for nonresidential customers, but that exclusion was repealed in 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

FEDERAL DEDUCTIONS

1.41 DEPRECIATION

Internal Revenue Code, Sections 167 and 168
Minnesota Statutes, Section 290.01, Subd. 19

A deduction is allowed for the depreciation of machinery, equipment, and structures used in a trade or business or held for the production of income. Beginning generally with property placed in service after December 31, 1986 (with some exceptions), the modified accelerated cost recovery system (MACRS) is used.

Under MACRS, machinery and equipment can be depreciated over three, five, seven, or ten years, and the 200% declining balance method is used. The 150% declining balance method applies to fifteen- and twenty-year property. Straight-line depreciation of 27.5 years is used for residential rental property, and 39 years is used for nonresidential real property.

Conceptually, the tax expenditure is the extent to which depreciation for tax purposes exceeds the actual decline in value of the asset during the applicable tax year. For machinery and equipment, the tax expenditure is measured as the difference between the current law depreciation schedule and straight-line depreciation over the period defined by the midpoint of the asset depreciation range (ADR) system that was in effect from 1971 to 1981. For structures, it is measured as the difference between current law depreciation and straight-line depreciation over forty years.

A depreciation deduction was part of the original Minnesota income tax enacted in 1933. Accelerated depreciation was first allowed through administrative practice by the federal government in 1946 and by law in 1954. Minnesota first enacted an accelerated depreciation provision in 1959. In 1987 Minnesota adopted MACRS enacted as part of the federal Tax Reform Act of 1986. This provision was last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$70,400,000	$71,200,000	$70,300,000	$69,800,000

1.42 EXPENSING DEPRECIABLE BUSINESS PROPERTY

Internal Revenue Code, Section 179
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to treat the cost of qualifying business property as an expense and to deduct the cost in the year the property is placed in service. The deduction is taken instead of the depreciation deduction. The maximum annual deduction is $19,000 for tax year 1999, $20,000 for 2000, $24,000 for 2001 and 2002, and $25,000 for 2003 and thereafter. If the taxpayer places more than $200,000 of qualifying personal property in service during the taxable year, the limitation is reduced by one dollar for each dollar that the cost exceeds $200,000.

This provision was adopted in 1982. In 1993 the maximum deduction was increased from $10,000 to $17,500, and in 1996 the phased-in increases in the maximum amounts were enacted.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,600,000	$2,400,000	$3,200,000	$1,900,000

1.43 EXCESS OF PERCENTAGE OVER COST DEPLETION

Internal Revenue Code, Sections 291, 611, 612, 613, and 613A
Minnesota Statutes, Section 290.01, Subd. 19

Depletion allowances refer to the way in which investment costs are recovered for mining or other extractive operations and may be taken for almost all exhaustible natural resources.

A taxpayer may choose from two forms of depletion: cost depletion or percentage depletion. Cost depletion is based on the taxpayer's basis in the property and is similar to depreciation in its application. Percentage depletion is based on a percentage of the gross income received from the extractive operation and has little relationship to a taxpayer's basis. Because cost depletion is a normal and necessary cost of doing business, only the amount of percentage depletion in excess of cost depletion is considered a tax expenditure.

A deduction for cost depletion was first allowed in 1913 for the federal income tax, and percentage depletion was first allowed as an option in 1926. A 1986 federal change adopted by Minnesota in 1987 denies the use of percentage depletion for lease bonuses, advance royalties, or other payments that are not directly related to actual production from the property. This restriction applies to oil, gas, and geothermal properties. The last change to this provision occurred in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$800,000	$800,000	$800,000	$800,000

1.44 FIVE-YEAR AMORTIZATION OF BUSINESS ORGANIZATIONAL AND START-UP COSTS

Internal Revenue Code, Sections 195 and 709
Minnesota Statutes, Section 290.01, Subd. 19

Under Section 195 of the Internal Revenue Code, taxpayers who pay or incur business investigatory start-up expenditures and subsequently enter the trade or business to which these costs relate may elect to amortize these expenses over a period of not less than sixty months, beginning with the month in which the business commences. Section 709 allows partnerships to similarly amortize organization fees.

Without these special provisions, these expenditures would be capitalized by adding them to the taxpayer's basis in the business. They would then be treated as nondepreciable intangible assets, with costs not being recoverable until the taxpayer sold their interest in the business.

Section 709 was enacted in 1976. Section 195 was enacted in 1980 and was last changed in 1984.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,700,000	$1,700,000	$1,700,000	$1,700,000

1.45 SEVEN-YEAR AMORTIZATION OF REFORESTATION EXPENDITURES

Internal Revenue Code, Section 194
Minnesota Statutes, Section 290.01, Subd. 19

In general, investment costs such as those a timber grower incurs in clearing land and planting trees are considered capital outlays and may not be deducted from income until the trees are sold. However, up to $10,000 expended in a year for reforestation can be amortized over seven years. Because timber growth periods are typically longer than fifteen years, this provision allows reforestation expenses to be deducted long before the general rule would allow them to be deducted.

This provision was enacted in 1980, and it was last changed in 1986.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

1.46 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code, Section 174
Minnesota Statutes, Section 290.01, Subd. 19

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. However, a taxpayer may elect to deduct as an expense in the current tax year all qualified research and development costs incurred in connection with a trade or business. If the asset resulting from the research or development expenditures has no determinable useful life (such as is the case with a process or formula), then the taxpayer may alternatively elect to amortize the costs over not less than sixty months.

The deduction is reduced by the amount of any federal research credit.

Section 174 was enacted in 1954 and was last changed in 1989.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

1.47 EXPENSING OF MAGAZINE CIRCULATION EXPENDITURES

Internal Revenue Code, Section 173
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to deduct as an expense in the current year expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical. This treatment is restricted to certain types of expenditures, and the election is binding for the current year and to similar expenditures in subsequent years. This provision is a tax expenditure because, in general, expenses incurred in creating or developing an asset must be capitalized.

Section 173 of the Internal Revenue Code was enacted in 1950 and was last changed in 1984.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

1.48 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 56, 57(2), 263, 291, 616, 617, and 1254
Minnesota Statutes, Section 290.01, Subd. 19

Current year expensing is allowed for items such as labor, fuel, repairs, and site preparation costs in the exploration and development of oil, gas, other fuel, and non-fuel mineral deposits. Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses but are treated as capital expenses, which increase the taxpayer's basis in the property.

Current year expensing of development costs for oil and gas has been allowed federally since 1916. Expensing of development costs for other minerals and of exploration costs for all minerals, including oil and gas, was first allowed in 1951.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

1.49 CASH ACCOUNTING AND EXPENSING FOR AGRICULTURE

Internal Revenue Code, Sections 162, 175, 180, 447, 461, 464, and 465
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer engaged in the business of farming may deduct certain expenditures made during the tax year rather than capitalize them. The expenditures must be for soil and water conservation under a government-approved plan, the purchase and application of fertilizer, or certain preproduction costs. The expensing of capital outlays is a tax expenditure because normally the cost of a capital outlay for land improvement would not be deductible.

Farmers are allowed to use cash accounting rather than the accrual system for income tax purposes. Therefore, costs attributable to goods not yet sold may be deducted in the current year.

Farmers have been allowed to use the cash accounting system for tax purposes since 1933. Minnesota began allowing the expensing of capital outlays in 1955. In 1986 the expensing provision was eliminated for land clearing and was restricted for soil and water conservation expenditures.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$12,300,000	$13,500,000	$14,600,000	$15,400,000

1.50 EXPENSING OF MULTIPERIOD AGRICULTURAL PRODUCTION COSTS

Internal Revenue Code, Section 263A(d)
Minnesota Statutes, Section 290.01, Subd. 19

Farmers are allowed to deduct in the current year certain multiperiod production costs rather than follow the general capitalization rules. Expensing is allowed in two types of situations.

Farmers who are allowed to use cash accounting may elect to deduct currently all preproductive costs of animals and also of plants that have a preproductive period of two years or less. These costs must be recaptured as ordinary income upon disposition of the product, and the alternative depreciation system must be used for farm assets placed in service during a year in which the election is in effect. Vintners and orchard growers may expense the costs of replacing plants or trees that have been damaged by disease, pests, frost, or other natural disasters.

Expensing has always been allowed for these types of costs incurred by farmers. However, this provision was enacted as part of the federal Tax Reform Act of 1986 as an exception to the uniform capitalization rules adopted in that same act. This provision was last changed in 1989.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,200,000	$1,300,000	$1,300,000	$1,400,000

1.51 EXPENSING OF MULTIPERIOD TIMBER GROWING COSTS

Internal Revenue Code, Section 263A(c)(5)
Minnesota Statutes, Section 290.01, Subd. 19

Timber growers are allowed to deduct in the current year multiperiod production costs rather than following the general capitalization rules. The exception to the capitalization rules applies to the costs incurred in raising, growing, or harvesting trees other than trees bearing fruit, nuts, or other crops, or ornamental trees.

Revised capitalization rules were enacted as part of the Tax Reform Act of 1986. Because the general rules that apply to other business activities are more restrictive, this provision is considered a tax expenditure.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,200,000	$1,300,000	$1,300,000	$1,400,000

1.52 SPECIAL RULES FOR MINING AND SOLID WASTE RECLAMATION RESERVES

Internal Revenue Code, Section 468
Minnesota Statutes, Section 290.01, Subd. 19

In general, expenses that will be incurred in the future may not be claimed as a current deduction. Under the accrual method of accounting, future expenses can be deducted only when the economic activity giving rise to the expense has occurred.

An exception is provided for mining and solid waste reclamation costs which are incurred in order to comply with a federal, state, or local law, as specified. A deduction may be taken in the current year for the estimated future reclamation or closing costs attributable to production or mining activity during the taxable year. A bookkeeping reserve must be maintained for tax purposes so that, when reclamation or closing costs are actually incurred, they can be compared to the deductions taken. Any excess of the reserve, including interest, over actual costs must be included in income at that time.

Section 468 was enacted in 1984 and was last changed in 1986.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

1.53 CASH ACCOUNTING OTHER THAN AGRICULTURE

Internal Revenue Code, Sections 446 and 448
Minnesota Statutes, Section 290.01, Subd. 19

Section 446 of the Internal Revenue Code allows a taxpayer to choose the cash method of accounting instead of the accrual method. The accrual method is considered a better measure of current-year income and expenses because it takes into account the income of receivables. This tax expenditure is the difference in net income measured by accrual accounting and cash accounting. Accrual accounting is required for businesses that maintain inventories.

Cash accounting has been permitted since 1933. The Tax Reform Act of 1986 placed some restrictions on the use of cash accounting by partnerships.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$600,000	$600,000	$600,000

1.54 INSTALLMENT SALES

Internal Revenue Code, Sections 453 and 453A
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain or loss from the sale of property is recognized in the year of the sale. An exception to the above rule is the installment method which may be used to report gains if at least one payment is received in a tax year other than the year of sale. The installment method can be used only by taxpayers who do not regularly deal in the property being sold, and gross profit is prorated over the period in which payments are received. The tax expenditure is the difference between what tax liability would be under year-of-sale reporting and what it is under installment reporting.

The installment method was first enacted in 1933. In 1986 the installment method was eliminated for revolving credit sales of personal property and sales of property regularly traded on an established market, such as stocks or securities. In 1987 the installment method was repealed for dealer sales of both real and personal property. At the time of this report, Minnesota has not had the opportunity to adopt the 1999 federal changes restricting the use of installment sales.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,900,000	$2,100,000	$2,200,000	$2,400,000

1.55 COMPLETED CONTRACT RULES

Internal Revenue Code, Section 460
Minnesota Statutes, Section 290.01, Subd. 19

Some taxpayers with contracts extending for more than one year are allowed to report some or all of the profit on the contracts under special accounting rules. Income on a long-term contract is reported only when the contract is completed, and costs allocable to the contract are deducted at that time. However, many indirect costs may be deducted in the year paid or incurred. Without these special rules, indirect costs could be deducted only when the income is reported.

The completed contract method is allowed for home construction contracts and for other construction contracts if they are no longer than two years in duration and if the taxpayer's average annual gross receipts for the three preceding years do not exceed $10 million.

The completed contract method was first allowed federally in 1918 and by Minnesota in 1934. The rules for long-term contracts were codified in the federal Tax Reform Act of 1986, and restrictions were placed on its use. This provision was last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

1.56 EMPLOYEE STOCK OWNERSHIP PLANS

Internal Revenue Code, Sections 401(a), 404(a), 415(c), 1042, 4975(e)(7), and 4978
Minnesota Statutes, Section 290.01, Subd. 19

An employee stock ownership plan (ESOP) is a qualified stock bonus plan or a combination of a stock bonus and a money purchase pension plan under which a tax-exempt trust holds employer stock for the benefit of the employees. The stock may be acquired through direct employer contributions or with the proceeds of a loan to the trust.

Employees are not taxed on employer contributions to an ESOP or the earnings on invested funds until they are distributed. A stockholder in a closely-held company may defer recognition of the gain from the sale of stock to an ESOP if the ESOP owns at least 30% of the company's stock after the sale and the seller reinvests the proceeds in a U.S. company.

The formation of ESOPs was first authorized in 1974. These provisions were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$300,000	$300,000	$300,000	$300,000

1.57 INDIVIDUAL RETIREMENT ACCOUNTS

Internal Revenue Code, Sections 219, 408, and 408A
Minnesota Statutes, Section 290.01, Subd. 19

An individual may make a contribution to an individual retirement account (IRA) of up to $2,000 per year or an amount equal to earned income, whichever is less. If the individual has more than one account, the total contribution to all accounts cannot exceed the lesser of $2,000 or earned income. Up to $2,000 can also be contributed for a nonworking spouse if the couple's combined contribution does not exceed their combined earned income

The contribution may be made to either a deductible IRA or a nondeductible IRA, referred to as a Roth IRA. For both types of IRAs, earnings on the account are excluded from income until the funds are distributed. For a deductible IRA, a deduction is taken when the contribution is made, and the distribution is taxable. If a distribution from a Roth IRA qualifies, the entire distribution is exempt from tax.

For a deductible IRA, if the taxpayer is a participant in an employer plan, the full deduction is allowed if adjusted gross income for tax year 1999 is $51,000 or less for a married-joint return or $31,000 or less for a single person. These amounts are increased annually until they reach $80,000 for a married-joint return in tax year 2007 and $50,000 for a single person in tax year 2005. In all cases, the maximum deduction is phased out over a range of $10,000 of income.

The spouse of an active participant in an employer plan may take a deduction for contributions to an IRA, but the deduction is phased out for taxpayers with adjusted gross income between $150,000 and $160,000. If neither the taxpayer nor the spouse is an active participant in an employer plan, no maximum income limit applies.

For a nondeductible IRA, the maximum contribution is phased out for joint filers with income between $150,00 and $160,000 and between $95,000 and $110,000 for other filers. Distributions are not subject to tax if made more than five years after the IRA has been established and if the distribution qualifies. Qualifying distributions are made after age 59-1/2, death, or disability of the individual or for first time homebuyer expenses.

The federal IRA provisions were enacted in 1974 and adopted by Minnesota in 1975. Several significant changes have occurred over the years. The last major changes were enacted federally in 1997 and adopted by Minnesota in 1998 when the income limits were increased and some restrictions were removed for deductible IRAs. Provisions for nondeductible IRAs existed previously, but in 1997 they were replaced by the Roth IRA which includes the exemption for qualifying distributions.

A deduction for IRA contributions was taken on approximately 90,000 returns in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$81,900,000	$86,500,000	$93,800,000	$102,400,000

1.58 KEOGH PLANS

Internal Revenue Code, Sections 401-405 and 408-415
Minnesota Statutes, Section 290.01, Subd. 19

A self-employed person may take a deduction for contributions made to a Keogh retirement plan of the lesser of 25% of self-employment income (net of any Keogh contributions) or $30,000. Earnings are not included in the recipient's income until they are withdrawn from the fund. A Keogh plan must also cover any eligible employees. The deduction for contributions made on behalf of employees is considered a normal business expense and not a tax expenditure.

Disbursements from a Keogh plan are included in the recipient's income except for the recovery of any previously-taxed contributions. Therefore, the Keogh provisions are deferrals, measured for a fiscal year as the exclusion of earnings and the deduction for contributions, net of disbursements included in income that year.

This provision was originally enacted in 1962. From 1982 to 1984 the Minnesota deduction was more restrictive than the federal deduction. The provision was last changed in 1986.

Approximately 27,000 Minnesota taxpayers took this deduction for tax year 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$26,800,000	$27,300,000	$28,400,000	$30,000,000

1.59 INTEREST ON EDUCATION LOANS

Internal Revenue Code, Section 221
Minnesota Statutes, Section 290.01, Subd. 19

A deduction is allowed for interest paid on qualified education loans under certain conditions. The deduction applies only to interest paid during the first sixty months that payments are required to be made. A person claimed as a dependent on someone else's return cannot take the deduction.

The maximum deduction is $1,500 for tax year 1999, $2,000 for tax year 2000, and $2,500 for 2001 and thereafter. The deduction is phased out for taxpayers with modified adjusted gross income of $40,000 to $55,000 ($60,000 to $75,000 for joint returns).

This deduction was enacted federally in 1997 and last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,000,000	$1,200,000	$1,500,000	$1,600,000

1.60 PER DIEM AMOUNTS PAID TO STATE LEGISLATORS

Internal Revenue Code, Section 162(h)
Minnesota Statutes, Sections 290.01, Subd. 19

State legislators who reside more than fifty miles from the state capitol building are allowed a deduction for per diem allowances received for days that the Legislature is in session and for committee meetings that the legislator is required to attend.

Minnesota enacted a deduction of all per diem allowances for all legislators in 1959, and the full deduction was allowed until the provision was repealed in 1987. The federal deduction became effective in 1976, and the fifty-mile restriction was added in 1981. Beginning with tax year 1987, Minnesota has conformed to the federal treatment and, therefore, disallows the deduction for legislators who reside within fifty miles of the capitol building and for nonqualifying interim per diem.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

1.61 TREATMENT OF CLEAN-FUEL VEHICLES

Internal Revenue Code, Section 179A
Minnesota Statutes, Section 290.01, Subd. 19

A deduction is allowed for a portion of the cost of a clean-fuel vehicle or the cost of retrofitting a vehicle to use clean fuel. The deduction is allowed for the cost attributable to the engine, storage of fuel, and exhaust system. The deduction is limited to: $50,000 for trucks and vans over 26,000 pounds and buses seating at least twenty adults; $5,000 for trucks and vans between 10,000 and 26,000 pounds; and $2,000 for all other vehicles. The deduction is phased out from the years 2002 through 2005. An additional deduction of up to $100,000 per location is allowed for the cost of property, other than buildings, used to store or dispense clean fuel.

Clean fuels are natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, and any other fuel if at least 85% of it is methanol, ethanol, any other alcohol, ether, or any combination.

This provision was enacted in 1992.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

FEDERAL PERSONAL DEDUCTIONS

1.62 ADDITIONAL STANDARD DEDUCTION FOR THE ELDERLY AND BLIND

Internal Revenue Code, Section 63(c)(3) and (f)
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer or spouse who is age 65 or over or blind is allowed an additional standard deduction. For tax year 1999, the additional amount for married couples is $850 for each person who is elderly or blind ($1,700 if elderly and blind). The additional amount for a single person or head of household is $1,050 for a taxpayer who is elderly or blind ($2,100 if elderly and blind). The amounts are indexed annually for inflation.

The basic standard deduction available to all taxpayers, including the elderly and blind, is not considered a tax expenditure because equal amounts are allowed to similarly-situated taxpayers.

From 1951 through 1986 Minnesota allowed to the elderly and the blind an additional personal credit against the tax. Prior to tax year 1987, an additional personal exemption was allowed to the elderly and the blind on the federal return. The additional standard deduction was enacted federally in 1986 and was adopted by Minnesota in 1987.

The tax on an estimated 172,000 returns will be reduced by this provision in tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$13,000,000	$13,500,000	$14,300,000	$14,700,000

1.63 MEDICAL AND DENTAL EXPENSES

Internal Revenue Code, Sections 63(d) and 213
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for unreimbursed medical expenses to the extent they exceed 7.5% of adjusted gross income. Deductible expenses must be for the taxpayer, spouse, or dependent and include health insurance premiums, medical care, dental care, prescription drugs, insulin, necessary transportation, and medical aids, such as eyeglasses, hearing aids, crutches, and wheelchairs.

A deduction for medical expenses has been allowed by Minnesota since 1933. The state adopted the federal provisions for this deduction beginning with tax year 1982. In 1987 Minnesota adopted the 1986 federal change which increased the floor for the deduction from 5% to 7.5% of adjusted gross income. This provision was last changed in 1996 when certain long-term care insurance premiums and unreimbursed long-term care services were included in the deduction.

An estimated 82,500 returns will have their tax reduced by this provision in tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$20,100,000	$21,400,000	$23,000,000	$23,800,000

1.64 REAL ESTATE TAXES

Internal Revenue Code, Sections 63(d) and 164
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for real estate taxes paid during the taxable year. The deduction is reduced by any Minnesota property tax refund received. Special assessments are not considered real estate taxes and cannot be deducted. This deduction is one of several deductions subject to the limitation of itemized deductions for higher-income taxpayers.

Business or trade-related real estate taxes are not considered tax expenditures because they are costs necessary for earning income.

Minnesota has allowed this deduction since 1933. The limitation of certain itemized deductions was made permanent in 1993 and was adopted by Minnesota in 1994.

Due to this deduction, the income tax is reduced on an estimated 666,000 returns in tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$93,300,000	$100,400,000	$107,100,000	$110,500,000

1.65 OTHER TAXES

Internal Revenue Code, Sections 63(d) and 164
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for specified taxes besides the real estate tax, including personal property taxes paid to state and local governments and foreign income taxes. The ad valorem portion of the motor vehicle registration tax (Chapter 15) is deductible under these provisions and accounts for most of the deduction. Also deductible are the personal property taxes paid on a mobile home owned by the taxpayer but situated on a rented lot. This deduction is one of several deductions subject to the limitation of itemized deductions for higher-income taxpayers.

This deduction was enacted in 1933 and changed in 1983. The limitation of certain itemized deductions was made permanent in 1993 and was adopted by Minnesota in 1994.

An estimated 549,000 returns benefit from this provision for tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$12,100,000	$12,600,000	$13,200,000	$13,700,000

1.66 INTEREST ON HOME MORTGAGES

Internal Revenue Code, Sections 63(d) and 163
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may take an itemized deduction for interest on debt secured by a principal or second residence. Although certain restrictions apply, most taxpayers can deduct the full amount of their mortgage interest. This deduction is one of several deductions subject to the limitation of itemized deductions for higher-income taxpayers.

For a debt incurred after October 13, 1987, mortgage interest is deductible on up to $1 million of debt used to buy, build, or improve a principal or second residence. If the debt is used for any other purpose, the limitation is $100,000 of debt. Home equity loans fall into this second category and are subject to the $100,000 debt limitation. If more than one home is involved, the limitations apply to the total amount of the mortgages.

Home mortgage interest was deductible without limitation for tax years 1933 through 1986. The current restrictions were enacted federally in 1987 and by Minnesota in 1988. The limitation of certain itemized deductions was made permanent in 1993 and was adopted by Minnesota in 1994.

This deduction will reduce state income tax on an estimated 644,000 returns in tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$268,700,000	$294,100,000	$317,000,000	$329,600,000

1.67 CHARITABLE CONTRIBUTIONS

Internal Revenue Code, Sections 63(d), 170, and 642(c)
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for contributions to organizations that are religious, charitable, educational, scientific, or literary in purpose. In general, the deduction is limited to a maximum of 50% of federal adjusted gross income, although other limitations apply to specific types of contributions. Excess contributions may be carried forward for up to five years. This deduction is one of several deductions subject to the limitation of itemized deductions for higher-income taxpayers.

A deduction for charitable contributions has been allowed since the Minnesota income tax was enacted in 1933. Until 1985, the Minnesota deduction differed from the federal deduction with regard to the maximum deduction and carry forward provision. The limitation of certain itemized deductions was made permanent in 1993 and adopted by Minnesota in 1994. This provision was last changed in 1998.

An estimated 650,000 returns will benefit from this deduction in tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$126,700,000	$133,700,000	$140,800,000	$145,800,000

1.68 CASUALTY AND THEFT LOSSES

Internal Revenue Code, Sections 63(d) and 165
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for unreimbursed nonbusiness losses caused by theft, vandalism, fire, storm, and car, boat, and other accidents. The deduction is allowed only to the extent that each separate casualty or theft loss exceeds $100 and the total of all net losses during the year exceeds 10% of federal adjusted gross income. If the loss is covered by insurance, a timely insurance claim must be filed.

A deduction for casualty or theft loss was first authorized for the federal income tax in 1913 and for the state tax in 1933. This provision was last changed in 1986.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,300,000	$1,300,000	$1,400,000	$1,400,000

MINNESOTA SUBTRACTIONS

1.69 K-12 EDUCATION EXPENSES

Minnesota Statutes, Section 290.01, Subd. 19b(3)

A subtraction from federal taxable income is allowed for qualifying education expenses paid for a dependent in kindergarten through twelfth grade. The maximum subtraction is $1,625 per child in kindergarten through sixth grade and $2,500 per child in seventh through twelfth grade. Beginning in tax year 2000, the child must meet the definition of a qualifying child rather than a dependent.

Qualifying expenses include amounts paid to others for tuition, transportation, nonreligious textbooks, and instructional materials and equipment required for regular school classes. Fees or tuition for instruction outside the regular school day also qualify, such as tutoring and educational summer camps. Amounts paid for computer hardware and educational software can be subtracted, but the subtraction for these purchases is limited to $200 per family. Expenses are reduced by the amount of any education tax credit (Item 1.83).

An education deduction was first enacted in 1955. From 1971 through 1973 Minnesota also provided a credit for tuition paid to private schools, but it was declared unconstitutional and repealed. In 1983 the United States Supreme Court ruled the deduction constitutional. In 1997 the deduction was expanded, beginning with tax year 1998. This provision was last changed in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$17,500,000	$18,300,000	$19,300,000	$20,200,000

1.70 CHARITABLE CONTRIBUTIONS FOR NONITEMIZERS

Minnesota Statutes, Section 290.01, Subd. 19b (11)

A taxpayer who does not itemize deductions on the federal return may subtract from federal taxable income 50% of charitable contributions made in excess of $500. To qualify for the subtraction, the contributions must meet the requirements for deductible contributions under the Internal Revenue Code.

This subtraction was enacted in 1999, effective with tax year 1999.

Approximately 300,000 returns are estimated to potentially use this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$3,100,000	$3,500,000	$3,700,000	$4,000,000

1.71 INCOME OF THE ELDERLY OR DISABLED

Minnesota Statutes, Sections 290.01, Subd. 19b (5) and 290.0802

A subtraction from federal taxable income is allowed for persons who are age 65 or over or totally disabled. The subtraction benefits low-income taxpayers who have more of their income from taxable sources such as pensions and interest than from nontaxable sources such as social security. The subtraction is allowed against any type of taxable income, not just pensions, and is computed as follows for a married couple who both qualify and file a joint return: $12,000 minus nontaxable retirement and nontaxable social security benefits minus one-half of federal adjusted gross income over $18,000. The $12,000 and $18,000 amounts used in the computation are different for the other filer types.

Public pensions were exempt from the Minnesota income tax from 1933 through 1977. From 1978 through 1986 a subtraction was allowed, in various forms, for public or private pension income, limited to a maximum amount with qualifying offsets. For tax year 1987 only, a credit against the tax was allowed which was equal to 40% of the federal credit for the elderly and disabled.

The elderly or disabled subtraction was enacted in 1988, and in 1994 the base amounts and income thresholds were increased by 20%. A minimum subtraction was also enacted in 1994 and was in effect for tax years 1994 through 1996 only. The minimum subtraction benefited taxpayers who had a greater portion of their social security benefits taxable due to 1993 federal law changes.

An estimated 19,000 taxpayers will benefit from this provision in tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,400,000	$2,100,000	$1,800,000	$1,600,000

1.72 SELF-EMPLOYED HEALTH INSURANCE

Internal Revenue Code, Section 162(l)
Minnesota Statutes, Sections 290.01, Subd. 19b(8)

A self-employed individual is allowed a subtraction from federal taxable income for the amount paid for health insurance premiums for the taxpayer, spouse, and dependents. The subtraction is allowed only for premiums not deducted in determining federal taxable income.

On the federal return, 60% of the premiums can be taken as a nonitemized deduction for tax year 1999 through 2001. The percentage increases to 70% for tax year 2002 and to 100% for tax year 2003 and thereafter. Remaining premiums may be taken as an itemized deduction for medical expenses, subject to a floor of 7.5% of adjusted gross income.

The tax expenditure measures the state tax reduction from both the federal nonitemized deduction and state subtraction. Premiums taken as an itemized deduction are included in Item 1.63.

Minnesota enacted the full subtraction of health insurance premiums for the self-employed in 1992, beginning with tax year 1993. The federal nonitemized deduction was first enacted in 1987 and was last changed in 1998.

Approximately 90,000 taxpayers are estimated to benefit from these provisions.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$8,400,000	$9,200,000	$9,700,000	$10,600,000

1.73 URBAN HOMESTEAD PROGRAM

Laws 1995, Chapter 255, Article 3, (Uncodified) as Amended by
Laws 1996, Chapter 464, Article 4, Sections 1 and 2

A subtraction from federal taxable income is allowed for eligible persons purchasing and occupying a home within specified geographic areas and time periods. The subtraction is allowed each year for up to five consecutive years, as long as the purchaser continues to own and occupy the home and meet all the eligibility requirements.

The amount of the subtraction is based on income and filing status and is not related to the purchase price of the home. The maximum subtraction is $15,000 for married-joint returns, $10,000 for single persons, and $12,500 for head of household. The maximum subtraction is reduced by 2% for each $1,000 of adjusted gross income over a threshold, so that it is phased out from $60,000 to $110,000 for married-joint returns, from $40,000 to $90,000 for single persons, and from $50,000 to $100,000 for head of household. No subtraction is allowed for married persons filing separately.

To qualify, the home purchased must be within a designated urban revitalization and stabilization zone. As originally enacted in the 1995 Metropolitan Livable Communities Act, the zones were designated by the Metropolitan Council in areas that were in transition toward blight and poverty, and the total number of existing homes in the zones could not exceed 1,000. Based on these criteria, zones were created in Minneapolis, St. Paul, and Columbia Heights. Homes must have been purchased between September 1, 1995, and June 30, 1997.

A 1996 law created an urban revitalization and stabilization zone within the 1996 65Ldn contour surrounding the Minneapolis-St. Paul International Airport or within one mile of the boundaries of the contour. The home must have been purchased after June 1, 1996. A 1997 law limited qualification to homes for which purchase agreements were entered into before July 1, 1997. Except for the geographic area covered and the time of purchase, all other provisions of the urban homestead program apply to this zone as well.

This program was enacted in 1995 and was last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,000,000	$2,000,000	$2,000,000	$2,000,000

1.74 YOUTH WORKS POSTSERVICE BENEFITS

Minnesota Statutes, Section 290.01, Subd. 19b (10)

A subtraction from federal taxable income is allowed for postservice benefits for working in the Minnesota Youth Works program. The benefits are usually in the form of tuition reimbursements or student loan payments. The subtraction is allowed to the extent that the benefits are included in federal taxable income.

This provision was enacted in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

1.75 DISPOSITION OF FARM PROPERTY

Minnesota Statutes, Section 290.491

A taxpayer may subtract from federal taxable income the income realized on a sale or exchange of farm property if the taxpayer is insolvent at the time of the sale, and the proceeds are used solely to discharge indebtedness of the property sold. The amount of the subtraction is limited to the excess of the taxpayer's debts over total assets and the amount of any debt forgiveness excluded from income under Section 108 of the Internal Revenue Code.

This provision was enacted in 1985. It was repealed in 1987 but was re-enacted in 1988, retroactive to tax year 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

PREFERENTIAL COMPUTATION

1.76 FIVE-YEAR AVERAGING OF LUMP SUM DISTRIBUTIONS

Internal Revenue Code, Section 402(e)
Minnesota Statutes, Section 290.032

A lump sum distribution from a qualified pension, profit-sharing, or stock bonus plan is eligible for the special five-year averaging provision. A separate tax is computed on the lump sum distribution in isolation of other income.

Several restrictions apply to using lump sum averaging, including age and reason for distribution. The Minnesota provisions for lump sum averaging are the same as the federal except that Minnesota does not allow the option of ten-year averaging, and any capital gains are treated as ordinary income.

A ten-year averaging provision was adopted by Minnesota in 1975. In 1987 Minnesota adopted five-year averaging and most of the federal changes enacted in 1986 that placed restrictions on the use of lump sum averaging. In 1997 Minnesota adopted the federal repeal of five-year averaging, beginning with tax year 2000. The transition rules from the Tax Reform Act of 1986 were not repealed, so some taxpayers will still be able to use averaging after that time.

Lump-sum averaging was used on 750 returns for tax year 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$900,000	*	*	*

*Less Than $50,000

CREDITS

1.77 CREDIT FOR INCOME TAX PAID TO OTHER STATES

Minnesota Statutes, Section 290.06, Subd. 22

A resident taxpayer may claim a nonrefundable credit for the amount of income tax paid to another state (or Canadian province or territory) to the extent that income taxed in the other state is included in Minnesota income. The credit is the lesser of the tax owed to the other state or the amount computed by multiplying the Minnesota gross tax computed on all income times the percentage that the income earned in the other state is to federal adjusted gross income.

This credit was enacted in 1959 and was last changed in 1997.

This credit was claimed on 24,000 returns for tax year 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$64,700,000	$71,200,000	$78,300,000	$86,100,000

1.78 MARRIAGE CREDIT

Minnesota Statutes, Section 290.0675

A nonrefundable credit is allowed against the individual income tax for a married couple filing a joint return if both spouses have earned income and their income situation results in a “marriage penalty” due to the size of the income tax brackets. The credit compensates for the extent to which the income tax is higher due to the tax brackets for a joint return compared to the two spouses filing as single persons.

The taxpayer does not calculate the credit; the law contains a look-up table which specifies the credit amount based on two variables: the joint taxable income of the couple and the earned income of the lesser-earning spouse. The credit does not apply unless taxable income is at least $25,000 and the earned income of the lesser-earning spouse is at least $14,000. The maximum credit for tax year 1999 is $261. The amounts in the table are indexed for inflation for tax years after 1999.

This credit was enacted in 1999, effective beginning with tax year 1999.

An estimated 350,000 returns will benefit from the credit.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$46,200,000	$48,400,000	$50,900,000	$52,900,000

1.79 CREDIT FOR LONG-TERM CARE INSURANCE

Minnesota Statutes, Section 290.0672

A nonrefundable credit is allowed against the individual income tax for premiums paid for long-term care insurance. A taxpayer may claim a credit for only one policy for each beneficiary (taxpayer or spouse), and the credit for each policy equals the lesser of: 25% of premiums paid to the extent not deducted in determining federal taxable income; or $100. The maximum credit is $200 for married couples filing joint returns and $100 for all other filers.

To qualify, the long-term care insurance policy must meet the requirements under specified sections of the Internal Revenue Code, have a lifetime benefit of at least $100,000, and include inflation protection, as specified.

This credit was enacted in 1997, effective beginning with tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,500,000	$1,700,000	$1,800,000	$2,000,000

1.80 CREDIT FOR INCREASES IN PROPERTY TAXES ON CABINS

Minnesota Statutes, Sections 290.06, Subd. 25 and 290A.04, Subd. 2j

A nonrefundable credit against the individual income tax is allowed based on the increase in Minnesota property tax on the taxpayer's seasonal residential recreational property, such as a cabin. The credit applies if the increase over the previous year's tax exceeds 10% and if the amount of the increase is $100 or more. The credit is equal to 75% of the first $300 of the excess of the increase over 10%, for a maximum credit of $225.

The credit applies only for two years: tax year 1998, for the increase in property taxes payable in 1998 over 1997, and tax year 1999, for the increase in property taxes payable in 1999 over 1998.

This credit was enacted in 1997.

The credit was claimed on about 560 returns for tax year 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$0	$0	$0

1.81 CHILD AND DEPENDENT CARE CREDIT

Internal Revenue Code, Section 21
Minnesota Statutes, Section 290.067

A Minnesota taxpayer may claim a refundable credit for a portion of dependent care expenses provided that those expenses were necessary in order to hold or look for a job. A dependent is defined as a child under age 13 or a dependent or spouse of any age who is disabled. The determination of the credit starts with the federal child and dependent care credit, which is equal to eligible expenses up to $2,400 for one dependent and $4,800 for two or more dependents multiplied by a percentage ranging from 30% to 20%, with the percentage decreasing as income increases.

The maximum state credit is reduced as income increases. For tax year 1999 the maximum amounts were reduced for taxpayers with total household income over $17,720, so that a taxpayer with total household income over $31,370 received no credit. The income level at which the maximum credit is reduced is indexed each year for inflation.

The state credit contains two provisions which are exceptions to the general rule that expenses must be incurred to maintain or look for employment. Operators of family day care homes may claim the credit if they care for their own child under age six, based on a deemed amount of expenses. A married couple with a child less than one year of age and filing a joint return is deemed to have $2,400 of qualifying expenses for that child, whether or not any were actually incurred.

The dependent care credit was enacted in 1977. In 1989 the income thresholds were changed and indexed. The credit was extended to operators of licensed family day care homes in 1991 and to married couples with a child under age one in 1994. This provision was last changed in 1995.

This credit was claimed on approximately 36,000 returns filed for tax year 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
Offset Against Tax	$6,100,000	$6,100,000	$6,000,000	$6,000,000
Refunded	5,900,000	5,900,000	6,000,000	6,000,000
State General Fund	$12,000,000	$12,000,000	$12,000,000	$12,000,000

1.82 WORKING FAMILY CREDIT

Internal Revenue Code, Section 32
Minnesota Statutes, Section 290.0671

The Minnesota working family credit is a refundable credit against the individual income tax allowed to taxpayers who are eligible for the federal earned income credit. To qualify, the taxpayer (or spouse) must have income from wages or self employment, and total earned income (or modified adjusted gross income, whichever is larger) cannot exceed a maximum amount. A taxpayer is not eligible if investment income exceeds a specified amount, which is $2,350 for tax year 1999 and is indexed for inflation.

Although the Minnesota working family credit uses the same eligibility requirements and definitions as the federal earned income credit, the calculation of state credit is separate. All the dollar amounts in the calculation are indexed annually for inflation. The following calculations apply to tax year 1999.

- For a taxpayer with no children, the credit is 1.1475% of the first $4,540 of earned income. The credit is reduced by 1.1475% of earned income or modified adjusted gross income, whichever is greater, in excess of $5,660. The maximum credit is $52. The credit is phased out by income of $10,200.
- For a taxpayer with one child, the credit is 7.45% of the first $6,790 of earned income, plus 8.5% of earned income over $11,850 but less than $13,210. The credit is reduced by 5.13% of earned income or modified adjusted gross income, whichever is greater, in excess of $14,810. The maximum credit is $621. The credit is phased out by income of $26,928.
- For a taxpayer with two or more children, the credit is 8.8% of the first $9,550 of earned income, plus 20% of earned income over $14,590 but less than $16,500. The credit is reduced by 9.38% of earned income or modified adjusted gross income, whichever is greater, in excess of $17,570. The maximum credit is $1,222. The credit is phased out by income of $30,580.

The working family credit was first enacted in 1991 and was equal to 10% of the federal earned income credit. The credit was increased several times, and federal changes were adopted. In 1998 the credit was changed from a percentage of the federal credit to a separate calculation. It was last changed in 1999 when the amount for taxpayers with children was increased.

The working family credit was claimed on about 210,000 returns for tax year 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
Offset Against Tax	$15,100,000	$15,800,000	$16,400,000	$16,600,000
Refunded	71,900,000	73,200,000	74,700,000	76,600,000
State General Fund	$87,000,000	$89,000,000	$91,100,000	$93,200,000

1.83 K-12 EDUCATION CREDIT

Minnesota Statutes, Section 290.0674

A refundable credit is allowed equal to eligible education-related expenses for a dependent in kindergarten through grade 12. The maximum credit of $1,000 per child and $2,000 per family is allowed to families with total household income of $33,500 or less. The maximum credit is phased out for household income between $33,500 and $37,500. If eligible expenses exceed the maximum allowed, the excess may be taken as a subtraction (Item 1.69). Beginning in tax year 2000, the child must meet the definition of a qualifying child rather than a dependent.

Eligible expenses include fees or tuition for instruction outside the regular school day or school year, such as tutoring and educational summer camps. Also eligible are costs required for the regular school day for textbooks, instructional materials, and transportation costs paid to others. Private school tuition does not qualify for the credit, although it does qualify for the subtraction. Eligible expenses also include personal computer hardware and educational software, limited to a maximum of $200 per family.

This credit was enacted in 1997, effective beginning with tax year 1998. The phaseout of the maximum credit and the change from dependent to qualifying child were enacted in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Offset Against Tax	$9,500,000	$11,500,000	$14,000,000	$15,500,000
Refunded	10,500,000	12,500,000	14,800,000	16,200,000
State General Fund	$20,000,000	$24,000,000	$28,800,000	$31,700,000

1.84 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(2) and 6(1)

Two refundable credits against the income tax are available to employers in designated enterprise zones: up to $3,000 annually for each additional worker employed in a designated enterprise zone, other than workers employed in construction; and up to $1,500 annually for each worker employed in the zone who does not qualify for the $3,000 credit.

This provision was enacted in 1983 and was scheduled to expire on December 31, 1996. However, a 1996 law change allowed border city enterprise zones to remain in existence until terminated by resolution adopted by the city. Other zones expired at the end of 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

Appendix to Chapter 1: Distributional Information on Selected Tax Expenditures in the Individual Income Tax

The following tables show information on the individual income tax and selected tax expenditures by income class for tax year 1999. The income classes are based on a comprehensive definition of income which includes, in addition to federal adjusted gross income, nontaxable interest, nontaxable social security and pensions, contributions to an IRA or Keogh plan, and other nontaxable sources of income reported on the return. For the tax expenditure items, the dollar amounts are the tax benefits to individuals.

	Total Returns Filed		Tax After All Credits			
				Amount		
Income Class	Number of Returns	Percent	Number of Returns	Total (000's)	Percent Of Total	Average
$ 9,999 or Less	432,886	18.4%	251,646	$(3,520)	(0.1)%	$(14)
10,000 - $ 19,999	323,958	13.7	294,261	49,611	1.0	169
20,000 - 29,999	331,087	14.0	310,789	195,854	3.9	630
30,000 - 39,999	277,443	11.8	270,852	304,819	6.1	1,125
40,000 - 49,999	224,630	9.5	221,186	362,748	7.2	1,640
50,000 - 74,999	389,761	16.5	389,470	972,692	19.4	2,497
75,000 - 99,999	187,499	8.0	187,242	740,133	14.8	3,953
100,000 - 149,999	105,146	4.5	104,689	625,591	12.5	5,976
150,000 - 199,999	34,249	1.5	34,071	311,620	6.2	9,146
200,000 - 499,999	36,175	1.5	35,901	595,337	11.9	16,583
500,000 or More	13,972	0.6	13,495	856,645	17.1	63,479
Total	2,356,806	100.0%	2,113,602	$5,011,530	100.0%	$2,371

Selected Tax Expenditures - Refundable Credits

	Working Family Credit				Child Care Credit			
		Amount				Amount		
Income Class	Number of Returns	Total (000's)	Percent Of Total	Average	Number of Returns	Total (000's)	Percent of Total	Average
$ 9,999 or Less	94,170	$20,967	24.1%	$223	4,708	$1,392	11.6%	$296
10,000 - $ 19,999	66,220	44,718	51.4	675	13,943	5,988	49.9	429
20,000 - 29,999	53,320	21,228	24.4	398	15,914	4,476	37.3	281
30,000 - 39,999	1,290	87	0.1	67	1,935	144	1.2	74
40,000 - 49,999	-	-	-	-	-	-	-	-
50,000 - 74,999	-	-	-	-	-	-	-	-
75,000 - 99,999	-	-	-	-	-	-	-	-
100,000 - 149,999	-	-	-	-	-	-	-	-
150,000 - 199,999	-	-	-	-	-	-	-	-
200,000 - 499,999	-	-	-	-	-	-	-	-
500,000 or More	-	-	-	-	-	-	-	-
Total	215,000	$87,000	100.0%	$405	36,500	$12,000	100.0%	$329

Appendix to Chapter 1 (Continued)

Selected Tax Expenditures - Itemized Deductions

	Real Estate Taxes				Mortgage Interest			
		Amount				Amount		
Income Class	Number of Returns	Total (000's)	Percent of Total	Average	Number of Returns	Total (000's)	Percent of Total	Average
$ 9,999 or Less	522	$16	-	$31	1,075	$51	-	$47
10,000 - $19,999	9,676	647	0.7%	67	9,020	1,449	0.5%	161
20,000 - 29,999	30,852	1,719	1.8	56	31,234	5,021	1.9	161
30,000 - 39,999	63,516	4,542	4.9	72	59,745	13,819	5.2	231
40,000 - 49,999	73,687	6,039	6.5	82	73,017	17,197	6.4	236
50,000 - 74,999	203,969	21,625	23.2	106	199,803	63,438	23.6	318
75,000 - 99,999	134,776	19,340	20.7	143	132,177	57,609	21.4	436
100,000 - 149,999	84,924	17,015	18.2	200	80,854	52,674	19.6	651
150,000 - 199,999	28,142	7,839	8.4	279	25,955	22,373	8.3	862
200,000 - 499,999	27,925	9,782	10.5	350	25,111	26,458	9.9	1,054
500,000 or More	7,884	4,769	5.1	605	6,160	8,620	3.2	1,399
Total	665,873	$93,333	100.0%	$140	644,151	$268,709	100.0%	$417

	Charitable Contributions				Medical and Dental Expenses			
		Amount				Amount		
Income Class	Number of Returns (000's)	Total (000's)	Percent of Total	Average	Number of Returns	Total	Percent of Total	Average
$ 9,999 or Less	521	$11	-	$21	22	$1	-	$45
10,000 - $19,999	9,152	286	0.2%	31	4,507	770	3.8%	171
20,000 - 29,999	29,773	1,536	1.2	52	10,295	1,561	7.8	152
30,000 - 39,999	57,902	3,266	2.6	56	20,924	5,045	25.1	241
40,000 - 49,999	72,582	5,394	4.3	74	14,606	2,517	12.5	172
50,000 - 74,999	199,446	21,002	16.6	105	24,195	6,917	34.4	286
75,000 - 99,999	136,183	19,926	15.7	146	5,354	1,286	6.4	240
100,000 - 149,999	85,011	19,717	15.6	232	1,883	1,348	6.7	716
150,000 - 199,999	28,437	9,741	7.7	343	413	180	0.9	436
200,000 - 499,999	27,697	15,273	12.0	551	236	299	1.5	1,267
500,000 or More	8,059	30,530	24.1	3,788	64	194	1.0	3,031
Total	654,763	$126,682	100.0%	$193	82,499	$20,118	100.0%	$244

Source: Distributions by income based on the House Income Tax Simulation Model usinginformation from a sample of 1996 Minnesota individual income tax returns which was projected for tax year 1999.

CHAPTER 2: CORPORATE FRANCHISE TAX

Collections and History

For fiscal year 1999, net revenues from the corporate franchise tax were $777 million, equaling 6.4% of total state revenue. The proceeds from the corporate franchise tax go into the state general fund.

The Minnesota corporate income tax was enacted in 1933, along with the individual income tax. Several changes were made to the tax rate since 1933. At times it was a flat rate; at others, a graduated rate schedule applied. The current rate of 9.8% has been in effect since 1990. The bank excise tax was first enacted in 1941 at a rate of 8%. The bank excise tax was at a rate different from the corporate income tax until 1973.

In 1987 the corporate income and bank excise taxes were replaced by the corporate franchise tax, and a federal definition of income (federal taxable income) was adopted. Although the Minnesota tax now conforms more closely to the federal, a number of modifications to federal taxable income still exist.

Tax Base

For purposes of this study, the tax base for the corporate franchise tax is defined to be income from all sources less expenses that are reasonable and necessary to generate that income. Such reasonable and necessary expenses are, therefore, not considered to be tax expenditures.

A tax expenditure is created when a certain type of income is excluded or when a deduction or credit is allowed for expenses other than those considered reasonable and necessary. For example, when depreciation measures the actual decline in the value of an asset during the tax year, it is a necessary business expense and not a tax expenditure. However, when accelerated depreciation or expensing is allowed, the excess over the actual depreciation is considered to be a tax expenditure.

Computation of the Tax

The computation of the corporate franchise tax is as follows:

	Income from all sources
minus:	federal exclusions
minus:	federal deductions
equals:	federal taxable income
plus:	Minnesota additions, including:
	- state, local, or foreign income taxes deducted federally
	- federally-exempt interest on government bonds
	- net operating loss deducted federally
	- federal dividend received deduction
	- losses from mining subject to the occupation tax
	- federal capital loss deduction
	- federal charitable contribution deduction
	- exempt foreign trade income of a foreign sales corporation

	- federal percentage depletion deduction
	- deemed dividends from foreign operating corporations
minus:	Minnesota subtractions, including:
	- foreign dividend gross up
	- salary expenses disallowed federally due to claiming federal jobs credit
	- capital loss deduction with no carrybacks
	- interest and expenses on income that is exempt federally but taxed by the state
	- cost depletion for mines, oil and gas wells, other natural deposits, and timber
	- state income tax refunds
	- 80% of foreign source royalties, fees, etc. received within unitary group
	- income or gains from mining operations subject to the occupation tax
	- handicap access expenditures disallowed federally due to claiming the federal credit
	- research expenses disallowed federally due to claiming the federal credit
plus or minus:	modifications to the federal accelerated cost recovery system
equals:	net income
times:	apportionment factor
equals:	taxable net income
minus:	Minnesota deductions
	- net operating loss
	- dividends received
	- Minnesota charitable contributions
equals:	Minnesota taxable income
times:	tax rate of 9.8%
equals:	gross tax
minus:	nonrefundable credits
	- research and development credit
	- alternative minimum tax carryover credit
	- job training program credit
	- gross premiums tax credit for insurance companies
	- guaranty association assessments credit for insurance companies
plus:	alternative minimum tax
plus:	minimum fee
equals:	tax liability
minus:	refundable enterprise zone credits
equals:	net corporate franchise tax payable

For most multistate corporations, income is apportioned to Minnesota based on a weighted three-factor formula of 15% of the Minnesota property ratio, 15% of the Minnesota payroll ratio, and 70% of the Minnesota sales ratio. For tax years beginning after December 31, 2000, the ratios will be changed to 12.5%, 12.5%, and 75% respectively. With special permission or under certain conditions, separate accounting or a single factor of sales may be used. For insurance companies, income is apportioned to Minnesota by the ratio that gross premiums collected in Minnesota is to total gross premiums collected for that year.

Since 1981 Minnesota has used a domestic unitary method of taxation. A group of corporations is considered to be a unitary business when there is unity of ownership, operation, and use. Only domestic corporations, that is, those organized under United States federal or state law, are included in the unitary group. The Minnesota taxable income of a corporation that is part of a unitary group is determined by applying an apportionment formula to the combined net income of the unitary business.

An alternative minimum tax on tax preference income is imposed to the extent that it exceeds the regular liability. The alternative minimum tax is equal to 5.8% of Minnesota alternative minimum taxable income.

In addition to the regular or alternative minimum tax, a minimum fee is imposed, based on the sum of the corporation's Minnesota property, payroll, and sales, as follows:

Property, Payroll, and Sales			Minimum Fee
Less than		$500,000	$ 0
$500,000	-	$999,999	$100
$1,000,000	-	$4,999,999	$300
$5,000,000	-	$9,999,999	$1,000
$10,000,000	-	$19,999,999	$2,000
$20,000,000	or more		$5,000

The unrelated business income of exempt organizations is subject to the Minnesota tax. The unrelated business income tax is based on the organization's federal taxable income, without the Minnesota additions to and subtractions from income which are applicable to other corporations.

Mining Occupation Tax

The occupation tax on taconite and iron ore is computed in the same way as the corporate franchise tax, with these exceptions: the starting point is the mine value of iron ore or taconite concentrates mined or produced in Minnesota; deductions allowed include only those expenses necessary to convert raw iron ore or taconite concentrates to marketable quality; the unitary principle is not applicable; and percentage depletion is allowed. Total occupation tax collections in fiscal year 1999 were $2.2 million. The tax expenditures for the occupation tax are not shown separately; they are included with the corporate franchise tax provisions. Because percentage depletion does not apply to other corporations, the fiscal impact for Item 2.11 applies only to occupation tax filers.

EXEMPT ORGANIZATIONS

2.01 CREDIT UNIONS

Internal Revenue Code, Section 501(c)(14)(A)
Minnesota Statutes, Section 290.05, Subd. 2

Credit unions organized and operated for mutual purposes and without profit or capital stock are exempt from both state and federal income taxation. The estimates are based on the assumption that credit unions would be taxed the same as similar financial institutions.

Credit unions have never been subject to the federal income tax and have been specifically excluded from state income taxation since 1937. In 1981 Minnesota adopted the language found in Subchapter F of the Internal Revenue Code which exempts numerous organizations, including credit unions.

In 1998 there were about 196 credit unions in Minnesota with approximately 1,345,000 members.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,600,000	$4,900,000	$5,200,000	$5,600,000

2.02 INSURANCE COMPANIES DOMICILED IN RETALIATORY STATES

Minnesota Statutes, Section 290.05, Subd. 1(c)

An insurance company domiciled in a state other than Minnesota or in another country is exempt from the corporate franchise tax if the state of domicile imposes retaliatory taxes on insurance companies and does not grant, on a reciprocal basis, an exemption to Minnesota-domiciled companies.

This exemption was enacted in 1989, effective beginning with tax year 1991.

An estimated 230 companies would have a Minnesota corporate franchise tax liability without this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$26,000,000	$26,000,000	$26,800,000	$27,300,000

2.03 SMALLER MUTUAL PROPERTY AND CASUALTY INSURANCE COMPANIES

Minnesota Statutes, Section 290.05, Subd. 1(d)

Mutual property and casualty insurance companies with total assets of $1.6 billion or less on December 31, 1989, are exempt from the corporate franchise tax. Town and farmers' mutual insurance companies are also exempt.

This exemption was enacted in 1989, effective beginning with tax year 1991. In 1990 the date of the asset test was set at December 31, 1989, instead of at the end of the previous year. This provision was last changed in 1992.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$300,000	$300,000

FEDERAL EXCLUSIONS

2.04 PERMANENT EXEMPTIONS FROM IMPUTED INTEREST RULES

Internal Revenue Code, Sections 483, 1274, and 1274A
Minnesota Statutes, Section 290.01, Subd. 19

The Internal Revenue Code generally requires that debt instruments bear a market rate of interest at least equal to the average rate on outstanding Treasury securities of comparable maturity. If the instrument does not, a market rate is imputed to it for tax purposes. The imputed interest must be included in the income of the recipient and is deducted by the payer.

Included in the exceptions to the imputed interest rules is debt associated with the sale of property when the total sales price does not exceed $250,000. Debt instruments for amounts not exceeding $2.8 million that are given in exchange for real property may not have imputed to them an interest rate exceeding 9%. The $2.8 million maximum is indexed annually for inflation.

Imputed interest rules and exceptions to the rules were first effective in 1984 and were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.05 INVESTMENT INCOME ON LIFE INSURANCE AND ANNUITY CONTRACTS

Internal Revenue Code, Sections 72, 101, 7702, and 7702A
Minnesota Statutes, Section 290.01, Subd. 19

Investment income earned on life insurance and annuity contracts is not included in the recipient's gross income as it accumulates. For a life insurance policy the exclusion applies to what is commonly referred to as "inside build-up" of investment income. When the premiums paid by the policyholder exceed the cost of insurance, the excess premiums are invested by the company, and the investment income is credited to the policy.

If the policy is surrendered before the death of the policyholder, the excess of the cash surrender value over the premiums paid is included in income. In this situation, the income is deferred rather than excluded. Policy proceeds paid because of the death of the insured are excluded from the gross income of a beneficiary, so that the investment income paid to beneficiaries is never taxed.

An annuity is an investment contract sold by a life insurance company in which the owner makes a deposit in either a lump sum or installment payments in exchange for regular payments for a lifetime or for a specified number of years. The income is not included in the gross income of the owner as it accumulates if the policyholder is a natural person. With certain exceptions, the deferral of investment income does not apply when an annuity is held by a corporation.

These exclusions have been in effect since 1933 and were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,900,000	$5,000,000	$5,100,000	$5,300,000

2.06 LIKE-KIND EXCHANGES

Internal Revenue Code, Section 1031
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain from the sale or exchange of property is recognized as income for tax purposes. However, the gain from a like-kind exchange is not recognized at the time of exchange if both the relinquished and the received property are held for productive use in a trade or business or for investment. The recognition of the gain is deferred until the received property is sold or otherwise disposed. In order for the gain to qualify for exclusion, the exchange must be concluded within specified time limits. This provision does not cover stock in trade or other property held primarily for sale, or stock, bonds, notes, or other securities.

Tax-free exchanges of like-kind property were allowed federally in 1921 and by Minnesota in 1933. These provisions were last amended in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,500,000	$1,500,000	$1,500,000	$1,500,000

2.07 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

Internal Revenue Code, Section 458
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer who distributes magazines, paperbacks, and sound recordings and who uses the accrual method of accounting may elect to exclude from gross income for the taxable year the income attributable to the qualified sale of any magazine, paperback, or sound recording which is returned to the taxpayer before the end of the merchandise return period, even though the merchandise return period extends into the next taxable year.

A sale of such merchandise is a qualified sale if the merchandise is not resold and the taxpayer has a legal obligation to adjust the sales price if it is not resold. The excludable amount is the amount by which the price is adjusted. Separate rules govern how the excludable income is distributed over time for magazines and for paperbacks and records.

Section 458 of the Internal Revenue Code was enacted in 1978.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.08 ALTERNATIVE COMPUTATION FOR SMALL PROPERTY AND CASUALTY COMPANIES

Internal Revenue Code, Section 831(b)
Minnesota Statutes, Section 290.01, Subd. 19

A property and casualty company with written premiums of between $350,000 and $1.2 million can elect to be taxed only on its investment income. Under this election, underwriting income and deductions are not included in the determination of taxable income.

This provision was part of the federal Tax Reform Act of 1986 and replaced preferential provisions that were allowed only to small mutual companies. In 1989 Minnesota adopted the current definition of federal taxable income for insurance companies as the starting point for its tax and, thereby, this provision was incorporated in Minnesota law, beginning with tax year 1991.

Because insurance companies domiciled in retaliatory states and smaller mutual property and casualty companies are exempt from the corporate franchise tax, fewer than twenty companies which are subject to the Minnesota tax are eligible for this special treatment.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

FEDERAL DEDUCTIONS

2.09 DEPRECIATION

Internal Revenue Code, Sections 167 and 168
Minnesota Statutes, Section 290.01, Subd. 19 and 19e

Beginning with property placed in service after December 31, 1987, a corporate taxpayer is allowed a deduction for the depreciation of machinery, equipment, and structures used in a trade or business or held for the production of income equal to the deduction allowed federally under the modified accelerated cost recovery system (MACRS). Federally, MACRS applies to property placed in service after December 31, 1986 (July 31, 1986, in some cases).

Under MACRS, machinery and equipment can be depreciated over three, five, seven, or ten years, and the 200% declining balance method is used. The 150% declining balance method applies to fifteen- and twenty-year property. Straight-line depreciation of 27.5 years is used for residential rental property, and 39 years is used for nonresidential real property.

For property placed in service after July 31, 1986, and before January 1, 1988, and for which the new rules apply, 15% of the federal deduction is disallowed. For property placed in service after December 31, 1980, and before January 1, 1987, 40% of the federal deduction is disallowed for fifteen-, eighteen-, and nineteen-year real property, and 20% is disallowed for all other property. Methods are provided for deducting the remaining depreciation after the end of the federal recovery period.

Conceptually the tax expenditure is the extent to which depreciation for tax purposes exceeds the actual decline in value of the asset during the applicable tax year. For machinery and equipment, the tax expenditure is measured as the difference between the current law depreciation schedule and straight-line depreciation over the period defined by the midpoint of the asset depreciation range (ADR) system that was in effect from 1971 to 1981. For structures, it is measured as the difference between current law depreciation and straight-line depreciation over forty years.

The depreciation deduction was a part of the original Minnesota income tax in 1933. Accelerated depreciation was first allowed through administrative practice by the federal government in 1946 and by law in 1954. Minnesota first enacted an accelerated depreciation provision in 1959. The current depreciation provisions were enacted in 1987. This provision was last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$95,500,000	$96,700,000	$98,600,000	$99,700,000

2.10 EXPENSING DEPRECIABLE BUSINESS PROPERTY

Internal Revenue Code, Section 179
Minnesota Statutes, Section 290.01, Subd. 19

A corporation may elect to treat the cost of qualifying business property as an expense and to deduct the entire cost in the year the property is placed in service rather than taking the depreciation deduction.The maximum annual deduction is $19,000 for tax year 1999, $20,000 for 2000, $24,000 for 2001 and 2002, and $25,000 for 2003 and thereafter. If the corporation places more than $200,000 of qualifying personal property in service during the year, the limitation is reduced by one dollar for each dollar that the cost exceeds $200,000.

This provision was adopted in 1982. In 1993 the maximum deduction was increased from $10,000 to $17,500, and in 1996 the phased-in increases in the maximum amounts were enacted.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,800,000	$2,400,000	$2,500,000	$2,000,000

2.11 EXCESS OF PERCENTAGE OVER COST DEPLETION(MINING OCCUPATION TAX)

Internal Revenue Code, Sections 291, 611, 612, 613, and 613A
Minnesota Statutes, Section 298.01, Subd. 3b(b) and 4c(a)(1)

Depletion allowances refer to the way in which investment costs are recovered for mining or other extractive operations and may be taken for almost all exhaustible natural resources. For the federal income tax, a corporation may choose either percentage depletion or cost depletion, but, only cost depletion is allowed for the Minnesota corporate franchise tax. However, the option is allowed for the mining occupation tax on taconite and iron ore.

Cost depletion is based on the taxpayer's basis in the property and is similar to depreciation in its application. Percentage depletion is based on a percentage of the gross income received from the extractive operation and has little relationship to a taxpayer's basis. Only the excess of percentage depletion over cost depletion is considered a tax expenditure.

For the federal income tax, a deduction for cost depletion was first allowed in 1913, and percentage depletion was first allowed as an option in 1926. Percentage depletion has never been allowed for the Minnesota corporate franchise tax. In 1989 percentage depletion was enacted along with the current method of computing the mining occupation tax. The last change to this provision occurred in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$900,000	$900,000	$700,000	$700,000

2.12 AMORTIZATION OF ORGANIZATIONAL AND START-UP COSTS

Internal Revenue Code, Sections 195 and 248
Minnesota Statutes, Section 290.01, Subd. 19

Corporations which incur certain expenses during their initial organizational or start-up phase may elect to amortize those costs over a period of not less than sixty months, beginning in the month in which the corporation commences operations. Without this special provision, corporate taxpayers would be required to capitalize the costs, adding them to their basis, and the costs would be recoverable only when the business is sold.

Minnesota first adopted the deduction for organizational expenses in 1955, and the deduction for start-up costs was added in 1980. The provision was last amended in 1985.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

2.13 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

Internal Revenue Code, Section 174
Minnesota Statutes, Section 290.01, Subd. 19 and Subd. 19d(14)

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. However, a corporation may elect to deduct as an expense in the current tax year all qualified research and development costs. If the asset resulting from the research or development expenditures has no determinable useful life (such as is the case with a process or a formula), then the taxpayer may alternatively elect to amortize the costs over not less than sixty months.

The deduction is reduced by the amount, if any, of the federal research credit. Minnesota allows a subtraction for the amount of research expenses disallowed due to claiming the federal credit, but only to the extent that the expenses exceed the Minnesota research credit.

Section 174 was enacted in 1954 and was last changed in 1989.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$8,700,000	$9,800,000	$10,200,000	$10,900,000

2.14 EXPENSING OF MAGAZINE CIRCULATION EXPENDITURES

Internal Revenue Code, Section 173
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to deduct as an expense in the current year expenditures to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical. This treatment is restricted to certain types of expenditures, and the election is binding for the current year and to similar expenditures in subsequent years.The provision is a tax expenditure because, in general, expenses incurred in creating or developing an asset must be capitalized.

This provision was adopted by Minnesota in 1951 and was last amended in 1984.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.15 EXPENSING FOR REMOVAL OF BARRIERS TO THE HANDICAPPED AND ELDERLY

Internal Revenue Code, Sections 44(d)(7) and 190
Minnesota Statutes, Section 290.01, Subd. 19 and 19d(13)

A taxpayer may elect to expense qualifying barrier removal expenses for property used in a trade or business in the year incurred instead of capitalizing them. To qualify, the removal of barriers must make the taxpayer's facility or public transportation vehicle more accessible to and usable by handicapped and elderly persons and must meet standards of the Architectural and Transportation Barriers Compliance Board. The maximum deduction per year is $15,000, and expenses used for the federal disabled access credit for small businesses are not deductible on the federal return. Minnesota allows a subtraction for expenses disallowed due to claiming the federal credit.

The federal provision was effective for tax year 1977, and Minnesota adopted this provision for corporate franchise tax purposes in 1987. In 1990 the maximum deduction was reduced from $35,000 to $15,000, and expenses used for the newly-enacted federal credit were disallowed. These changes were adopted by Minnesota in 1991, at which time Minnesota also enacted a subtraction for expenses disallowed due to taking the federal credit.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.16 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 56, 57(2), 263, 291, 616, 617, and 1254
Minnesota Statutes, Section 290.01, Subd. 19

Current-year expensing is allowed for items such as labor, fuel, repairs, and site preparation costs incurred in the exploration and development of oil, gas, other fuel, and non-fuel mineral deposits.

Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses but are treated as capital expenses, which increase the taxpayer's basis in the property.

Expensing of exploration and development costs for all minerals was first allowed by Minnesota in 1967. Prior to 1987, Minnesota allowed this expensing deduction for minerals but not for oil and gas. In 1987 Minnesota conformed to the federal treatment for all the types of deposits mentioned by adopting federal taxable income as the starting point for the tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$800,000	$900,000	$1,000,000	$1,100,000

2.17 CASH ACCOUNTING AND EXPENSING FOR AGRICULTURE

Internal Revenue Code, Sections 162, 175, 180, 447, 461, 464, and 465
Minnesota Statutes, Section 290.01, Subd. 19

A farm corporation may deduct certain expenditures made during the tax year rather than capitalize them. The expenditures must be for soil and water conservation under a government-approved plan, the purchase and application of fertilizer, or certain preproduction costs. The expensing of capital outlays is a tax expenditure because normally the cost of a capital outlay for land improvement would not be deductible but would be added to the basis of the property.

Family farm corporations are allowed to use cash accounting rather than the accrual system for income tax purposes if their annual gross receipts are $25 million or less. Therefore, costs attributable to goods not yet sold may be deducted in the current year.

Certain agricultural corporations have been allowed to use the cash accounting system for tax purposes since 1933. Minnesota began allowing the expensing of capital outlays in 1955. In 1987 cash accounting was repealed for farms with annual gross receipts over $25 million.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$400,000	$500,000	$500,000

2.18 EXPENSING OF MULTIPERIOD AGRICULTURAL PRODUCTION COSTS

Internal Revenue Code, Section 263A(d)
Minnesota Statutes, Section 290.01, Subd. 19

Farmers are allowed to deduct in the current year certain multiperiod production costs rather than follow the general capitalization rules. Expensing is allowed in two types of situations.

Farmers who are allowed to use cash accounting may elect to deduct currently all preproductive costs of animals and also of plants that have a preproductive period of two years or less. These costs must be recaptured as ordinary income upon disposition of the product, and the alternative depreciation system must be used for farm assets placed in service during a year in which the election is in effect. Vintners and orchard growers may expense the costs of replacing plants or trees that have been damaged by disease, pests, frost, or other natural disasters.

Expensing has always been allowed for these types of costs incurred by farmers. However, this provision was enacted as part of the federal Tax Reform Act of 1986 as an exception to the uniform capitalization rules adopted in that same act. This provision was last changed in 1989.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.19 EXPENSING OF MULTIPERIOD TIMBER GROWING COSTS

Internal Revenue Code, Section 263A(c)(5)
Minnesota Statutes, Section 290.01, Subd. 19

Timber growers are allowed to deduct in the current year multiperiod production costs rather than following the general capitalization rules. The exception to the capitalization rules applies to the costs incurred in raising, growing, or harvesting trees other than trees bearing fruit, nuts, or other crops, or ornamental trees.

Revised capitalization rules were enacted as part of the Tax Reform Act of 1986. Because the general rules that apply to other business activities are more restrictive, this provision is considered a tax expenditure.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$800,000	$900,000	$1,000,000	$1,100,000

2.20 SPECIAL RULES FOR MINING AND SOLID WASTE RECLAMATION RESERVES

Internal Revenue Code, Section 468
Minnesota Statutes, Section 290.01, Subd. 19

In general, expenses that will be incurred in the future may not be claimed as a current deduction. Under the accrual method of accounting, future expenses can be deducted only when the economic activity giving rise to the expense has occurred.

An exception is provided for mining and solid waste reclamation costs which are incurred in order to comply with a federal, state, or local law, as specified. A deduction may be taken in the current year for the estimated future reclamation or closing costs attributable to production or mining activity during the taxable year. A bookkeeping reserve must be maintained for tax purposes so that, when reclamation or closing costs are actually incurred, they can be compared to the deductions taken. Any excess of the reserve, including interest, over actual costs must be included in income at that time.

Section 468 was enacted in 1984 and was last changed in 1986. Minnesota first adopted this provision for corporate tax purposes in 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.21 CASH ACCOUNTING OTHER THAN AGRICULTURE

Internal Revenue Code, Sections 446 and 448
Minnesota Statutes, Section 290.01, Subd. 19

Section 446 of the Internal Revenue Code allows a taxpayer to choose the cash method of accounting instead of the accrual method. The accrual method is considered a better measure of current-year income and expenses because it takes into account the income of receivables. This tax expenditure is the difference in net income measured by accrual accounting and cash accounting.

A corporation may use cash accounting only if it meets one of the following conditions: average annual gross receipts of $5 million or less; qualified personal service corporation; farming corporation; or timber corporation.

Cash accounting has been permitted since 1933. Prior to the 1986 federal changes which were adopted by Minnesota in 1987, cash accounting could be used by any corporation that did not maintain an inventory.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.22 INSTALLMENT SALES

Internal Revenue Code, Sections 453 and 453A
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain or loss from the sale of property is recognized in the year of the sale. An exception to the above rule is the installment method which may be used to report gains if at least one payment is received in a tax year other than the year of sale. The installment method can be used only by taxpayers who do not regularly deal in the property being sold, and gross profit is prorated over the period in which payments are received. The tax expenditure is the difference between what tax liability would be under year-of-sale reporting and what it is under installment reporting.

The installment method was first enacted in 1933. In 1986 the installment method was eliminated for revolving credit sales of personal property and sales of property regularly traded on an established market, such as stocks or securities. In 1987 the installment method was repealed for dealer sales of both real and personal property. At the time of this report, Minnesota has not had the opportunity to adopt the 1999 federal changes restricting the use of installment sales.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,700,000	$1,800,000	$1,900,000	$2,000,000

2.23 COMPLETED CONTRACT RULES

Internal Revenue Code, Section 460
Minnesota Statutes, Section 290.01, Subd. 19

Some taxpayers with contracts extending for more than one year are allowed to report some or all of the profit on the contracts under special accounting rules. Income on a long-term contract is reported only when the contract is completed, and costs allocable to the contract are deducted at that time. However, many indirect costs may be deducted in the year paid or incurred. Without these special rules, indirect costs could be deducted only when the income is reported.

The completed contract method is allowed for home construction contracts and for other construction contracts if they are no longer than two years in duration and if the taxpayer's average annual gross receipts for the three preceding years do not exceed $10 million.

The completed contract method was first allowed federally in 1918 and by Minnesota in 1934. The rules for long-term contracts were codified in the federal Tax Reform Act of 1986, and restrictions were placed on its use. This provision was last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$700,000	$700,000	$700,000	$700,000

2.24 EMPLOYEE STOCK OWNERSHIP PLANS

Internal Revenue Code, Sections 133, 401(a), 404(a) and (k), 415(c), 1042, 4975(e)(7), and 4978
Minnesota Statutes, Section 290.01, Subd. 19

An employee stock ownership plan (ESOP) is a qualified stock bonus plan or a combination of a stock bonus and a money purchase pension plan under which a tax-exempt trust holds employer stock for the benefit of the employees. The stock may be acquired through direct employer contributions or with the proceeds of a loan to the trust. There are three components to the ESOP tax expenditure: exclusion of interest on ESOP loans; dividend deduction; and nonrecognition of gain on stock sales.

A corporation is allowed to deduct from its income dividends paid to an ESOP and dividends used to make payments on ESOP loans.

If a corporation sells qualified stock to an employee organization, the corporation does not recognize the gain on the sale. In order to qualify for the nonrecognition treatment, certain conditions must be met by the buyer and seller. The stock in the sale must be qualified stock, that is, stock which has no readily tradable securities outstanding. The buyer of the stock must be an employee organization which is defined as an ESOP or a worker-owned cooperative, and after selling the stock the corporation must reinvest in another domestic corporation. Also, after the sale is completed, the employee organization must own at least 30% of the company stock.

The federal provisions were enacted in 1984 and were amended by the 1986 Tax Reform Act. Minnesota adopted the dividend deduction and the nonrecognition of gain on stock sales in 1984. In 1987 Minnesota adopted the interest exclusion along with the 1986 federal changes. In 1996 the 50% interest exclusion for a financial institution loan to an ESOP was repealed. These provisions were last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,400,000	$4,700,000	$4,900,000	$5,000,000

2.25 CAPITAL CONSTRUCTION FUNDS OF SHIPPING COMPANIES

Internal Revenue Code, Section 7518
Minnesota Statutes, Section 290.01, Subd. 19

Tax incentives are provided to shipping companies which own or lease vessels operating in the foreign or domestic commerce of the United States or in United States fisheries.

If the taxpayer enters into an agreement with the appropriate federal agency, deposits in a capital construction fund may be deducted from taxable income up to the portion of taxable income attributable to the operation of the vessel covered by the agreement. Earnings on the fund, which also may include nondeductible deposits, are exempt from taxation.

Withdrawals from the fund are not taxable if they are used to acquire, construct, or reconstruct vessels covered by the agreement. Such a withdrawal is treated first as made out of the capital account, second as made out of the capital gain account, and third as made out of the ordinary income account. Provisions are made for the adjustment of basis.

In general, these provisions were contained in the 1936 Merchant Marine Act and have applied federally since that time. The provisions were modified somewhat and codified in the federal Tax Reform Act of 1986. Minnesota first adopted these provisions in 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

2.26 UNPAID PROPERTY LOSS RESERVES OF PROPERTY AND CASUALTY INSURANCE COMPANIES

Internal Revenue Code, Sections 832(b)(5) and 846
Minnesota Statutes, Section 290.01, Subd. 19

A property and casualty company can deduct additions to reserves for losses from its underwriting business, including not only losses incurred and paid but also losses incurred but not paid, anticipated losses not yet reported, and contested claims. Unpaid losses must be discounted to account partially for the time value of money.

The deduction for unpaid losses was enacted federally in 1954 and the discounting requirement was added in the federal Tax Reform Act of 1986. In 1989 Minnesota adopted this provision, beginning with tax year 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,200,000	$2,200,000	$2,200,000	$2,300,000

*Less Than $50,000

2.27 SPECIAL TREATMENT OF LIFE INSURANCE COMPANY RESERVES

Internal Revenue Code, Sections 803(a), 805(a)(2), and 807(a) and (b)
Minnesota Statutes, Section 290.01, Subd. 19

A life insurance company can deduct from its gross income the increase in its life insurance reserves and must add to its gross income any decrease in its reserves. The deduction for the increase in reserves is a tax expenditure because it is for future payment of claims, not claims already filed and paid.

This deduction was enacted in 1984. In 1989 Minnesota adopted this provision, beginning with tax year 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$900,000	$900,000	$1,000,000	$1,000,000

2.28 TREATMENT OF SMALL LIFE INSURANCE COMPANIES

Internal Revenue Code, Section 806
Minnesota Statutes, Section 290.01, Subd. 19

A special deduction is available only to life insurance companies with assets of less than $500 million at the end of the tax year. The deduction is equal to 60% of the first $3 million of life insurance company taxable income and is reduced by 15% of any taxable income over $3 million, so that the deduction is reduced to zero at taxable income of $15 million and above.

This deduction was enacted federally in 1984. In 1989 Minnesota adopted this provision, beginning with tax year 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

2.29 TREATMENT OF CLEAN-FUEL VEHICLES

Internal Revenue Code, Section 179A
Minnesota Statutes, Section 290.01, Subd. 19

A deduction is allowed for a portion of the cost of a clean-fuel vehicle or the cost of retrofitting a vehicle to use clean fuel. The deduction is allowed for the cost attributable to the engine, storage of fuel, and exhaust system. The deduction is limited to: $50,000 for trucks and vans over 26,000 pounds and buses seating at least twenty adults; $5,000 for trucks and vans between 10,000 and

26,000 pounds; and $2,000 for all other vehicles. The deduction is phased out from the years 2002 through 2005. An additional deduction of up to $100,000 per location is allowed for the cost of property, other than buildings, used to store or dispense clean fuel.

Clean fuels are natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, and any other fuel if at least 85% of it is methanol, ethanol, any other alcohol, ether, or any combination.

This provision was enacted in 1992.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$400,000	$400,000	$300,000

APPORTIONMENT

2.30 WEIGHTED APPORTIONMENT

Minnesota Statutes, Section 290.191

A multistate corporation must use a three-factor formula to apportion its net income to Minnesota. Net income is apportioned to Minnesota based on a weighted formula which is the sum of 15% of the Minnesota property ratio, 15% of the Minnesota payroll ratio, and 70% of the Minnesota sales ratio. For tax years beginning after December 31, 2000, the percentages in the formula are changed to 12.5% for property, 12.5% for payroll, and 75% for sales.

The fiscal impact of the tax expenditure is measured by comparing the weighted formula to the average of the Minnesota property, payroll, and sales ratios. Some corporations pay a lower tax under the weighted formula; others pay more. The estimates measure the net impact of the weighted formula compared to the average-ratio formula for all corporations. They show the extent to which the benefits of the weighted formula for some corporations exceed the benefits of the average-ratio formula for other corporations.

In 1939 manufacturing firms were allowed the option of choosing between the weighted-ratio formula and the average-ratio formula. The option was extended to nonmanufacturing firms in 1953. In 1987 the average-ratio option was repealed. The percentages in the weighted formula were changed in 1999, effective for tax years beginning after December 31, 2000.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$118,100,000	$116,600,000	$132,000,000	$137,300,000

2.31 THROWBACK SALES

Minnesota Statutes, Section 290.191, Subd. 5

The sales factor in the three-factor apportionment formula is determined by the destination of the sales. If a corporation with property and payroll in Minnesota makes sales from Minnesota to a customer in a state in which the selling corporation has no nexus and is therefore not taxable, the sales are not attributed anywhere. The Multistate Tax Compact and the tax laws of many states address this issue with a throwback rule. The throwback rule requires that a sale be thrown back to the state of the origin if the selling corporation is not taxable in the state of the purchaser. Sales to the federal government are also thrown back because of the difficulty in determining the destination of the sales.

Minnesota has no throwback rule. Therefore, the apportionment factor and taxable income are lower for some corporations than would occur under a throwback rule. For example, a corporation with 100% of its property and payroll in Minnesota and 10% of its sales in Minnesota has an apportionment factor of 37% under existing law but would have a factor of 100% under the throwback rule. The other 63% of income is not apportioned anywhere.

Prior to 1973 Minnesota used an origin-of-sale basis for corporate apportionment. In 1973, when Minnesota switched to a destination sale basis, throwback was not adopted. This provision was changed last in 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$23,000,000	$23,000,000	$26,900,000	$28,000,000

2.32 SINGLE-FACTOR APPORTIONMENT FOR MAIL ORDER COMPANIES

Minnesota Statutes, Section 290.191, Subd. 4

A corporation which consists exclusively of selling tangible personal property and services by mail, telephone, facsimile, or other electronic media and has at least 99% of its property and 99% of its payroll in Minnesota may apportion its income to Minnesota based only on the percentage of sales delivered in Minnesota. Without this provision, the business would use the weighted apportionment formula (Item 2.30). The property and payroll at a distribution center outside Minnesota are disregarded in meeting the 99% property and payroll requirements if the sole activity at the distribution center is filling orders and no solicitation of orders occurs there.

This provision was enacted in 1985 and was last changed in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,500,000	$4,400,000	$3,800,000	$3,900,000

MINNESOTA SUBTRACTIONS

2.33 DIVIDEND RECEIVED DEDUCTION

Minnesota Statutes, Section 290.21, Subd. 4

In computing Minnesota taxable income, a corporation adds back the federal dividend received deduction and determines a separate Minnesota dividend received deduction which is subtracted after income is apportioned.

The deduction is 80% of the dividends received from another corporation if the recipient owns 20% or more of the stock of the paying corporation, and it is 70% if the recipient owns less than 20%. Under certain circumstances, including reorganization, the deduction can be 100%. The dividends are deductible only to the extent they are included in Minnesota taxable net income which is after apportionment. Therefore, if income is apportioned, the dividends must also be apportioned.

The dividend received deduction is not allowed if: the corporate stock is included in the inventory of the taxpayer corporation; the corporation holds the stock primarily for sale to customers in the ordinary course of business; or the business of the corporation consists mainly of holding the stocks and collecting income and gains from them.

The dividend received deduction was enacted in 1947. Major changes were made to this provision in 1987 and 1988 when the percentages of the deduction were reduced and the conditions were modified. In 1989 the 100% deduction allowed under certain circumstances was adopted.

The tax is reduced on approximately 3,400 corporations due to this deduction.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$76,000,000	$75,000,000	$76,100,000	$79,200,000

2.34 CHARITABLE CONTRIBUTIONS

Minnesota Statutes, Section 290.21, Subd. 3

Minnesota does not allow the federal charitable contribution deduction. The federal deduction must be added back to federal taxable income, and a separate Minnesota deduction for charitable contributions is determined, which is subtracted after income is apportioned.

A deduction is allowed for charitable, public purpose, religious, scientific, literary, artistic, or educational contributions made to an organization located in and carrying on substantially all of its activity in Minnesota. A deduction is also allowed for a contribution to a foundation carrying out most of its activities outside Minnesota, but only a portion is deductible equal to the foundation's expenditure for Minnesota organizations to its total expenditures. A deduction for a contribution to the United States government is allowed only for real property located in Minnesota.

The contribution deduction is limited to 15% of the taxpayer's net income less the deduction allowed for dividends received; no carryovers are allowed.

This deduction was enacted in 1933 and was last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$10,300,000	$10,200,000	$10,300,000	$10,700,000

2.35 FOREIGN SOURCE INCOME

Minnesota Statutes, Sections 290.01, Subd. 6b, 19c(13), and 19d(11); 290.17, Subd. 4(f)-(i); and 290.191, Subd. 5(a)

Most foreign income is not taxed by Minnesota, which is the net effect of a number of provisions. For royalties, fees, and other like income received from a foreign operating corporation or a foreign corporation that is part of the same unitary group as the receiving corporation, 80% of such income is subtracted from federal taxable income.

In addition to the subtraction for income received from a foreign operating corporation, income earned by a foreign operating corporation is also subject to special provisions. A foreign operating corporation is defined as a domestic corporation that is: part of a unitary group having at least one member taxable in Minnesota; and either the average of its property and payroll percentages assigned inside the United States is 20% or less, or it has a valid election under Section 936 of the Internal Revenue Code.

The adjusted net income of a foreign operating corporation is deemed to be paid as a dividend to its shareholders, and the deemed dividend is eligible for the dividends received deduction. Dividends actually paid by a foreign operating corporation to a corporate shareholder which is a member of the same unitary group are eliminated from the net income of the unitary business. A foreign operating corporation is not required to file a Minnesota return, and its apportionment factors are not included in the apportionment factors of the unitary business.

All foreign source royalties were deductible for tax years 1985 and 1986. In 1987 the deduction was reduced from 100% to 35%. The current provisions were enacted in 1988.

Approximately 2,100 corporations benefit from these provisions.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$51,700,000	$51,100,000	$51,800,000	$53,900,000

2.36 DISPOSITION OF FARM PROPERTY

Minnesota Statutes, Section 290.491

A taxpayer may subtract from federal taxable income the income realized on a sale or exchange of farm property if the taxpayer is insolvent at the time of the sale, and the proceeds are used solely to discharge indebtedness of the property sold. The amount of the subtraction is limited to the excess of the taxpayer's debts over total assets and the amount of any debt forgiveness excluded from income under Section 108 of the Internal Revenue Code.

This provision was enacted in 1985. It was repealed in 1987 but was re-enacted in 1988, retroactive to tax year 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

CREDITS

2.37 RESEARCH AND DEVELOPMENT CREDIT

Minnesota Statutes, Section 290.068

A corporate taxpayer may claim a nonrefundable credit against the franchise tax based on the increase in qualified expenditures for research and development performed solely within Minnesota. Expenditures include wages, costs of supplies, computer costs, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota.

The credit is equal to 5% of the first $2 million of current-year research expenditures over the base amount and 2.5% of the excess over $2 million. The base amount is determined by multiplying the corporation's percentage of gross receipts spent on research for tax years 1984 through 1988 (but not over 16%) by the average gross receipts of the company for the previous four years. Start-up companies with fewer than three years in the 1984-1988 period use 3% in the computation. Only Minnesota gross receipts and Minnesota research expenditures are used. Any excess credit can be carried forward up to fifteen years.

The research and development credit was enacted in 1981, and in 1987 the percentages were reduced from 12.5% and 6.25% to 5% and 2.5%, respectively. The computation of the base amount was changed, beginning with tax year 1990. Unlike the federal credit, the Minnesota credit does not have an expiration date.

The credit was claimed on approximately 240 returns in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$16,700,000	$16,500,000	$16,700,000	$17,400,000

*Less Than $50,000

2.38 CREDIT FOR TAX PAID TO OTHER STATES

Minnesota Statutes, Section 290.06, Subd. 27

A nonrefundable credit is allowed against the corporate franchise tax for tax paid to another state if the taxpayer is required to assign the entire amount of an item of income to the other state. The difference between the tax paid to the other state and the tax that would have been paid if the item had not been included in the net income of that state is determined. The credit is equal to the difference in tax multiplied by the taxpayer's apportionment percentage on the Minnesota return. The credit cannot exceed the reduction in Minnesota tax that would occur if the item were not taxed by Minnesota.

This credit was enacted in 1999, effective beginning with tax year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$0	$0	$0	$1,800,000

2.39 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(2) and 6(1)

Two refundable credits against the franchise tax are available to employers in designated enterprise zones: up to $3,000 annually for each additional worker employed in a designated enterprise zone, other than workers employed in construction; and up to $1,500 annually for each worker employed in the zone who does not qualify for the $3,000 credit.

These credits were enacted in 1983 and scheduled to expire on December 31, 1996. However, a 1996 law change allowed border city enterprise zones to remain in existence until terminated by resolution adopted by the city. Other zones expired at the end of 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$400,000	$400,000	*

2.40 AIRCRAFT MAINTENANCE AND ENGINE REPAIR FACILITIES JOB CREDIT

Minnesota Statutes, Section 290.06, Subd. 24

A credit against the corporate franchise tax is available to a corporation that leases and operates a heavy maintenance base for aircraft and/or an engine repair facility. The credit is equal to $5,000 multiplied by the number of full-time employees at each facility.

The credit is available for the first five taxable years that the facility is in operation. For the first year that the facility is in operation, the credit cannot exceed 80% of the wages paid during that tax

*Less Than $50,000

year. For each of the succeeding four years, that percentage is 20%. If the credit exceeds the amount of tax, the unused portion can be carried forward up to ten years.

To qualify, the heavy maintenance facility must be owned by the State of Minnesota or one if its political subdivisions and leased to the corporation. The aircraft engine repair facility must meet the specifications described in Minnesota Statutes, Section 116R.02, Subd. 6. The specifications include that the facility is located in the city of Hibbing and that the construction of the facility is financed with specified bonding authority.

This credit was enacted in 1991 as part of a financing package for construction of a heavy maintenance facility in Duluth and a jet engine repair facility in Hibbing.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,100,000	$2,100,000	$2,100,000	$0

2.41 JOB TRAINING PROGRAM CREDIT

Minnesota Statutes, Section 290.0673

A refundable credit is allowed against the corporate franchise tax equal to placement fees and retention fees paid to a qualifying job training program upon hiring a qualified graduate of the program and for retaining such a person.

The job training program must satisfy specified requirements. The total amount of credit certificates is limited to $1.2 million for calendar years 1997 through 2001, with an amount specified for each year. The fees qualifying for the credit are also limited to a maximum amount for each graduate of $8,000 for placement fees and $6,000 for retention fees.

This credit was enacted in 1997, effective for tax years 1997 through 2001. In 1998 the credit was changed from a nonrefundable to a refundable credit.

Fewer than twenty corporations are expected to take the credit each year.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$100,000

2.42 CREDIT FOR GROSS PREMIUMS TAX (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35, Subd. 3

Insurance companies doing business in Minnesota may take a nonrefundable credit against the corporate franchise tax for the amount of Minnesota gross premiums tax paid during the tax year.

Insurance companies domiciled in states, other than Minnesota, that have retaliatory taxes are exempt from the tax, as are smaller mutual property and casualty companies. These companies are not required to file in Minnesota and are not represented in the estimates.

This credit was enacted in 1937 and was last changed in 1991.

About 110 companies receive a tax benefit from this credit.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$13,800,000	$13,000,000	$13,000,000	$13,400,000

2.43 CREDIT FOR GUARANTY ASSOCIATION ASSESSMENTS (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35, Subd. 6

An insurance company is allowed a credit against the corporate franchise tax based on guaranty association assessments paid in a prior year(s).

When an insurance company becomes insolvent, any amounts that remain unpaid to its policyholders are paid through assessments that are imposed on solvent companies by a guaranty association. One guaranty association is authorized by Minnesota law to make assessments for property and casualty companies and another for life and health companies.

When an insurance company pays an assessment to either of these associations, the credit is allowed equal to 20% of the assessment for each of the five calendar years following the year in which the assessment was paid. In other words, the credit allows the company to recover the amount of any assessment in equal parts over the next five years.

A similar credit is allowed against the premiums tax (Item 12.06). If the credit exceeds the greater of the company's corporate franchise tax or premiums tax for that year, the excess may be carried forward.

Beginning in 1999, the total credits allowed to all companies are restricted if the total guaranty assessments levied over the preceding five years exceed the sum of revenues from the insurance premiums tax and the corporate franchise tax on insurance companies in the preceding year.

This credit was enacted in 1994. It applies to assessments for insolvencies of property and casualty companies which occur after July 31, 1994, and to assessments made after July 31, 1994, for life and health companies.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$500,000	$400,000	$300,000	$300,000

CHAPTER 3: ESTATE TAX

Collections and History

Revenues from the Minnesota estate tax were $58 million in fiscal year 1999. All revenues from this tax go into the state general fund.

In 1905 a tax on the estates of decedents was first enacted in Minnesota in the form of an inheritance tax. Minnesota had an inheritance tax until 1979 when it was repealed and an estate tax was adopted. The inheritance tax was imposed on each individual who received property from an estate, and the amount of tax depended upon the amount of property received and the relationship of the recipient to the decedent. The estate tax is imposed on the taxable estate before it is distributed.

Minnesota had a gift tax from 1937 until it was repealed in 1979. Minnesota does not have a generation-skipping transfer tax.

In 1985 the computation of the Minnesota estate tax was changed to equal the Minnesota portion of the federal tax credit for state death taxes, known as the "pick-up tax". If a federal law change affects the computation of the federal credit on which the state tax is based, a state law change is required to adopt the federal change for state tax purposes.

Tax Base

The tax base for the estate tax is defined for this study as the net estate transferred. In other words, it is gross estate less administrative costs and other necessary and reasonable expenses paid before the estate is distributed. Therefore, a tax expenditure is created in the estate tax when a certain component of the estate is exempted or excluded because of its source or when a distribution is deducted from taxable estate because of the identity of the recipient. Preferential valuations are also considered to be tax expenditures.

Computation of the Tax

An estate tax return must be filed if the decedent's federal gross estate exceeds $650,000 in 1999 and $675,000 in 2000 and 2001. The Minnesota estate tax is equal to the Minnesota portion of the maximum federal credit for state death taxes, which is computed as follows:

	Gross estate
minus:	federal exclusions
equals:	federal gross estate
minus:	federal exemptions and deductions
equals:	federal taxable estate
minus:	$60,000
equals:	federal adjusted taxable estate
times:	graduated rates (0.8% to 16%)
equals:	maximum credit for state death taxes
times:	proportion of Minnesota gross estate to federal gross estate
equals:	Minnesota estate tax

PREFERENTIAL VALUATION

3.01 SPECIAL USE VALUATION

Internal Revenue Code, Section 2032A
Minnesota Statutes, Section 291.03

Property is generally included in an estate at its fair market value on the date of death. Fair market value is a property's value based on its best possible use. However, certain property which is used in a farm or other closely-held business may be valued at its farm or business use value, even though it is less than the market value. Specified conditions must be met in order to qualify for this treatment, and the total decrease in the value of the property for which the special use valuation applies cannot be more than $760,000. The estimates measure the difference between tax liability using the fair market value and tax liability using the special use valuation.

The special use valuation option was included in Minnesota's estate tax when it was enacted in 1979. In 1985 Minnesota adopted this provision through the federal pick-up tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$300,000	$300,000	$300,000

EXCLUSIONS

3.02 LIFE INSURANCE PROCEEDS

Internal Revenue Code, Section 2042
Minnesota Statutes, Section 291.03

In general, life insurance proceeds payable to an estate or to any beneficiaries are included in gross estate. However, the proceeds payable to a beneficiary may be excluded from gross estate if the decedent had forfeited the right to any benefit from or control over the policy. To qualify for the exclusion, the decedent must have possessed none of the incidents of ownership in the policy at the time of death. The incidents of ownership include the power to change the beneficiary, the power to cancel or surrender the policy, the power to obtain a loan against the policy or to use the policy as collateral, and the right to any of the policy's economic benefits.

The estimates do not include death benefits paid to a spouse because such benefits would also be exempt under the marital deduction (Item 3.05).

This provision was originally enacted in 1951 under the inheritance tax and it was carried over to the estate tax in 1979. Minnesota adopted the federal provision in 1985.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$5,600,000	$6,200,000	$6,900,000	$7,700,000

3.03 ANNUITIES

Internal Revenue Code, Section 2039
Minnesota Statutes, Section 291.03

For the estates of decedents dying after December 31, 1984, most annuities are included in gross estate. An exclusion is allowed only if one of these conditions is met: 1) on December 31, 1984, the decedent was both a participant in the plan and in pay status, and the decedent irrevocably elected the form of the benefit before July 18, 1984; or 2) the decedent separated from service before January 1, 1985, and did not change the form of benefit before death. Because these conditions are rarely met, most annuities cannot be excluded.

An exclusion for pensions and annuities was enacted in 1959 as part of the inheritance tax and was carried over to the estate tax in 1979. Federal changes enacted in 1984 eliminated the excludability for most pensions and annuities, and Minnesota fully adopted the changes in 1985 through the federal pick-up tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

3.04 SOCIAL SECURITY BENEFITS

Revenue Rulings 57-87 and 67-277
Minnesota Statutes, Section 291.03

Social security lump sum death benefits which are paid to surviving spouses and dependents are exempt from the Minnesota estate tax. The amount of the lump sum benefit is fixed at $255.

This exemption was enacted in 1963 under the inheritance tax laws and was carried over to the estate tax without change when the inheritance tax was repealed in 1979. In 1985 Minnesota adopted this provision through the federal pick-up tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

DEDUCTIONS

3.05 MARITAL DEDUCTION

Internal Revenue Code, Section 2056
Minnesota Statutes, Section 291.03

The net value of all property passing from a decedent to a surviving spouse may be deducted from gross estate. The net value of the property is the gross value reduced by the amount of exemptions and deductions associated with the property being passed to the spouse.

A marital deduction was enacted in 1911 as a $10,000 inheritance tax deduction. In 1979, when the inheritance tax was repealed, the marital deduction was continued for estate tax purposes, with a maximum deduction of $250,000 or one-half the adjusted gross estate, whichever was greater. An unlimited marital deduction was enacted in 1981. In 1985 Minnesota adopted the federal provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$46,500,000	$49,400,000	$52,500,000	$55,700,000

3.06 CHARITABLE GIFTS

Internal Revenue Code, Section 2055
Minnesota Statutes, Section 291.03

Charitable gifts to certain organizations may be deducted from gross estate. Qualifying recipients include charitable, scientific, literary, educational, and religious organizations and federal, state, and local governments.

An inheritance tax exemption for charitable gifts was enacted in 1911. In 1985 Minnesota adopted the federal deduction for charitable gifts.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$17,100,000	$18,100,000	$19,100,000	$20,200,000

CHAPTER 4: GENERAL SALES AND USE TAX

Collections and History

Revenues from the general sales and use tax totaled $3.4 billion in fiscal year 1999 (before reduction for the $1.3 billion rebate), making it the second largest source of state revenue with 28% of the total. All revenues from the general sales and use tax go into the general fund.

The Minnesota general sales and use tax was enacted in a special session of the 1967 Legislature and became effective on August 1, 1967, at a rate of 3%. The rate was increased to 4% on November 1, 1971, 5% on July 1, 1981, and 6% on January 1, 1983. The rate has been 6.5% since July 1, 1991.

Originally, the general sales and use tax applied to motor vehicles, but in 1971 motor vehicles were exempted from the sales tax and made subject to the newly-enacted motor vehicle excise tax, now called the motor vehicle sales tax. Although the purchase of a motor vehicle is subject to the motor vehicle sales tax, the lease of a motor vehicle comes under the general sales tax.

The tax base for the sales tax has been changed in nearly every legislative session, with exemptions added and others repealed. Exemptions were enacted for residential heating fuel in 1978, residential water in 1979, capital equipment in new or expanding industries in 1989, replacement capital equipment in 1997, and farm machinery in 1998.

The exemption for state government purchases was repealed in 1987. The general exemption for local government purchases was repealed in 1992, although purchases by school districts and specified other purchases remain exempt. Since 1992 the exemption has been expanded to include other types of local government purchases. Other exemptions that were repealed include cigarettes in 1981, candy and soft drinks in 1982, and most nonprescribed drugs and medicines in 1987.

Tax Base

For purposes of this study, the tax base for the general sales and use tax is defined as the gross receipts from the sale of tangible personal property or services to the final consumer. This definition is a working definition for this study and should not be interpreted as a presumption of what the ideal tax base should be. Although services could be considered outside the tax base, selected services are included in this study for information purposes.

Items purchased for resale in the regular course of business are not included in the tax base because they are not a sale to the final consumer. In agricultural and industrial production, the sales of raw materials, component parts, and products consumed directly in the process are considered to be for resale, and therefore the exemption of these items is not a tax expenditure. However, the sale of machinery, equipment, and tools used in agricultural or industrial production is not considered a sale for resale.

The exemption of motor vehicles from the sales tax is not considered a tax expenditure because motor vehicles are subject to an alternative tax, the motor vehicle sales tax (Chapter 5).

Computation of the Tax

The sales tax is imposed on the gross receipts from taxable sales made by any person in Minnesota. The complementary use tax is imposed on the storage, use, distribution, or consumption in Minnesota of taxable personal property unless the Minnesota sales tax was paid on the sales price. The rate for both the sales tax and the use tax is 6.5%. An additional 2.5% tax is imposed on alcoholic beverages, both on-sale and off-sale, and an additional 6.2% tax is imposed on the rental of a car, van, or pickup truck for less than 29 days.

Generally, a retail sale is subject to the tax unless it is specifically exempted by law. Taxable sales also include: selling, leasing, or renting tangible personal property; the sale of meals or drinks; the furnishing of lodging for less than thirty days; the admission to places of amusement or athletic events; the furnishing of electricity, gas, water, or steam; and telephone service.

The tax is imposed on the sales price of the item, which is defined as the total consideration valued in money, whether paid in money or otherwise. Exclusions from the sales price include property taken in trade for resale, cash discounts, and separately-stated interest, finance, or carrying charges.

The sales tax is paid by the purchaser to the seller; the seller collects and remits the tax to the state. The use tax is paid directly by the purchaser to the state.

EXEMPTIONS - PARTICULAR GOODS AND SERVICES

4.01 FOOD PRODUCTS

Minnesota Statutes, Sections 297A.01, Subd. 3(c) and 297A.25, Subd. 2

Generally, food purchased for human consumption is exempt from the sales tax. The exemption includes, for example, meats, dairy products, vegetables, fruits, cereals, bread and other baked goods, coffee, tea, spices, and sugar.

Food and drinks served by a restaurant are taxable, as are all food and drinks sold in vending machines. Food or drinks prepared by the retailer for immediate consumption either on or off the retailer's premises are also taxable, such as sandwiches sold by a delicatessen.

Taxable items also include candy, chewing gum, soft drinks and other carbonated beverages, ice, and ice cream, ice milk, or frozen yogurt products sold in individual servings.

The exemption for food products was included when the sales and use tax was enacted in 1967. Candy and soft drinks were included in the exemption until 1982. The provision was last changed in 1997 when the tax was extended to more types of prepared food.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$397,000,000	$408,500,000	$421,000,000	$434,900,000

4.02 CLOTHING AND WEARING APPAREL

Minnesota Statutes, Section 297A.25, Subd. 8
Minnesota Rules, Part 8130.5400

Generally, all clothing, whether new or used, is exempt from the sales and use tax. The exemption includes inner and outer wear, footwear, headgear, gloves and mittens, neckwear, belts, hosiery, and similar items customarily worn for general use. Also exempted are fabrics, thread, buttons, zippers, and similar items which are to be directly incorporated into wearing apparel.

This exemption does not apply to jewelry, articles made of fur or pelt, handbags, billfolds, sports clothing sold for exclusive use in a sporting activity, or work-related safety articles.

The exemption for clothing was included in the sales and use tax statutes enacted in 1967.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$382,800,000	$401,100,000	$420,900,000	$443,600,000

4.03 DRUGS AND MEDICINES

Minnesota Statutes, Section 297A.25, Subd. 3

An exemption from the sales and use tax applies to prescribed drugs and medicine, insulin, and nonprescription analgesics. Drugs and medicine, other than analgesics, sold over the counter are subject to the sales and use tax.

An exemption for all drugs and medicine, whether prescription or nonprescription, was part of the original sales and use tax law enacted in 1967. In 1987 the exemption was limited to prescribed drugs and medicine and to insulin. In 1988 certain nonprescription analgesics were again exempted, and in 1997 the exemption was extended to all analgesics, effective July 1, 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$95,200,000	$104,200,000	$114,000,000	$124,900,000

4.04 THERAPEUTIC AND PROSTHETIC DEVICES

Minnesota Statutes, Section 297A.25, Subd. 3

The sales of therapeutic and prosthetic devices are exempt from the Minnesota sales and use tax.

A therapeutic device must be useful not only in the preservation of health, but it must also serve to cure or heal. It must serve to alleviate human injury, illness, or disease, either directly or by administering a curative agent. Examples of exempt items are syringes, oxygen tents, vaporizers, hospital beds, wheelchairs, and equipment and supplies for dialysis treatment.

A prosthetic device must be used to replace an injured, diseased, or missing part of the human body, either temporarily or permanently.

This provision was enacted in 1967 and was last changed in 1993.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$6,400,000	$6,800,000	$7,200,000	$7,700,000

4.05 PRESCRIPTION EYEGLASSES

Minnesota Statutes, Section 297A.25, Subd. 3

Sales of prescription eyeglasses and contact lenses are exempt from the sales and use tax.

This provision was enacted in 1967 and has not been changed.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$8,900,000	$9,300,000	$9,800,000	$10,400,000

4.06 BABY CARE PRODUCTS

Minnesota Statutes, Section 297A.25, Subd. 8(3)

Lotion, oil, powder, and similar products used for babies are exempt from the sales and use tax.

This exemption was enacted as part of the original sales tax law in 1967.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$400,000	$400,000	$400,000

4.07 FEMININE HYGIENE ITEMS

Minnesota Statutes, Section 297A.25, Subd. 26

Consumer purchases of feminine hygiene items, including sanitary napkins, tampons, and similar products, are exempt from the sales and use tax.

This exemption was enacted in 1981.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,500,000	$2,600,000	$2,700,000	$2,900,000

4.08 CASKETS AND BURIAL VAULTS

Minnesota Statutes, Section 297A.25, Subd. 17

Caskets and burial vaults are exempt from the sales and use tax.

This provision was enacted in 1967.

Approximately 37,000 deaths occurred in Minnesota in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$5,100,000	$5,100,000	$5,100,000	$5,100,000

4.09 PUBLICATIONS

Minnesota Statutes, Section 297A.25, Subd. 10

Publications regularly issued at least once every three months are exempt from the sales and use tax. Included in this exemption are newspapers, magazines, and journals, and also items such as seasonal catalogs, shoppers' guides, advertising circulars, and loose leaf or similar type of service publications. Magazines and periodicals sold over the counter are taxable.

This provision was enacted in 1967. In 1983 magazines sold over the counter became taxable.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$43,000,000	$44,300,000	$45,600,000	$47,000,000

4.10 TEXTBOOKS REQUIRED FOR SCHOOL USE

Minnesota Statutes, Section 297A.25, Subd. 21

Sales of textbooks to students are exempt from the sales and use tax if the books are required for a course of study at a public or private school, college, university, business, or trade school.

This provision was enacted in 1973.

There were about 290,000 post-secondary students in Minnesota in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$6,600,000	$6,900,000	$7,100,000	$7,400,000

4.11 PERSONAL COMPUTERS REQUIRED FOR SCHOOL USE

Minnesota Statutes, Section 297A.25, Subd. 58

Personal computers and related software which are sold to students by educational institutions are exempt if each student is required to purchase or possess such a personal computer and related software as a condition of enrollment.

The exemption applies only to sales by the school to its students, including a public or private school, college, university, business, or trade school.

This exemption was enacted in 1994.

Approximately 2,100 students attend schools at which they are required to rent personal computers from the schools.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

4.12 MOTOR FUELS

Minnesota Statutes, Section 297A.25, Subd. 7(1)

Petroleum products taxed under the motor fuels tax (Minnesota Statutes, Chapter 296A) are exempt from the sales and use tax. The exemption applies to gasoline and special fuel for highway, aviation, marine, snowmobile, or all-terrain vehicle use.

This exemption was enacted in 1967 and was last changed in 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$234,400,000	$248,600,000	$258,900,000	$272,800,000

4.13 RESIDENTIAL HEATING FUELS

Minnesota Statutes, Section 297A.25, Subd. 23

An exemption from the sales and use tax applies to all fuel oil, coal, wood, steam, hot water, propane gas, and liquefied petroleum gas sold to residential customers for residential use. Also, purchases of natural gas by residential customers who use natural gas for their primary source of residential heat are exempt for the six billing months of November through April. Likewise, the purchase of electricity is exempt for six months for customers using electricity as the primary source of residential heat.

This provision was enacted in 1978 and was expanded in 1984 to include hot water.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$84,600,000	$91,800,000	$98,600,000	$104,500,000

4.14 RESIDENTIAL WATER SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3(f)

The furnishing of water for residential use is exempt from the Minnesota sales and use tax.

This provision was enacted in 1979.

It is estimated that approximately 84% of the housing units in Minnesota use the public water supply.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$18,500,000	$18,900,000	$19,500,000	$20,100,000

4.15 SEWER SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3(f)

The furnishing of sewer services is exempt from the Minnesota sales and use tax.

Sewer service has never been subject to the sales and use tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$21,700,000	$22,200,000	$22,800,000	$23,500,000

4.16 USED MANUFACTURED HOMES

Minnesota Statutes, Section 297A.25, Subd. 27

The sale of a manufactured home to be used as a residence is exempt from the sales and use tax unless it is the first retail sale of the home in Minnesota.

Generally, the sale of a manufactured home for residential use in Minnesota is taxed at 65% of the dealer's cost (Item 4.81). The estimates measure the difference between the exemption and taxation at 65% of the dealer's cost.

This provision was enacted in 1984.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$500,000	$500,000	$600,000	$600,000

4.17 SELECTED SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3 and 4

The inclusion of services in the concept of the tax base for the sales tax is subject to debate. Although the primary focus of the sales tax has been tangible personal property, a number of services are taxable, and the trend has been to extend the sales tax to additional services. Estimates of the exemption of the services listed below are provided for purposes of information and illustration.

When the sales tax was enacted in 1967, some services were taxable, including local telephone service, gas and electric service, and preparing and serving meals. In 1987 the tax was extended to a number of services including: long distance telephone service; parking; laundry and dry cleaning; building and residential cleaning, maintenance and exterminating; detective and security services; pet grooming; and lawn and garden services. The tax was extended to pet boarding and private communication services in 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$905,800,000	$953,000,000	$1,006,300,000	$1,062,300,000

	Fiscal Year Impact			
	2000 (000's)	2001 (000's)	2002 (000's)	2003 (000's)
Personal Services:				
Beauty Shops	$23,500	$24,400	$25,200	$25,900
Barber Shops	2,800	2,900	3,000	3,100
Shoe Repair	1,200	1,300	1,300	1,400
Funeral Services	7,000	7,400	7,900	8,400
Tax Preparation	2,700	2,800	2,900	3,000
Miscellaneous Personal Services	4,100	4,200	4,400	4,600
Personal Services Total	$41,300	$43,000	$44,700	$46,400
Business Services:				
Advertising Agencies	$49,600	$53,100	$57,200	$61,500
Direct Mail Advertising	13,900	14,900	16,100	17,300
Consumer Credit Reporting, Mercantile Reporting, Adjustment, and Collection Agencies	19,000	20,300	21,900	23,500
Secretarial Services	2,400	2,500	2,700	2,900
Computer and Data Processing Services	156,800	168,000	180,700	194,500
Other Business Services	75,800	81,200	87,400	94,100
Business Services Total	$317,500	$340,000	$366,000	$393,800
Legal Services Total	$142,700	$147,900	$153,900	160,300
Engineering, Architectural, and Surveying Services Total	$76,300	$79,100	$82,300	$85,700
Accounting Services Total	$57,000	$59,100	$61,500	$64,000
Research, Development and Testing Services Total	$22,100	$22,900	$23,900	$24,900
Management and Public Relations Services Total	$95,400	$98,800	$102,900	$107,100
Scientific Consulting Services Total	$7,200	$7,500	$7,800	$8,100
Automotive Repair and Maintenance Services Total	$99,900	$106,600	$113,600	$120,800
Miscellaneous Repair Services Total	$46,400	$48,100	$49,700	$51,200

4.18 YMCA, YWCA, AND JCC MEMBERSHIP DUES

Minnesota Statutes, Section 297A.25, Subd. 37

Generally, the sales tax applies to the granting of membership in a club or association that provides sports and athletic facilities to its members, including one-time initiation fees and periodic membership dues. However, such initiation fees and periodic membership dues to the YMCA, YWCA, and to the Jewish Community Centers of Greater Minneapolis and of Greater St. Paul are exempt. The exemption does not apply to separate charges made for using the sports and athletic facilities.

The exemption for the YMCA and YWCA was enacted in 1987 when the sales tax was first imposed on memberships to clubs providing sports and athletic facilities. The provision was clarified and recodified in 1988. The exemption was extended to the Jewish Community Centers in 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,500,000	$1,500,000	$1,600,000	$1,600,000

4.19 CROSS COUNTRY SKI PASSES FOR PUBLIC TRAILS

Minnesota Statutes, Section 297A.25, Subd. 39

Cross country ski passes issued by the Minnesota Department of Natural Resources for use of public trails are exempt from the sales and use tax.

This exemption was enacted in 1988.

Approximately 44,500 cross country ski passes were purchased in fiscal year 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

4.20 PERSONAL PROPERTY BROUGHT INTO MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 32

When individuals or businesses move into Minnesota, all articles of tangible personal property they bring with them are exempt from the Minnesota use tax. Unless the Minnesota sales tax had previously been levied on them, these items would be subject to the use tax when brought into the state. The estimates are net of the reduction for the amount of sales tax paid to other states (Item 4.82).

This provision was enacted in 1967.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$7,200,000	$7,300,000	$7,400,000	$7,600,000

4.21 DE MINIMIS USE TAX EXEMPTION FOR INDIVIDUALS

Minnesota Statutes, Section 297A.14, Subd. 4

Purchases that would otherwise be subject to the use tax are exempt if they are made by an individual for personal use, and total purchases subject to use tax do not exceed $770 in the calendar year. If such purchases exceed $770, the entire amount is subject to use tax.

A lower tax rate applies if sales or use tax had previously been paid on the purchases to another state (Item 4.82).

This exemption was enacted in 1996.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

4.22 CAPITAL EQUIPMENT

Minnesota Statutes, Sections 297A.01, Subd. 16 and 297A.25, Subd. 42

Certain capital equipment and machinery purchases are exempt from the sales and use tax. To qualify, the capital equipment, and the materials necessary to construct and install it, must be used in Minnesota by the purchaser or lessee for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail. Capital equipment includes all machinery and equipment that is essential to the integrated production process, including machinery and equipment used to operate or control the production equipment.

Beginning July 1, 1998, equipment purchased as replacements and replacement or repair parts are also exempt. Prior to that time, replacement equipment was taxed at a reduced rate.

The exemption does not apply to motor vehicles subject to the motor vehicle sales tax, machinery or equipment used to receive or store raw materials, pollution control equipment, and other equipment used for nonproduction purposes. The exemption is not available at the time of purchase; a claim for refund must be filed.

The exemption for non-replacement capital equipment was enacted in 1989 and replaced the reduced rate of 4% that had applied to capital equipment used in new or expanding industries since 1984. The exemption was extended to include mining in 1990 and on-line data retrieval equipment in 1993. The phased-in reduction in the tax rate for replacement equipment was enacted in 1994. In 1997 the reduced rates were changed to a complete exemption, effective July 1, 1998.

Refunds were paid to about 2,300 companies under these provisions in fiscal year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$149,000,000	$150,700,000	$158,100,000	$165,000,000

4.23 ACCESSORY TOOLS

Minnesota Statutes, Section 297A.25, Subd. 9

This provision exempts from the sales and use tax accessory tools, equipment, and other short-lived items which meet three criteria: are separate units detachable from machinery; are used to produce a direct effect on a product; and have an ordinary useful life of less than twelve months. Items exempt under this provision include drill bits, grinding and abrasive wheels, saw blades, printing plates, dies, jigs, taps, patterns, and molds.

This exemption was enacted in 1973.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$6,900,000	$6,900,000	$7,000,000	$7,100,000

4.24 SPECIAL TOOLING

Minnesota Statutes, Sections 297A.01, Subd. 17 and 297A.25, Subd. 53

Special tooling is exempt from the sales and use tax. Special tooling is defined as tools, dies, jigs, patterns, gauges and other special tools which have value and use only for the buyer and for the use for which it is made. To qualify, items must be special ordered and produced in accordance with buyer specifications. Items purchased from inventory or ordered from a catalog or other sales literature do not qualify. The estimates exclude items that also qualify for the accessory tools exemption in Item 4.23.

A reduced rate for special tooling was enacted in 1984. In 1994 the reduced rate was replaced with the exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,500,000	$4,600,000	$4,700,000	$4,800,000

4.25 RESOURCE RECOVERY EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 28

Equipment used to process solid or hazardous waste at a resource recovery facility is exempt from the sales and use tax. The exemption includes pollution control equipment at a facility that burns refuse-derived fuel or mixed municipal solid waste as its primary fuel.

This provision was enacted in 1984 and extended to include pollution control equipment in 1996.

It is expected that equipment will be purchased under this exemption for thirteen facilities in fiscal years 2000 through 2003.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$300,000	$200,000	$200,000

4.26 USED MOTOR OIL

Minnesota Statutes, Section 297A.25, Subd. 38

The sale of used motor oil is exempt from the sales and use tax.

This exemption was enacted in 1988.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$300,000	$300,000

4.27 TACONITE PRODUCTION MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 15

The sale of mill liners, grinding rods, and grinding balls to taconite mining companies is exempt from the sales and use tax. To qualify, the items must be substantially consumed in the production of taconite, and the material of the items must be added to and become a part of the product being processed.

The estimates do not include items that would qualify under the exemption for accessory tools (Item 4.23) or as sales for resale in that they become part of the final product.

This exemption was enacted in 1971.

Seven taconite companies are located in Minnesota.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.28 WIND ENERGY CONVERSION SYSTEMS

Minnesota Statutes, Sections 297A.25, Subd. 72

Wind energy conversion systems and the materials used to manufacture, install, construct, repair, or replace them are exempt from the sales and use tax if the systems are used as an electric power source. Wind energy conversion systems include any device which converts wind energy to a form of usable energy, such as a wind charger, windmill, or wind turbine. The estimates do not include purchases that would qualify as capital equipment (Item 4.22).

*Less Than $50,000

This exemption was first enacted in 1992, and expired June 30, 1996. In 1997 it was re-enacted for one year. The exemption was made permanent in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$500,000	$400,000	$300,000	$400,000

4.29 AIR COOLING EQUIPMENT

Minnesota Statutes, Sections 297A.25, Subd. 49

Air cooling equipment is exempt if it is purchased for conversion or replacement of an existing groundwater-based once-through cooling system as required under Minnesota Statutes, Section 103G.271, Subd. 5. These systems using in excess of five million gallons annually must be terminated and converted or replaced by the end of their design life but not later than the year 2010.

This exemption was enacted in 1992.

Eight systems are scheduled for conversion or replacement in fiscal years 2000 through 2003.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$300,000	$400,000	*

4.30 AIRFLIGHT EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 14
Minnesota Rules, Part 8130.6000

The gross receipts from the sale of airflight equipment to airline companies are exempt from the sales and use tax. Airflight equipment includes airplanes, communications and navigational equipment, flight simulators, and parts necessary for the repair and maintenance of airflight equipment. The exemption does not apply to airplanes with a gross weight of less than 30,000 pounds that are used on intermittent or irregularly timed flights.

This exemption was enacted in 1967 and was last changed in 1996.

The primary beneficiaries are the eighteen major carriers that fly into Minnesota. There are twenty-six cargo companies and ten charter companies that also benefit from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$10,300,000	$10,300,000	$9,500,000	$9,000,000

*Less Than $50,000

4.31 LARGE SHIPS

Minnesota Statutes, Section 297A.25, Subd. 45

Vessels with a gross registered tonnage of at least 3,000 tons are exempt from the sales and use tax.

This exemption was enacted in 1992.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

4.32 REPAIR AND REPLACEMENT PARTS FOR SHIPS AND VESSELS

Minnesota Statutes, Section 297A.25, Subd. 45

An exemption from the sales and use tax is allowed for lubricants and repair, replacement, and rebuilding parts and materials for ships or vessels used principally in interstate or foreign commerce.

This exemption was enacted in 1990, and was last changed in 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

4.33 PETROLEUM PRODUCTS USED BY TRANSIT SYSTEMS

Minnesota Statutes, Section 297A.25, Subd. 7(3)

An exemption from the sales and use tax is allowed for purchases of petroleum products by a transit system receiving financial assistance through the Metropolitan Council (seven-county metropolitan area) or the Public Transit Subsidy Program (outside the metropolitan area).

This provision was enacted in 1992.

This exemption applies to about eighty transit systems.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$600,000	$600,000	$600,000

4.34 PETROLEUM PRODUCTS USED IN PASSENGER SNOWMOBILES

Minnesota Statute, Section 297A.25, Subd. 7(4)

An exemption from the sales and use tax is allowed for petroleum products used in a passenger snowmobile for off-highway business use as part of the operation of a resort. A passenger snowmobile is defined as a self-propelled vehicle designed for travel on snow or ice, steered by skis or runners, with an enclosed section seating four to twelve passengers.

This provision was enacted in 1993.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.35 LOGGING EQUIPMENT

Minnesota Statutes, Sections 297A.02, Subd. 2 and 297A.25, Subd. 59

Effective July 1, 2000, logging equipment is exempt from the sales and use tax. Prior to that time, logging equipment is subject to a preferential tax rate, with a 1% rate in effect from July 1, 1999, to June 30, 2000. Qualifying logging equipment includes chain saws used for commercial logging.

A preferential rate for logging equipment was enacted in 1984 at 4% and was reduced to 2% in 1985. In 1991 the rate was increased to 2.5% when the general rate was increased by 0.5%. In 1998 the rate was phased down to 2% on July 1, 1998, and to 1% on July 1, 1999, with the full exemption effective on July 1, 2000.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$700,000	$700,000	$700,000

4.36 FARM MACHINERY

Minnesota Statutes, Sections 297A.02, Subd. 2 and 297A.25, Subd. 59

Effective July 1, 2000, all farm machinery is exempt from the Minnesota sales and use tax. Prior to that time, used farm machinery is exempt, but new farm machinery is subject to a preferential tax rate, with a 1% rate in effect from July 1, 1999, to June 30, 2000.

Qualifying farm machinery includes machinery, equipment, implements, and accessories used directly and principally in the production for sale of agricultural products, including livestock. Irrigation equipment purchased as an irrigation system also qualifies.

*Less Than $50,000

A preferential rate for farm machinery was first enacted in 1981 at 4% when the general rate was 5%. In 1985 the rate was reduced to 2%, and in 1991 it was increased to 2.5% when the general rate was increased by 0.5%. In 1998 the rate was phased down to 2% on July 1, 1998, and to 1% on July 1, 1999, with the full exemption effective on July 1, 2000. Starting in 1994, these rates were applicable only to new farm machinery, because used farm machinery was exempted. The exemption for used farm machinery was enacted as a temporary, one-year provision in 1994, with one-year extensions enacted in 1995 and 1996. The exemption of used farm machinery was made permanent in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
New Machinery	$11,900,000	$14,100,000	$14,100,000	$14,100,000
Used Machinery	$4,500,000	$4,700,000	$4,800,000	$4,900,000
Total - State General Fund	$16,400,000	$18,800,000	$18,900,000	$19,000,000

4.37 REPAIR AND REPLACEMENT PARTS FOR FARM MACHINERY

Minnesota Statutes, Section 297A.25, Subd. 29

Repair and replacement parts, except tires, used for maintenance or repair of farm machinery are exempt from the sales and use tax. To qualify, the machinery must be used in agricultural production and the part must replace a farm machinery part assigned a specific or generic part number by the manufacturer of the machinery.

This exemption was enacted in 1985. Although the provision has not been changed, changes have been made to the definition of farm machinery (Item 4.36) which affect the machinery that is eligible for the exemption.

There are approximately 80,000 farms in Minnesota.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$7,000,000	$7,000,000	$7,000,000	$7,000,000

4.38 PETROLEUM PRODUCTS USED TO IMPROVE AGRICULTURAL LAND

Minnesota Statutes, Section 297A.25, Subd. 7(2)

Petroleum products used to improve agricultural land are exempt from the sales and use tax. Products qualifying for exemption are those used in constructing, maintaining, and repairing drainage ditches, tile drainage systems, grass waterways, water impoundment, and other erosion control structures.

This provision was enacted in 1985.

Approximately 140 contractors make purchases covered by this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.39 FARM CONSERVATION PROGRAM ITEMS

Minnesota Statutes, Section 297A.25, Subd. 9

Seeds, trees, fertilizers, and herbicides sold to farmers for use in specified conservation programs are exempt from the sales and use tax. Under these programs, farmers agree to keep farmland out of production. The set-aside acres are required to be planted with cover crops, and the farmers are reimbursed by the federal or state government for a portion of the costs involved.

Purchases under the federal Conservation Reserve Program and the Wheat and Feed Grain Program qualify for exemption. The qualifying state program is the conservation reserve program established under the Reinvest in Minnesota Resources Law (RIM).

This provision was enacted in 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$300,000	$300,000	$300,000	$300,000

4.40 USED FARM TIRES

Minnesota Statutes, Section 297A.25, Subd. 54

The first $5,000 of gross receipts from the sale of used, remanufactured, or repaired tires for farm machinery by a sole proprietor in a calendar year are exempt from the sales and use tax under certain conditions. To qualify, the seller's gross receipts from all sales must have been less than $10,000 in the previous year, and the tires cannot be retreaded.

This exemption was enacted in 1994. Repair and replacement parts for farm machinery have been exempt since 1985 (Item 4.37), but tires are specifically excluded from that exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

4.41 HORSES

Minnesota Statutes, Section 297A.25, Subd. 57(a)

The gross receipts from the sale of horses are exempt from the sales and use tax.

This exemption was enacted in 1994 and was extended in 1995 to include racehorses.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$900,000	$900,000	$900,000	$900,000

4.42 PRIZES AT CARNIVALS AND FAIRS

Minnesota Statutes, Section 297A.25, Subd. 79

An exemption from the sales and use tax is allowed for items which will be given as prizes to players in games of skill or chance conducted at events such as community festivals, fairs, and carnivals lasting fewer than six days. The exemption does not apply to property awarded as prizes in connection with the state lottery or lawful gambling (Chapter 11).

This exemption was enacted in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

4.43 TELEVISION COMMERCIALS

Minnesota Statutes, Section 297A.25, Subd. 81

An exemption applies to the sale of tangible personal property primarily used or consumed in the production of a television commercial, including preproduction and postproduction. The sale of the commercial itself is also exempt, regardless of the medium in which it is transferred.

The exemption was enacted in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,000,000	$1,100,000	$1,100,000	$1,200,000

4.44 ADVERTISING MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 22

An exemption from the sales and use tax applies to the sale of advertising and promotional materials which are stored in Minnesota and subsequently shipped out of state by the purchaser for use outside Minnesota. Mailing and reply envelopes and cards used exclusively in connection with the advertising and promotional materials are included in the exemption.

This exemption was enacted in 1973 and was extended to mailing and reply envelopes and cards in 1985.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$6,400,000	$6,800,000	$7,100,000	$7,500,000

4.45 COURT REPORTER DOCUMENTS

Minnesota Statutes, Section 297A.25, Subd. 64

The gross receipts from the sale of transcripts or copies of transcripts of verbatim testimony produced and sold by court reporters to parties to the proceedings, or their representatives, are exempt from the sales and use tax.

This exemption was enacted in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$600,000	$700,000	$700,000

4.46 CERTAIN INTERSTATE TELEPHONE SERVICE

Minnesota Statutes, Section 297A.25, Subd. 36

Charges for telephone service, including long distance service, are subject to the sales tax. However, exemptions apply in two situations:

- WATS (wide area telephone service) calls made from outside Minnesota to an individual or business in Minnesota at no toll charge to the person making the call.
- Charges paid by a qualified telemarketing firm that entitle it to make an unlimited number of long distance calls from a location in Minnesota to outside the state. To qualify, a telemarketing firm must derive at least 80% of its revenue from soliciting or providing information, soliciting sales or receiving orders, or conducting research. A company selling its own product does not qualify for the exemption.

Prior to 1987, all interstate long distance telephone service was exempt from the sales tax. In 1987 the general exemption was removed, and the exemption for incoming WATS calls was enacted. The exemption for telemarketing firms was enacted in 1990.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$8,400,000	$9,000,000	$9,500,000	$10,000,000

4.47 METROPOLITAN PUBLIC SAFETY RADIO SYSTEMS

Minnesota Statutes, Section 297A.25, Subd. 69

Products and services, including end user equipment, used for construction, ownership, operation, maintenance, and enhancement of the backbone system of the metropolitan public safety radio communication system are exempt from the sales and use tax. The backbone system consists of a shared regionwide infrastructure network and the subsystems interconnected by the shared network in the seven-county metropolitan area.

This exemption was enacted in 1997, effective for sales from August 1, 1997, to July 31, 2003.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,100,000	$1,900,000	$1,700,000	$900,000

4.48 PACKING MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 6

Sales of packing materials used to pack and ship household goods are exempt from the sales and use tax. The ultimate destination of the goods must be outside Minnesota, and the goods must not be returned to Minnesota except in the course of interstate commerce.

This exemption was enacted in 1973.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

4.49 PROPERTY FOR BUSINESS USE OUTSIDE MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 5

The sale and delivery of personal property to a purchaser in Minnesota, who subsequently transports it outside the state before using it, is exempt from the sales and use tax if one of the following conditions is met: the item is used for business and is not subject to the sales tax in the state or country to which it is transported; or the property is repair or replacement parts to be used in the other state or country as part of a maintenance contract.

This provision was enacted in 1967 and was last changed in 1988.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.50 AUTOMATIC FIRE-SAFETY SPRINKLER SYSTEMS

Minnesota Statutes, Section 297A.25, Subd. 51

The gross receipts from the sale of certain automatic fire-safety sprinkler systems are exempt from the sales and use tax.

To qualify, the sprinkler systems must be installed in the following types of existing buildings after January 1, 1992: multifamily residential property containing four or more units; property containing four or more contiguous residential units for use by customers of the owner, such as hotels, motels, and lodging houses; and office buildings or mixed use commercial buildings if at least one story capable of occupancy is at least 75 feet above the ground.

This provision was enacted in 1992. In 1993 it was extended to office and commercial buildings.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$900,000	$800,000	$700,000	$700,000

4.51 BUILDING MATERIALS FOR RESIDENCES OF DISABLED VETERANS

Minnesota Statutes, Section 297A.25, Subd. 20

The sales of building materials used in constructing or remodeling a disabled veteran's residence are exempt from the sales and use tax if the project is financed in whole or in part by the U.S. Government in accordance with United States Code, Title 38, Sections 801 to 805.

*Less Than $50,000

This exemption was enacted in 1971.

The number of beneficiaries is usually fewer than thirty per year.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.52 CHAIR LIFTS, RAMPS, AND ELEVATORS IN HOMESTEADS

Minnesota Statutes, Section 297A.25, Subd. 43

The sale of chair lifts, ramps, and elevators and the building materials used to install or construct them are exempt from the sales and use tax if they are authorized by a physician and installed in or attached to the owner's homestead.

This exemption was enacted in 1989.

Approximately sixty people benefited from this provision in fiscal year 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.53 AMBULANCES LEASED TO LICENSED AMBULANCE SERVICES

Minnesota Statutes, Section 297A.25, Subd. 44

The lease of a motor vehicle for use as an ambulance by a licensed ambulance service is exempt from the sales and use tax. The provision includes both public and private ambulance services. Although the sale of a motor vehicle comes under the motor vehicle sales tax (Chapter 5), the lease of a motor vehicle is subject to the general sales tax.

This provision was enacted in 1990.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

4.54 FIREFIGHTERS' PERSONAL PROTECTIVE EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 56

The gross receipts from the sale of firefighters' personal protective equipment to an organized fire department are exempt from the sales and use tax.

The exemption includes helmets, goggles, self-contained breathing apparatuses, canister filter masks, personal alert safety systems, optical or thermal imaging search devices, and all safety equipment required by the Occupational Safety and Health Administration. Also included are items of protective clothing, boots, and gloves that do not qualify under the general clothing exemption.

This exemption was enacted in 1994 and was amended in 1997. Prior to June 1, 1992, all local government purchases were exempt from the sales and use tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$600,000	$700,000	$700,000

4.55 PARTS AND ACCESSORIES TO MAKE MOTOR VEHICLES HANDICAPPED ACCESSIBLE

Minnesota Statutes, Section 297A.25, Subd. 52

The gross receipts from the sale of parts and accessories used solely to modify a motor vehicle to make it handicapped accessible are exempt from the sales and use tax. This provision applies to modifications made after a vehicle is purchased.

A provision in the motor vehicle sales tax (Item 5.16) applies to the purchase price of a vehicle that has already been modified.

This exemption was enacted in 1993.

It is estimated that an average of 3,400 vehicles qualify for this exemption each year.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$700,000	$700,000	$700,000	$700,000

EXEMPTIONS - SALES TO PARTICULAR GROUPS

4.56 CERTAIN SALES TO LOCAL GOVERNMENTS

Minnesota Statutes, Section 297A.25, Subd. 7(5), 11, 34, 41, and 65

A general exemption does not apply to sales to local units of government, but several specific exemptions do apply.

The gross receipts from the sale of tangible personal property and utility services to Minnesota school districts, public libraries, and to hospitals and nursing homes owned and operated by political subdivisions are exempt from the sales and use tax.

Other exemptions for sales to local governments include: the purchase and lease of fire trucks, ambulances, and marked police patrol cars; motor fuel used in these vehicles; medical supplies and equipment for ambulances; repair and replacement parts for emergency rescue vehicles and fire trucks; machinery and equipment used directly for collection and disposal of mixed municipal solid waste at a landfill; construction materials and supplies used to construct or improve a correctional facility in a county or city; and town road maintenance equipment.

A general exemption for all local governments was part of the original sales tax law enacted in 1967. In 1992 the general exemption was repealed, and the exemptions for school districts, hospitals, nursing homes, libraries, and medical supplies for ambulances were enacted. The exemptions were expanded in 1993, 1995, 1997, and 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
School Districts	$40,000,000	$40,300,000	$40,700,000	$41,100,000
Hospitals	9,000,000	9,100,000	9,300,000	9,400,000
Nursing Homes	900,000	900,000	1,000,000	1,000,000
Libraries	2,200,000	2,300,000	2,400,000	2,500,000
Fire Trucks, Ambulances, Patrol Cars	3,500,000	3,600,000	3,600,000	3,700,000
Motor Fuel in These Vehicles	200,000	300,000	300,000	300,000
Ambulance Medical Supplies	200,000	200,000	200,000	200,000
Repairs Parts for Certain Vehicles	100,000	100,000	100,000	100,000
Landfill Machinery and Equipment	100,000	100,000	100,000	100,000
Correctional Facility Construction Materials	2,000,000	2,000,000	2,000,000	2,000,000
Town Road Maintenance Equipment	100,000	100,000	100,000	100,000
Total - State General Fund	$58,300,000	$59,000,000	$59,800,000	$60,500,000

4.57 SALES TO NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 16

The sale of tangible personal property and utility services to charitable, religious, or educational organizations is exempt from the sales and use tax. To qualify for exemption, the property must be used in the performance of the organization's charitable, religious, or educational functions. Nonprofit senior citizens' groups are also included in the exemption.

This provision was included in the sales and use tax when it was enacted in 1967. In 1983 the exemption was extended to the purchase of utilities, and in 1989 the leasing of motor vehicles was excluded from the exemption. The provision was last changed in 1993.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$58,700,000	$59,700,000	$60,800,000	$62,000,000

4.58 SALES TO VETERANS' ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 25

The gross receipts from the sale of tangible personal property to an organization of military service veterans or an auxiliary unit are exempt from the sales and use tax. The group must be organized in Minnesota and exempt from federal taxation under Section 501(c)(19) of the Internal Revenue Code. The property must be used for charitable, civic, educational, or nonprofit purposes and not for social, recreational, pleasure, or profit purposes.

This provision was enacted in 1980.

Approximately 820 organizations qualify for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$300,000	$300,000

4.59 DULUTH ENTERTAINMENT CONVENTION CENTER

Minnesota Statutes, Section 297A.25, Subd. 60

Construction materials and supplies used or consumed in constructing improvements to the Duluth Entertainment Convention Center are exempt from the sales and use tax. The exemption applies regardless of whether the purchases are made by the owners of the facility or a contractor.

This exemption was enacted in 1995 and was scheduled to expire December 31, 1998. In 1998 the expiration date was eliminated.

One facility will benefit from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$200,000	$0	$0

4.60 MINNEAPOLIS CONVENTION CENTER

Minnesota Statutes, Section 297A.25, Subd. 74

An exemption from the sales and use tax is allowed for materials, supplies, or equipment used or consumed in the construction, improvement, or expansion of the Minneapolis convention center. The exemption applies whether the purchases are made by the city or by a construction manager or contractor.

This exemption was enacted in 1998.

One facility is the beneficiary of this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,200,000	$1,200,000	$0	$0

4.61 ST. PAUL RIVERCENTRE ARENA

Minnesota Statutes, Section 297A.25, Subd. 75

An exemption from the sales and use tax is allowed for materials, supplies, or equipment used or consumed in the construction, improvement, or expansion of the RiverCentre arena complex in St. Paul. The exemption applies whether the purchases are made by the city or by a construction manager or contractor.

This exemption was enacted in 1998.

One facility is the beneficiary of this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,300,000	$300,000	$0	$0

4.62 EARLE BROWN HERITAGE CENTER

Minnesota Statutes, Section 297A.25 Subd. 78

Materials and supplies used or consumed in and equipment incorporated into the construction, improvement, or expansion of the Earle Brown Heritage Center in Brooklyn Center are exempt from the sales and use tax. The exemption applies regardless of whether the purchases are made by the city or a contractor, subcontractor, or builder.

This exemption was enacted in 1998 and is effective for purchases made from July 1, 1998, to June 30, 2003.

One facility will benefit from this exemption

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	$0	$0

*Less Than $50,000

4.63 LAKE SUPERIOR CENTER

Minnesota Statutes, Section 297A.25, Subd. 66

Construction materials and supplies used or consumed in constructing the Lake Superior Center are exempt from the sales and use tax. The exemption applies regardless of whether the purchases are made by the owner, a contractor, subcontractor, or builder.

This exemption was enacted in 1997.

One facility benefits from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$500,000	$100,000	$0	$0

4.64 SCIENCE MUSEUM OF MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 67

Construction materials and supplies used or consumed in constructing the Science Museum of Minnesota are exempt from the sales and use tax. The exemption applies regardless of whether the purchases are made by the owner, a contractor, subcontractor, or builder.

This exemption was enacted in 1997.

One facility benefits from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$0	$0	$0

4.65 AGRICULTURAL PROCESSING FACILITY

Minnesota Statutes, Section 297A.25, Subd. 80

Construction materials, supplies, and equipment are exempt from the sales and use tax if used in the expansion or improvement of a cattle slaughtering facility. The cost of the project must exceed $15 million and the number of jobs must increase by at least 150. The exemption completion date for the project must be by December 31, 2001. The exemption applies regardless of whether purchases are made by the owner or a contractor, subcontractor, or builder.

This exemption was enacted in 1999.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$0	$400,000	$200,000	$0

4.66 BIOMASS ELECTRICAL GENERATING FACILITY

Minnesota Statutes, Section 297A.25, Subd. 82

Materials and supplies used or consumed in and equipment incorporated into the construction, improvement, or expansion of a facility using biomass to generate electricity are exempt from the sales and use tax. The exemption applies regardless of whether purchases are made by the owner or a contractor, subcontractor, or builder.

To qualify for the exemption the facility must exclusively utilize residue wood, sawdust, bark, chipped wood, or brush to generate electricity. The facility must use a reciprocated grate combination system and have a total gross capacity between 15 and 21 megawatts.

This exemption was enacted in 1999 and is effective until June 30, 2001.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$500,000	*	$0	$0

*Less Than $50,000

4.67 BIOSOLIDS PROCESSING EQUIPMENT AND FACILITIES

Minnesota Statutes, Section 297A.25, Subd. 73

An exemption from the sales and use tax is allowed for equipment designed to process, dewater, and recycle biosolids for wastewater treatment facilities of political subdivisions. Materials incidental to the installation of the equipment are included in the exemption. Also exempt are materials used to construct buildings to house the biosolid processing equipment if purchased before July 1, 2001.

The equipment exemption was enacted in 1998. The exemption was extended in 1999 to include construction materials. The exemption for construction materials is limited to purchases from July 1, 1998, to June 30, 2001.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,400,000	$1,000,000	$700,000	$600,000

4.68 BUSINESS INCUBATOR AND INDUSTRIAL PARK FACILITY

Minnesota Statutes, Section 297A.25, Subd. 68

Materials and supplies used or consumed in constructing a business incubator and industrial park facility, as specified, are exempt from the sales and use tax.

To qualify for the exemption, the facility must be owned and operated by a nonprofit charitable organization exempt under Section 501(c)(3) of the Internal Revenue Code. The facility must meet several other conditions, including that it is used for the development of nonretail businesses and offers access to equipment, space, services, and advice to tenant businesses to encourage economic development and job creation in the area served by the organization.

This exemption was enacted in 1997.

One facility is expected to benefit from this exemption

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	$0	$0	$0

*Less Than $50,000

4.69 DISTRICT HEATING AND COOLING FACILITY

Minnesota Statutes, Section 297A.25, Subd. 70(3)

Materials and supplies used or consumed in constructing, equipping, or modifying a district heating and cooling system cogeneration facility are exempt from the sales and use tax. The exemption applies regardless of whether the purchases are made by the owner, a contractor, subcontractor, or builder. To qualify, the facility must utilize wood waste as a primary fuel source and satisfy the requirements of the biomass mandate in Minnesota Statutes, Section 216B.2424, Subd. 5.

This exemption was enacted in 1997.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$0	$0

4.70 SOYBEAN PROCESSING FACILITY

Minnesota Statutes, Section 297A.25, Subd. 77

Construction materials and supplies are exempt from the sales and use tax if they are used or consumed in constructing a facility for soybean oilseed processing and refining and the total capital investment made in the facility is at least $60 million. The facility must be constructed by a Minnesota-based cooperative organized under Chapter 308A. The exemption applies regardless of whether purchased by the owner or a contractor, subcontractor, or builder.

This exemption was enacted in 1998.

One facility is expected to benefit from this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	$200,000	$1,000,000	$200,000

*Less Than $50,000

EXEMPTIONS - SALES BY PARTICULAR GROUPS

4.71 ISOLATED OR OCCASIONAL SALES

Minnesota Statutes, Section 297A.25, Subd. 12

Isolated or occasional sales made by persons not engaged in selling such property in the normal course of business are exempt from the sales and use tax. The isolated or occasional sale exemption does not apply to tangible personal property used in a trade or business unless certain conditions exist.

The isolated or occasional sale of property used in a trade or business is taxed unless the sale comes under one of these categories: sales of farm machinery; farm auction sales; sale of substantially all of the assets of a trade or business; and sales not exceeding $1,000 in a twelve-month period. Also exempt are sales that occur in transactions covered in several Internal Revenue Code sections, such as contributions to capital, certain liquidations, and involuntary conversions.

The isolated or occasional sale exemption was enacted in 1967. In 1991 property used in a trade or business was eliminated from the general exemption, except for transactions covered under specified Internal Revenue Code sections. In 1992 the exemption was reinstated for farm machinery and the other exceptions listed above, retroactive to July 1, 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$22,100,000	$22,800,000	$23,800,000	$24,900,000

4.72 INSTITUTIONAL MEALS

Minnesota Statutes, Section 297A.01, Subd. 3(c)

Although prepared meals and drinks are generally subject to the sales tax, the following are exempt:

1. Meals and drinks served to patients, residents, or inmates of hospitals, nursing homes, sanitariums, senior citizens' homes, and correctional, detention, and detoxification facilities.
2. Meals served at public and private schools, universities, and colleges.
3. Congregate dining, home delivery of meals, and other qualifying programs which provide meals to senior citizens or the handicapped.

This provision was enacted in 1967 and was last changed in 1988.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$33,300,000	$33,900,000	$34,500,000	$35,200,000

4.73 FUNDRAISING SALES BY NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.256, Subd. 1

Sales made by nonprofit organizations are taxable unless specifically exempted by statute. An exemption from the sales tax does apply to certain fundraising sales made by nonprofit organizations. The exemption applies to:

1. Fundraising sales by an organization that: a) is an educational or social organization for people age eighteen and under or is a senior citizen group that is exempt from the sales tax; and b) has gross annual receipts from fundraising that do not exceed $10,000.

2. Sales, including personal property, admission charges, food, meals, and drinks at fundraising events sponsored by a nonprofit organization when the entire proceeds, except necessary expenses, go exclusively for charitable, religious, or educational purposes. This exemption does not apply to bingo or other gambling activities. The exemption is limited to no more than 24 days a year.

This provision was enacted in 1985 and was last changed in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,800,000	$4,900,000	$5,000,000	$5,000,000

4.74 CANDY SALES BY CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 297A.01, Subd. 3(c)(iv)

Candy, candy products, and gum are exempt from the sales tax when sold for fundraising purposes by a nonprofit organization which provides educational and social activities primarily for young people age eighteen and under.

The estimates do not include sales of candy by organizations with gross receipts from fundraising of $10,000 or less because the sales would also qualify for the fundraising exemption (Item 4.73).

This exemption was enacted in 1984 and was recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

4.75 MINNESOTA AMATEUR SPORTS COMMISSION EVENTS

Minnesota Statutes, Section 297A.256, Subd. 2

An exemption from the sales tax applies to certain sales made by a nonprofit corporation designated by the Minnesota Amateur Sports Commission to conduct a series of statewide amateur athletic games and related events, workshops, and clinics. The exemption applies to the sale of tangible personal property, admission charges, and sales of food, meals, and drinks by the nonprofit corporation at fundraising events, athletic events, or athletic facilities. Purchases made by the nonprofit corporation are also exempt.

This exemption was enacted in 1994.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.76 ADMISSION TO CHARITABLE GOLF TOURNAMENTS

Minnesota Statutes, Section 297A.256, Subd. 1(d)

The gross receipts from the sale of tickets or admission to a golf tournament held in Minnesota are exempt if the beneficiary of the tournament's net proceeds qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.

This exemption was enacted in 1994.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

4.77 ADMISSION TO SCHOOL-SPONSORED EVENTS

Minnesota Statutes, Section 297A.25, Subd. 30

The gross receipts from the sale of tickets or admissions to regular season school games, events, and activities of elementary and secondary schools are exempt from the sales and use tax. The estimates do not include sales of tickets that would be exempt as admission to artistic events (Item 4.78) or under the fundraising exemption (Item 4.73).

This exemption was enacted in 1985.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$700,000	$700,000	$700,000	$700,000

*Less Than $50,000

4.78 ADMISSION TO ARTISTIC EVENTS

Minnesota Statutes, Section 297A.25, Subd. 24

The gross receipts from the sale of tickets or admissions to events which provide opportunities for participation in the creation, performance, or appreciation of the arts are exempt from the sales tax if the events are sponsored by a tax-exempt organization or a municipal board which promotes cultural events.

This exemption was enacted in 1980 and was extended to municipal boards in 1992.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,100,000	$4,200,000	$4,200,000	$4,300,000

4.79 SACRAMENTAL WINE SOLD BY RELIGIOUS ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 46

The gross receipts from the sale of wine for sacramental purposes in religious ceremonies are exempt from the sales and use tax if the wine is purchased from a rabbi, priest or minister of a church or other established religious organization.

This exemption was enacted in 1991.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

REDUCED SALES PRICE

4.80 PRICE REDUCED BY VALUE OF TRADE IN

Minnesota Statutes, Section 297A.01, Subd. 8
Minnesota Rules, Part 8130.1500

The sales price is reduced by the amount allowed as credit for tangible personal property taken in trade for resale. To qualify for the reduction in sales price, the property must be taxable under the sales and use tax or the motor vehicle sales tax and of the type of property normally sold in the regular course of the retailer's business. Trade-ins for farm machinery are not included in the estimates after June 30, 2000, when farm machinery becomes exempt from the sales tax.

*Less Than $50,000

This provision was enacted in 1967.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,900,000	$3,000,000	$3,100,000	$3,300,000

4.81 NEW MANUFACTURED HOMES

Minnesota Statutes, Section 297A.02, Subd. 4

The sale in Minnesota of a manufactured home used as a residence is taxed at 65% of the dealer's cost. The estimates measure the difference between application of the tax on the full sales price and 65% of the dealer's cost.

This provision applies only to the first sale of a manufactured home in the state because an exemption applies to any subsequent sale. The exemption for used manufactured homes is estimated separately in Item 4.16.

The use of 65% of the sales price, instead of the full price, was enacted in 1984. In 1998 the base for the tax was changed from sales price to dealer's cost.

Approximately 3,000 manufactured homes were placed in Minnesota in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$3,900,000	$4,200,000	$4,700,000	$5,200,000

REDUCED RATES

4.82 TAX PAID TO OTHER STATES

Minnesota Statutes, Section 297A.24

Tangible personal property on which sales tax was paid to another state is taxed at a rate equal to the difference between the Minnesota rate and the other state's rate. If the other state's rate is equal to or greater than Minnesota's rate, no Minnesota use tax is imposed.

This provision was enacted in 1967 and was last changed in 1981.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$3,600,000	$3,700,000	$3,800,000	$3,900,000

Appendix to Chapter 4: Distributional Information on Selected Tax Expenditures in the Sales and Use Tax

The following table shows how the benefits from six selected tax expenditures are distributed across income classes. Income classes are based on a comprehensive definition of income, including all forms of cash income, both taxable and nontaxable. The distributional impact of individual tax expenditures are estimated only if (1) they provide substantial benefits directly to households and (2) good data is available on the distribution of consumer purchases by income level. For comparison purposes, the third column of the table shows how the existing sales tax paid on purchases by Minnesota consumers is distributed by income class.

The distributional estimates shown in the table apply only to the portion of each tax expenditure that directly benefits Minnesota consumers. For example, the tax expenditure estimate for the exemption of motor fuels from the sales tax is $234.4 million. Direct sales to Minnesota households account for $102.9 million of this total; sales to out-of-state visitors account for $37.7 million, and sales to businesses account for $93.8 million. For both vehicle repairs and drugs and medical supplies, the distributions apply only to out-of-pocket costs. The portions of these two tax expenditures that reflect payments by insurance companies are included in the business share.

			Resident Consumers' Share of Tax Expenditures					
Income Class	**Percent of Total Households**	**Sales Tax on Resident Consumer Purchases**	**Food**	**Clothing**	**Drugs & Medical Supplies**	**Motor Fuels**	**Vehicle Repairs**	**Beauty & Barber**
$ 9,999 or Less	15.3%	4.9%	9.5%	3.2%	7.6%	4.3%	2.2%	4.7%
10,000 - $ 19,999	17.1%	8.7%	11.7%	6.3%	13.0%	9.1%	8.5%	8.5%
20,000 - 29,999	14.3%	10.4%	11.4%	8.3%	12.4%	11.8%	10.5%	9.3%
30,000 - 39,999	11.3%	10.0%	10.3%	8.9%	11.5%	11.2%	10.7%	9.2%
40,000 - 49,999	9.1%	9.5%	9.5%	9.2%	9.3%	10.9%	10.5%	8.3%
50,000 - 74,999	16.4%	21.6%	20.8%	22.9%	20.6%	23.6%	23.6%	20.4%
75,000 - 99,999	8.3%	13.8%	12.1%	15.8%	11.8%	13.8%	14.9%	13.8%
100,000 - 149,999	4.7%	9.9%	7.5%	11.1%	7.3%	8.3%	9.6%	10.1%
150,000 - 199,999	1.5%	3.6%	2.7%	4.3%	2.5%	2.8%	3.5%	4.3%
200,000 - 499,999	1.6%	5.3%	3.2%	6.1%	2.9%	3.1%	4.3%	6.6%
500,000 or More	0.4%	2.1%	1.2%	3.9%	1.1%	1.0%	1.7%	4.8%
All Households	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

	Tax Expenditure Amounts FY2000 (Millions)					
	Food	**Clothing**	**Drugs & Medical Supplies**	**Motor Fuels**	**Vehicle Repairs**	**Beauty & Barber**
Resident Consumers' Share:	$383.5	$368.3	$67.2	$102.9	$43.9	$25.5
Visitors' Share:	13.5	14.5	[a]	37.7	1.6	0.8
Business Share:	[a]	[a]	43.3[b]	93.8	54.4[b]	[a]
Total Tax Expenditure	$397.0	$382.8	$110.5	$234.4	$99.9	$26.3

[a] Negligible
[b] Includes portion paid by insurance

Source: Consumption patterns by income, marital status, age, household size, and housing status are derived from detailed data from the Consumer Expenditure Survey (1992-1996). Expenditures are estimated for each household in the Tax Incidence Sample, which is blown up to represent all Minnesota households.

CHAPTER 5: MOTOR VEHICLE SALES TAX

Collections and History

Total revenues from the motor vehicle sales tax were $478 million in fiscal year 1999. All revenues from this tax go into the state general fund.

Motor vehicles were subject to the 3% general sales tax when it was enacted in 1967. The sales tax on motor vehicles was replaced by the motor vehicle excise tax during the 1971 legislative session. In 1994 the term used for this tax in statute was changed from excise tax to sales tax.

This tax went into effect on January 1, 1972, at the rate of 4%. The rate was increased to 5% on July 1, 1981, and to 6% on July 1, 1983. The rate has been 6.5% since July 1, 1991.

Tax Base

The tax base for the motor vehicle sales tax is the purchase price of a motor vehicle when ownership is transferred and the motor vehicle is required to be registered under the laws of Minnesota. Regardless of the number of times a vehicle is sold, each transfer of ownership is in the tax base. The transfer of a motor vehicle to a dealer for resale in the regular course of business is not considered to be within the base. For a vehicle transferred by gift or for a nominal or no monetary consideration, the purchase price is deemed to be the average value of similar motor vehicles.

Computation of the Tax

The motor vehicle sales tax is imposed when a motor vehicle required to be registered in Minnesota is purchased or acquired, either in or outside Minnesota. The 6.5% rate is applied to the purchase price, which is defined as the total consideration valued in money, whether paid in money or otherwise. When one motor vehicle is taken in trade on another vehicle, the trade-in value is deducted in arriving at the net purchase price.

This tax is different from the general sales and use tax in Chapter 4 in two respects: isolated and occasional sales are taxable transactions, and a transfer without monetary consideration is subject to tax based on the average value of similar vehicles.

The tax is paid to the motor vehicle registrar, and it must be paid before registration plates or a certificate of title can be issued.

EXEMPTIONS

5.01 VEHICLES ACQUIRED BY INHERITANCE

Minnesota Statutes, Section 297B.01, Subd. 7(a)

The acquisition of a motor vehicle by inheritance from or by bequest of a decedent is exempt from the motor vehicle sales tax. Without this exemption, the tax on the transfer of a motor vehicle without monetary consideration would be based on the average value of similar vehicles.

This provision was enacted in 1971.

An estimated 5,500 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,400,000	$2,500,000	$2,600,000	$2,600,000

5.02 VEHICLES OF PERSONS MOVING INTO MINNESOTA

Minnesota Statutes, Section 297B.03(2)

When a person moves to Minnesota, any motor vehicle owned by that person which was purchased and titled in another state more than sixty days prior to the move is exempt from the motor vehicle sales tax.

This provision was enacted in 1971.

An estimated 35,500 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$8,400,000	$8,500,000	$8,700,000	$8,800,000

5.03 TRANSFERS BETWEEN JOINT OWNERS

Minnesota Statutes, Section 297B.01, Subd. 7(b)

The transfer of a motor vehicle is exempt from the motor vehicle sales tax if it was previously registered in the names of two or more joint owners and is subsequently transferred without monetary consideration to one or more of the joint owners.

This provision was enacted in 1971.

An estimated 6,500 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,900,000	$3,000,000	$3,100,000	$3,200,000

5.04 TRANSFERS BETWEEN FAMILY MEMBERS

Minnesota Statutes, Section 297B.01, Subd. 7(c) and 8

The transfer of a vehicle in the form of a gift between qualifying family members is exempt from the motor vehicle sales tax. The exemption applies to a transfer between spouses, a parent and a child, a guardian and a ward, and between a foster parent and foster child.

This exemption was enacted in 1971 and was last changed in 1996.

An estimated 53,000 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$17,100,000	$17,600,000	$18,100,000	$18,500,000

5.05 TRANSFERS IN DIVORCE PROCEEDINGS

Minnesota Statutes, Section 297B.01, Subd. 7(d)

The transfer of a motor vehicle between husband and wife in a divorce proceeding is exempt from the motor vehicle sales tax. The exemption applies whether the transfer is voluntary or involuntary. Because transfers between joint owners are exempt under another provision (Item 5.03), the estimates include only transfers involving a vehicle previously registered to one person.

This provision was enacted in 1974.

An estimated 950 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$400,000	$400,000	$400,000	$400,000

5.06 CORPORATE AND PARTNERSHIP TRANSFERS

Minnesota Statutes, Section 297B.03(4)

When an individual transfers a vehicle to a corporation in exchange for stock or securities, the transfer is exempt from the motor vehicle sales tax. The exemption also applies to the transfer of a vehicle to a partnership in exchange for an interest in the partnership.

This provision was enacted in 1975.

An estimated 1,100 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$800,000	$800,000	$800,000	$800,000

5.07 SALES TO DISABLED VETERANS

Minnesota Statutes, Section 297B.03(1)

Disabled veterans who purchase motor vehicles with funds provided either in whole or in part by the Veterans Administration under the provisions of United States Code, Title 38, Section 1901, are not required to pay the motor vehicle sales tax.

This provision was enacted in 1971.

Fewer than twenty vehicles qualify under this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

5.08 AMBULANCES PURCHASED BY PRIVATE AMBULANCE SERVICES

Minnesota Statutes, Section 297B.03(7)

The purchase of a motor vehicle for use as an ambulance by a privately-owned licensed ambulance service is exempt from the motor vehicle sales tax. Ambulances purchased by local units of government are also exempt, but the exemption of these purchases is not considered a tax expenditure because publicly-owned ambulances are not required to be registered and, therefore, are not in the tax base.

This provision was enacted in 1990.

*Less Than $50,000

Fewer than twenty vehicles qualify under this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

5.09 BOOKMOBILES

Minnesota Statutes, Section 297B.03(8)

The purchase of a motor vehicle by or for a public library for use as a bookmobile or a library delivery vehicle is exempt from the motor vehicle sales tax.

This exemption was enacted in 1994.

Fewer than ten vehicles qualify under this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

5.10 VEHICLES USED IN AUTOMOTIVE TRAINING PROGRAMS

Minnesota Statutes, Section 297B.03(6)

The purchase or use of a motor vehicle by a public or a private nonprofit educational institution is exempt from the motor vehicle sales tax if the vehicle is used as an instructional aid in an automotive training program operated by the institution. Motor vehicle body and mechanical repair courses qualify for the exemption; driver education programs do not. The vehicles are usually donated to the institution.

This exemption was enacted in 1988. These vehicles had previously been included under the exemptions for local government units and nonprofit organizations which were repealed in 1987.

An estimated 300 transfer qualify under this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

5.11 VEHICLES DONATED TO EXEMPT ORGANIZATIONS

Minnesota Statutes, Section 297B.01, Subd. 7(e) and 8

The transfer of a motor vehicle in the form of a gift to an exempt organization is not subject to the motor vehicle sales tax. To qualify, the organization must be exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code, and the motor vehicle must be used exclusively for religious, charitable, or educational purposes.

This exemption was enacted in 1997.

An estimated 170 vehicle transfers qualify under this exemption annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

5.12 READY-MIXED CONCRETE TRUCKS

Minnesota Statutes, Section 297B.03(9)

The purchase of a ready-mixed concrete truck is exempt from the motor vehicle sales tax.

This exemption was enacted in 1998.

The exemption applies to an estimated 100 vehicles annually.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$600,000	$600,000	$600,000	$600,000

5.13 TOWN ROAD MAINTENANCE VEHICLES

Minnesota Statutes, Section 297B.03 (10)

Motor vehicles purchased by a town to be used exclusively for road maintenance are exempt from the motor vehicle sales tax. The exemption applies to snowplows and dump trucks but not to automobiles, pickup trucks, or vans.

This exemption was enacted in 1998.

An estimated fifty vehicles are purchased under this exemption in an average year.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

REDUCED PURCHASE PRICE

5.14 FEDERAL EXCISE TAXES

Minnesota Statutes, Section 297B.01, Subd. 8

When computing the Minnesota motor vehicle sales tax, any federal taxes imposed on the retail sale of a vehicle are excluded from the purchase price. At the present time three federal excise taxes are levied upon new motor vehicles. For trucks in excess of 33,000 pounds gross vehicle weight, the tax is 12% of retail price, and for trailers or semi-trailers in excess of 26,000 pounds gross vehicle weight, the tax is 12% of retail price. The luxury tax on passenger vehicles over a threshold is 6% of retail price for 1999, 5% for 2000, 4% for 2001 and 3% for 2002. The luxury tax is repealed in 2003. The threshold for the luxury tax is indexed for inflation and is $36,000 for 1999 and $38,000 for 2000.

This provision was enacted in 1983 and has not been changed.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,000,000	$1,000,000	$1,000,000	$1,000,000

5.15 PRICE REDUCED BY VALUE OF TRADE IN

Minnesota Statutes, Section 297B.01, Subd. 8

When a motor vehicle is taken in trade as part payment on another motor vehicle, the selling price is reduced by the amount of trade-in value allowed. The 6.5% motor vehicle sales tax is applied to the reduced price. This provision applies both to dealer sales and to sales between individuals.

The provision was enacted in 1971.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$83,300,000	$90,200,000	$97,600,000	$105,500,000

5.16 HANDICAPPED-ACCESSIBLE MODIFICATIONS

Minnesota Statutes, Sections 297B.01, Subd. 8

The value of modifications necessary to make a motor vehicle handicapped accessible is excluded from the purchase price used for computing the motor vehicle sales tax.

A sales tax exemption enacted in 1993 applies to the parts and accessories used to modify a vehicle after it is purchased (Item 4.55).

This provision was enacted in 1992.

It is estimated that an average of 600 vehicles qualify under this provision each year.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

PREFERENTIAL COMPUTATIONS

5.17 FLAT TAXES ON OLDER CARS AND COLLECTOR VEHICLES

Minnesota Statutes, Sections 297B.02, Subd. 2 and 3 and 297B.025

In lieu of the 6.5% motor vehicle sales tax, a flat tax of $10 is imposed on the transfer of a passenger automobile that is in at least its tenth year of vehicle life and has a resale value of less than $3,000.

A passenger automobile that is registered and licensed as a collector vehicle (pioneer, classic, collector, street rod, collector military vehicle, or fire truck) is subject to a flat tax of $90 upon transfer of ownership, instead of being taxed at 6.5% of the purchase price. In order to be registered as a collector vehicle, several requirements must be met, including the type and age of the vehicle. Also, the vehicle must be owned and operated solely as a collector's item and not used for general transportation purposes.

Compared to a tax of 6.5% of the purchase price, the $10 flat tax is lower for an older car sold for more than $153, and the $90 tax is lower for a collector vehicle sold for more than $1,385.

The $10 flat tax on older cars was enacted in 1985. The $90 flat tax on collector vehicles was enacted in 1988 and was extended to collector military vehicles in 1989 and to collector fire trucks in 1995.

The tax on an estimated 240,000 vehicle transfers is reduced by these provisions each year.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$15,800,000	$16,100,000	$16,400,000	$16,700,000

CREDIT

5.18 CREDIT FOR TAXES PAID TO OTHER STATES

Minnesota Statutes, Section 297B.08

Minnesota allows a credit against the motor vehicle sales tax for any sales, use, or excise tax paid on the vehicle to another state. The credit is allowed only if the other state has a similar provision allowing a credit for taxes paid in Minnesota.

Because vehicles purchased by nonresidents more than sixty days prior to moving into Minnesota are exempt (Item 5.02), this provision affects only purchases by nonresidents that occurred within the sixty days prior to the move and purchases by residents for any tax paid to another state.

This exemption was enacted in 1971.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$2,300,000	$2,300,000	$2,400,000	$2,400,000

CHAPTER 6: HIGHWAY FUELS EXCISE TAXES

Collections and History

The net revenues from the taxes on highway gasoline and special fuels were $577 million in fiscal year 1999. All revenues from these taxes go into the highway user tax distribution fund.

Minnesota first imposed an excise tax on highway fuels in 1925 at a rate of 2¢ per gallon. Eleven rate increases have occurred since then. The current rate of 20¢ per gallon has been in effect since 1988.

An annual permit fee applied to vehicles using alternate fuels at various times from 1985 to 1995. In 1995 separate rates were enacted for liquefied petroleum gas, liquefied natural gas, and compressed natural gas.

Tax Base

The tax base for the highway fuels excise taxes is motor fuel used in vehicles on Minnesota highways. Therefore, it is not considered a tax expenditure when the tax does not apply to off-road usage, such as for farming, or to out-of-state usage.

Computation of the Tax

The highway fuel tax rate is 20¢ per gallon and is imposed on gasoline and special fuels (diesel) used on Minnesota highways. Other rates apply to alternative fuels. Motor carriers based in states other than Minnesota pay the road tax which is 20¢ per gallon for gasoline or special fuel purchased in another state and used on Minnesota highways. A person who purchases gasoline or special fuel in Minnesota and regularly drives in another state(s) may claim a refund for the tax paid on the fuel used in another state.

EXEMPTIONS

6.01 TRANSIT SYSTEMS RECEIVING STATE FINANCIAL ASSISTANCE

Minnesota Statutes, Sections 296A.07, Subd. 4 and 296A.08, Subd. 3

The highway fuels excise taxes are not imposed on gasoline and special fuel purchased by a transit system that receives state financial assistance from the Metropolitan Council (seven-county metropolitan area) or the Public Transit Subsidy Program (outside the metropolitan area).

An exemption for transit systems owned by local governments was enacted in 1977. In 1990 the exemption was extended to all systems receiving state financial assistance. This provision was last changed when it was recodified in 1998.

About eighty companies are eligible for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$2,700,000	$2,700,000	$2,700,000	$2,700,000

6.02 MOTOR VEHICLES NOT REQUIRING REGISTRATION (SPECIAL FUELS)

Minnesota Statutes, Sections 168.012, Subd. 1 and 296A.16, Subd. 2

The highway special fuels (diesel) tax is imposed on licensed motor vehicles, which are those requiring registration. Vehicles not requiring registration include municipal fire apparatus, police patrols, and ambulances, the appearance of which is unmistakable. Special fuel used in these vehicles is exempt from the excise tax.

This provision was enacted in 1951 and was recodified in 1998.

An estimated 3,400 vehicles qualify for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$600,000	$600,000	$600,000	$600,000

6.03 RECIPROCAL AGREEMENTS FOR OUT-OF-STATE PURCHASES

Minnesota Statutes, Section 296A.27, Subd. 3

In general, all gasoline and special fuels used in vehicles on Minnesota highways are subject to the Minnesota highway fuels excise taxes. Motor carriers based in states other than Minnesota pay the road tax for gasoline or special fuel purchased in another state and used on Minnesota highways.

This provision authorizes the Commissioner of Public Safety or the Commissioner of Revenue to enter into a reciprocal agreement with officials in another state under which motor carriers based in that state are exempt from paying the Minnesota road tax if the other state exempts Minnesota-based motor carriers from paying that state's road tax.

Currently Minnesota has limited agreements with North Dakota and Wisconsin.

This provision was enacted in 1961 and was last changed when it was recodified in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	*	*	*	*

*Less Than $50,000

CHAPTER 7: ALCOHOLIC BEVERAGE TAXES

Collections and History

In fiscal year 1999, the revenues from the alcoholic beverage taxes were: $40 million from distilled spirits; $15.3 million from beer; and $3.4 million from wine. All revenues from these taxes are deposited in the state general fund.

An excise tax was first imposed on alcoholic beverages in Minnesota in 1934. The initial rates were: 60¢ per gallon for distilled spirits; $1 per barrel for 3.2% beer and $2 per barrel for strong beer; and wine rates ranging from 10¢ to 60¢ per gallon. The tax rates were increased (and occasionally decreased) at various times, and the current rates have been in effect since 1987.

Tax Base

The tax base for the alcoholic beverages taxes is alcoholic beverages for human consumption which are manufactured, imported, sold, or possessed in Minnesota. Therefore, the exemptions for alcohol used for purposes other than human consumption are not tax expenditures, such as the exemption for alcohol used in industrial production.

Computation of the Tax

The tax is paid by the wholesaler, distributor, or manufacturer upon acquisition for sale within Minnesota. The tax is based on volume, not price. Alcoholic beverages are also subject to a sales tax rate of 9% of the purchase price instead of the general sales tax rate of 6.5%.

The tax rates are:

Beer: Alcohol by Weight	Tax per Barrel of 31 Gallons
3.2% or less	$2.40
More than 3.2%	$4.60

	Tax	
	Per Gallon	Per Liter
Distilled Spirits (includes liqueurs, cordials, and specialties, regardless of alcoholic content)	$5.03	$1.33
Wine: Alcohol by Volume		
14% or less	$ .30	$ .08
More than 14% to 21%	.95	.25
More than 21% to 24%	1.82	.48
More than 24%	3.52	.93
Sparkling Wine	1.82	.48

EXEMPTIONS

7.01 CONSUMER PURCHASES MADE OUT OF STATE

Minnesota Statutes, Sections 297G.07, Subd. 2

A person entering Minnesota from another state may have in possession one liter of distilled spirits or wine or nine quarts of beer without paying the Minnesota excise tax. A person entering Minnesota from a foreign country may have in possession four liters of distilled spirits or wine or ten quarts of beer without paying the Minnesota excise tax. The alcoholic beverage must accompany the person into the state and cannot be sold or used commercially.

This provision was enacted in 1947. It was last changed in 1997 when it was recodified.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$100,000	$100,000	$100,000	$100,000

7.02 HOME PRODUCTION AND USE

Minnesota Statutes, Section 297G.07, Subd. 1(6)

Beer naturally brewed and fruit juices naturally fermented in the home for family use are exempt from the alcoholic beverage taxes.

This exemption was first authorized by statute in 1957 and was recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

7.03 SALES TO FOOD PROCESSORS AND PHARMACEUTICAL FIRMS

Minnesota Statutes, Section 297G.07, Subd. 1(8)

Alcoholic beverages sold to authorized manufacturers of food products or pharmaceutical firms are exempt from the alcoholic beverage taxes. The alcoholic beverage must be used exclusively in the manufacture of food products or medicines.

This exemption was first codified in 1988 and was recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

7.04 CONSUMPTION ON BREWERY PREMISES

Minnesota Statutes, Section 297G.07, Subd. 1(4)

Beer that is served by a brewery at no charge for on-premise consumption or is distributed to brewery employees for on-premise consumption under a labor contract is exempt from the Minnesota excise tax.

This provision was enacted in 1941. It was last changed when it was recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

7.05 WINE FOR TASTING AND TESTING

Minnesota Statutes, Section 297G.09

Wine which is used for tasting and testing purposes is exempt from the Minnesota excise tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

7.06 WINE FOR SACRAMENTAL PURPOSES

Minnesota Statutes, Sections 297G.07, Subd. 1(7)

Sales of wine exclusively for sacramental purposes to a minister, rabbi, or priest of a church or established religious organization are not subject to the Minnesota excise tax.

This provision was adopted in 1937 and was last changed when it was recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

*Less Than $50,000

7.07 SHIPMENTS OF WINE FOR PERSONAL USE

Minnesota Statutes, Section 297G.07, Subd. 1(5)

An exemption from the excise tax is allowed for certain shipments of wine to a Minnesota resident from a winery licensed in a state which provides Minnesota wineries an equal reciprocal shipping privilege. The shipment must be for personal use, and no more than two cases of wine containing a maximum of nine liters per case can be shipped to any resident in a calendar year.

This exemption was enacted in 1993 and was recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

CREDIT

7.08 SMALL BREWERS' CREDIT

Minnesota Statutes, Section 297G.04, Subd. 2

A credit is allowed to a brewer who manufactures less than 100,000 barrels of beer in the calendar year preceding the year for which the credit is claimed. The credit is $4.60 per barrel on 25,000 barrels sold in a fiscal year, with a maximum credit of the lesser of the brewer's tax liability or $115,000.

The credit was enacted in 1985 and was recodified in 1997. A credit for beer produced and sold in Minnesota had been in effect from 1973 to 1985.

Twenty-three breweries qualified for this credit in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

*Less Than $50,000

CHAPTER 8: CIGARETTE AND TOBACCO TAXES

Collections and History

In fiscal year 1999, cigarette tax revenues were $175 million and tobacco products tax revenues were $14 million. The revenues from the cigarette tax are distributed as follows: debt service on specified bonds is paid first; 2¢ per pack to the Minnesota future resources fund; and the balance to the state general fund. Revenues from the tobacco products tax go to the state general fund.

The cigarette tax was enacted in 1947 at a rate of 3¢ per pack. The tax rate was increased several times and has been 48¢ since 1992. Cigarettes were first subject to the general sales tax in 1982.

The tobacco products tax was enacted in 1955 at a rate of 15% of the wholesale price. The rate was increased to 20% in 1959, to 25% in 1985, and it has been 35% since 1987. Tobacco products have been subject to the general sales tax since it was enacted in 1967.

Tax Base

The tax base is essentially the same for both the cigarette tax and the tobacco products tax. It is the sale of cigarettes or tobacco products in Minnesota. Also included in the tax base is the use or storage in Minnesota of cigarettes or tobacco products if the Minnesota tax was not paid previously. Although the jurisdictional tax base is the same for both taxes, the cigarette tax is based on volume, and the tobacco tax is based on wholesale price.

Computation of the Tax

The cigarette tax is 48¢ per pack of twenty cigarettes. The tax is paid by the distributor by purchasing stamps that are affixed to the packages. The distributors receive a discount of 1% for the first $1.5 million of stamps purchased each year and 0.6% for purchases of stamps over $1.5 million. A use and storage tax of 48¢ per pack is imposed on cigarettes that are used or stored in Minnesota, on which the tax had not previously been paid (unstamped packages).

The tobacco products tax is 35% of the wholesale price. The tax is imposed on all tobacco products, except cigarettes, and includes cigars, smoking tobacco, and chewing tobacco. The tax is paid by the distributor, who receives a discount of 1.5% of the tax. A use and storage tax of 35% of the cost is imposed on tobacco products that are used or stored in Minnesota, on which the tax had not previously been paid.

EXEMPTION

8.01 CONSUMER PURCHASES MADE OUT OF STATE

Minnesota Statutes, Sections 297F.06, Subd. 3 and 4

A use and storage tax equal to the cigarette tax is imposed on consumers in possession of cigarettes which were not previously subject to the Minnesota cigarette excise tax. Likewise, a use and storage tax equal to the tobacco products tax is imposed on consumers in possession of tobacco products not previously subject to the tobacco products tax.

For both taxes, limited quantities in the possession of a consumer are exempt from the tax if brought into Minnesota by the consumer. The exemption applies to quantities which do not exceed: 200 cigarettes; fifty cigars; ten ounces of snuff or snuff powder; and one pound of smoking or chewing tobacco or any other tobacco products.

The exemption for cigarettes was enacted in 1949, and the exemption for tobacco products was enacted in 1957. Both provisions were recodified in 1997.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	$2,700,000	$2,700,000	$2,700,000	$2,700,000

CHAPTER 9: MORTGAGE REGISTRY TAX

Collections and History

In fiscal year 1999, state revenues from the mortgage registry tax were $89.8 million. The tax is collected by each county. Three percent of the proceeds of the tax are deposited in the county revenue fund, and 97% goes to the state general fund.

Minnesota first enacted a mortgage registry tax in 1907 at a rate of 50¢ for each $100 of principal debt secured by a mortgage of real property. In 1945 the rate was changed to 15¢ for each $100 of such debt, and since 1987 the tax has been 23¢ for each $100 of principal debt.

Tax Base

The tax base is the amount of principal debt secured by a mortgage of real property within Minnesota. Only registered mortgages are within the tax base. Although similar to a mortgage in some respects, a contract for deed is not a mortgage because the debt is not secured by real property.

Computation of the Tax

The mortgage registry tax is 23¢ for each $100, or fraction thereof, of principal debt which is secured by any mortgage of real property within Minnesota and which is recorded or registered. The tax is paid by the holder of the mortgage to the county treasurer at or before the time of filing the mortgage for record or registration.

EXEMPTION

9.01 CERTAIN PERSONS AND ORGANIZATIONS

Minnesota Statutes, Section 287.04

The mortgage registry tax does not apply to mortgages taken in good faith by persons or corporations whose property is exempt from the general property tax, as specified. The exempt property includes churches, schools, colleges, hospitals, and public property used for any public purpose. The exemption also applies if the mortgagee is a fraternal benefit society.

This provision was enacted in 1907 and was last changed when it was recodified in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	$600,000	$600,000	$600,000	$600,000

CHAPTER 10: DEED TRANSFER TAX

Collections and History

State revenues from the deed transfer tax were $62.9 million in fiscal year 1999. Each county collects the tax, and 3% of the proceeds is deposited in the county revenue fund and 97% in the state general fund.

Minnesota enacted a deed transfer tax in 1961 at a rate of $1.10 for consideration of $1,000 or less plus 55¢ for each $500 in excess of $1,000. In 1967 the rates were doubled to $2.20 and $1.10. Since 1987 the rate has been $1.65 for consideration of $500 or less plus $1.65 for each additional $500.

Tax Base

The tax base for the deed transfer tax is the granting, assigning, transferring, or otherwise conveying of real estate by deed or instrument.

Computation of the Tax

When the consideration is in excess of $500, the tax is $1.65 plus $1.65 for each $500, or fractional part of $500, in excess of $500. The tax is a flat $1.65 in these situations: transfers made by instruments pursuant to mergers, consolidations, sales, or transfers of substantially all of the assets of entities pursuant to plans of reorganization; transfers made with no consideration; or transfers made with consideration of $500 or less.

The person who grants, assigns, transfers, or conveys real estate is liable for the tax. The deed or instrument cannot be recorded or registered unless the tax is paid or unless the transaction is exempt. The tax is paid to the county at the time of transfer.

EXEMPTIONS

10.01 DEEDS PARTITIONING PROPERTY OF CO-OWNERS

Minnesota Statutes, Section 287.22 (9)

A deed to or from a co-owner partitioning undivided interest in the same piece of property is exempt from the deed transfer tax.

This provision was enacted in 1984 and was recodified in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	$100,000	$100,000	$100,000	$100,000

10.02 DEEDS OF DISTRIBUTION BY PERSONAL REPRESENTATIVES

Minnesota Statutes, Section 287.22 (8)

A deed of distribution by a personal representative is exempt from the deed transfer tax.

This provision was enacted in 1975 and was recodified in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	*	*	*	*

10.03 DEEDS FOR CEMETERY LOTS

Minnesota Statutes, Section 287.22 (7)

A deed transferring one or more cemetery lots is exempt from the deed transfer tax.

This provision was enacted in 1961 and was recodified in 1999.

An estimated 25,000 cemetery lots are sold each year.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

10.04 EXCHANGE OF PERMANENT SCHOOL FUND LANDS

Minnesota Statutes. Section 287.22 (10)

A deed or other instrument issued pursuant to a permanent school fund land exchange is exempt from the deed transfer tax.

This exemption was enacted in 1991 and was recodified in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	*	*	*	*

10.05 MORTGAGE OR LIEN FORECLOSURE SALES

Minnesota Statutes, Section 287.22 (11) and (12)

A referee's or sheriff's certificate of sale in a mortgage or lien foreclosure sale is exempt from the deed transfer tax. Also exempt is a referee's, sheriff's, or certificate holder's certificate of redemption from a mortgage or lien foreclosure sale issued to the redeeming mortgagor or lien holder.

These provisions were enacted in 1993 and was recodified in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	$800,000	$900,000	$1,000,000	$1,000,000

10.06 DECREE OF MARRIAGE DISSOLUTION

Minnesota Statutes, Section 287.22 (14)

The transfer of one spouse's interest in real estate to the other spouse is exempt from the deed transfer tax if the transfer is by decree of marriage dissolution, or if the transfer is by deed or other instrument made pursuant to the decree.

This exemption was enacted in 1997 and was recodified in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Total - All Funds	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

CHAPTER 11: LAWFUL GAMBLING TAXES

Collections and History

In fiscal year 1999, revenues from the lawful gambling taxes were: $29.1 million from the tax on pull-tabs and tipboards; $2.1 million from the tax on bingo, raffles, and paddlewheels; and $31.5 million from the combined receipts tax. The proceeds from these taxes are deposited in the state general fund.

The lawful gambling tax was enacted in 1984 and covered bingo, raffles, paddlewheels, pull-tabs, and tipboards. Initially the tax was 10% of gross receipts less prizes for all types of lawful gambling. For that tax which now applies only to bingo, raffles, and paddlewheels the rate was reduced to 9.5% in 1998 and 9% in 1999.

A separate tax on pull-tabs was enacted 1986, and that tax was extended to tipboards in 1988. In 1989 an additional tax was imposed on the combined receipts of an organization from pull-tabs and tipboards. The tax rates were reduced in 1998 and 1999.

Tax Base

The tax base is lawful gambling authorized by statute.

Computation of the Tax

Lawful gambling is allowed only by qualifying organizations which are licensed by the Gambling Control Board or which are exempt from licensing by statute. The organization must be a fraternal, religious, veterans, or other nonprofit organization. Organizations which are exempt from licensing are also exempt from the tax. The profits from lawful gambling must be used for the purposes specified by statute.

The 9% lawful gambling tax covers bingo, raffles, and paddlewheels and is based on gross receipts less prizes actually paid out.

Pull-tabs and tipboards are subject to a separate tax which is 1.8% of the face resale value of all the pull-tabs or tipboards in each deal. A "deal" is defined as each separate package, or series of packages, consisting of one game of pull-tabs or tipboards. The tax is paid by the licensed distributors of pull-tabs and tipboards.

Organizations are subject to a tax on their gross receipts from pull-tabs and tipboards. The tax is imposed on the fiscal year combined receipts of the organization according to the following graduated rate schedule:

Fiscal Year Combined Receipts		Tax Rate
Not over	$500,000	0.0 %
$500,001 -	$700,000	1.8 %
$700,001 -	$900,000	3.6 %
$900,001	and over	5.4 %

EXEMPTIONS

11.01 BINGO AT CERTAIN ORGANIZATIONS

Minnesota Statutes, Sections 297E.02, Subd. 2 and 349.166, Subd. 1(b)

An exemption from the lawful gambling tax is allowed for bingo conducted within a nursing home or a senior citizen housing project or by a senior citizen organization if certain conditions are met, including: the prizes for a single bingo game do not exceed $10; total prizes awarded at a single bingo occasion do not exceed $200; and no more than two bingo occasions are held each week.

This provision was enacted in 1985 and was recodified in 1994.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

11.02 BINGO AT FAIRS AND CIVIC CELEBRATIONS

Minnesota Statutes, Sections 297E.02, Subd. 2 and 349.166, Subd. 1(a)(1)

The lawful gambling tax is not imposed on bingo conducted by an organization in connection with a county fair, the state fair, or a civic celebration. To qualify, the bingo cannot be conducted for more than twelve consecutive days in a calendar year.

This exemption was enacted in 1984 and was recodified in 1994.

About 50 organizations qualify for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

11.03 INFREQUENT BINGO OCCASIONS

Minnesota Statutes, Sections 297E.02, Subd. 2 and 349.166, Subd. 1(a)(2)

An exemption from the lawful gambling tax is allowed for bingo conducted by an organization which conducts four or fewer bingo occasions in a calendar year. This exemption does not apply if the organization holds a lawful gambling license. For example, if an organization holds a license for pull-tabs, it cannot conduct bingo under this exemption.

*Less Than $50,000

This exemption was enacted in 1984 and was recodified in 1994.

About 200 organizations qualify for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

11.04 SMALLER RAFFLES

Minnesota Statutes, Sections 297E.02, Subd. 2 and 349.166, Subd. 1(c)

If the value of all raffle prizes awarded by an organization in a calendar year does not exceed $750, then the raffles of that organization are exempt from the lawful gambling tax.

This provision was enacted in 1984 and was last changed when it was recodified in 1994.

About 450 organizations benefit from this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	*	*	*	*

11.05 RAFFLES BY CERTAIN ORGANIZATIONS

Minnesota Statutes, Sections 297E.02, Subd. 2 and Subd. 349.166, Subd. 3

The lawful gambling tax does not apply to a raffle conducted by an organization that delivers health or social services and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The prizes awarded in the raffle must be real or personal property donated by an individual, firm, or other organization.

This exemption was enacted in 1984 and was recodified in 1994.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$300,000	$300,000	$300,000	$300,000

*Less Than $50,000

11.06 LAWFUL GAMBLING UNDER CERTAIN CONDITIONS

Minnesota Statutes, Sections 297E.02, Subd. 2 and 349.166, Subd. 2

Lawful gambling is exempt from the lawful gambling taxes if certain conditions are met, including that the organization conducts lawful gambling on five or fewer days in a calendar year and the organization does not award more than $50,000 in prizes for lawful gambling in a calendar year.

This exemption was enacted in 1986 and was recodified in 1994.

About 800 organizations qualified for this exemption in 1998

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$700,000	$700,000	$700,000	$700,000

CHAPTER 12: INSURANCE PREMIUMS TAXES

Collections and History

In fiscal year 1999, the revenues from the insurance premiums taxes totaled $180 million. The proceeds from the taxes on health maintenance organizations and nonprofit health service plan corporations are deposited in the health care access fund; the proceeds from the other taxes are deposited in the state general fund. Aids are paid to local fire and police departments based on the amount of tax on certain types of insurance.

A tax on insurance premiums was first enacted in Minnesota in 1868 at a rate of 2% of the premiums received by foreign (non-Minnesota) insurance companies. In 1872 the tax was extended to domestic (Minnesota) companies. The basic rate remains at 2%.

In 1913 the fire marshal tax was enacted at a rate of 0.375%, and the rate was increased to the current 0.5% rate in 1937. In 1934 a surcharge was enacted at a rate of 2% on fire, lightning, and sprinkler leakage premiums on property located in cities of the first class. The rate remains at 2% and the surcharge is in addition to other taxes. A tax on surplus lines insurance premiums was enacted in 1963 at a rate of 2%, and the rate was increased to the current 3% rate in 1978.

In 1992 a tax of 1% was enacted on the premiums of health maintenance organizations and nonprofit health service plan corporations as part of the funding for the MinnesotaCare program. The tax went into effect on January 1, 1996. In 1997 the imposition of this tax was made contingent on certain conditions (Item 12.04).

Tax Base

For purposes of this study, the tax base is defined as gross premiums less return premiums received by domestic and foreign insurance companies on all direct business in Minnesota.

Computation of the Tax

The 2% premiums tax is imposed on the gross premiums less return premiums received by domestic and foreign insurance companies on all direct business in Minnesota. A domestic company is one which is incorporated in Minnesota and a foreign company is one which is incorporated in another state or country. Reduced rates apply to smaller mutual property and casualty insurance companies.

The 0.5% fire marshal tax is imposed on the gross fire premiums and assessments less return premiums received by the company in Minnesota. Every insurance company must pay this tax, with the exception of farmers' and township mutual fire insurance companies.

The amount of premiums tax paid, except for the surcharge, is allowed as a credit against the corporate franchise tax for companies required to file corporate franchise tax returns. A credit is allowed against both the insurance premiums tax and the corporate franchise tax for guaranty association assessments.

EXEMPTIONS

12.01 FRATERNAL BENEFIT SOCIETIES

Minnesota Statutes, Section 64B.24

Fraternal benefit societies or associations are exempt from the Minnesota gross premiums tax. These societies are nonprofit, charitable organizations which provide life, sickness and/or accident benefits for their members.

This exemption was enacted in 1907 and was last changed in 1985.

Forty-two fraternal benefit societies did business in Minnesota in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$3,900,000	$4,000,000	$4,100,000	$4,200,000

12.02 FARMERS' MUTUAL AND TOWNSHIP MUTUAL FIRE INSURANCE COMPANIES (FIRE MARSHAL TAX)

Minnesota Statutes, Section 299F.21, Subd. 1

Farmers' mutual and township mutual insurance companies are exempt from the fire marshal tax. All other insurance companies doing business in Minnesota are required to pay the tax which is 0.5% of gross fire insurance premiums and assessments received annually on all direct business in Minnesota.

This exemption was enacted in 1915 and was last changed in 1987.

Approximately 100 insurance companies receive this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$200,000	$200,000	$200,000	$200,000

12.03 MINNESOTA COMPREHENSIVE HEALTH INSURANCE PLAN PREMIUMS

Minnesota Statutes, Section 62E.13, Subd. 10

The Minnesota Comprehensive Health Association (MCHA) was established by state law to provide health insurance coverage to high risk persons. Premiums received by the writing carrier for the MCHA plan are exempt from the 2% gross premiums tax.

This exemption was enacted in 1976 as part of the MCHA legislation. The exemption was repealed in 1987 but was re-enacted in 1988.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$1,000,000	$1,000,000	$1,000,000	$1,000,000

EXEMPTION/REDUCED RATE

12.04 HEALTH MAINTENANCE ORGANIZATIONS AND NONPROFIT HEALTH SERVICE PLAN CORPORATIONS

Minnesota Statutes, Section 60A.15, Subd. 1

Several sources of revenue fund Minnesota's health care access program, MinnesotaCare. The imposition of the premiums tax on health maintenance organizations and nonprofit health service plan corporations depends on a determination by the Commissioner of Finance of the projected balance in the health care access fund. If it is determined that there will be a deficit in the fund, the tax will be imposed at one of these rates: 0.25%, 0.5%, 0.75%, or 1%. The estimates assume that the tax will not be imposed until January 1, 2001, at which time it will be imposed at the 1% rate.

The tax expenditure measures the exemption for the year 2000 and the 1% tax thereafter compared to the 2% tax that applies generally to insurance premiums.

An exemption from the premiums tax for nonprofit health service plan corporations was enacted in 1971, and an exemption for health maintenance organizations was enacted in 1973. A 1% premiums tax was enacted on these entities in 1992, effective January 1, 1996, and was imposed in 1996 and 1997. In 1997 provisions were enacted which made the tax contingent on cost containment goals for 1998 and 1999 and, for years after 1999, on the balance in the health care access fund.

Ten health maintenance organizations and three nonprofit health service plan corporations do business in Minnesota.

	Fiscal Year Impact			
	2000	2001	2002	2003
Health Maintenance Organizations	$41,700,000	$31,500,000	$22,600,000	$23,500,000
Nonprofit Health Service Plan Corporations	$15,700,000	$11,900,000	$8,500,000	$8,900,000
Total - Health Care Access Fund	$57,400,000	$43,400,000	$31,100,000	$32,400,000

REDUCED RATES

12.05 SMALLER MUTUAL PROPERTY AND CASUALTY INSURANCE COMPANIES

Minnesota Statutes, Section 60A.02 Subd. 4 and 60A.15, Subd. 1(e)(2) and (3)

The gross premiums tax rate imposed on certain mutual property and casualty insurance companies is either 1% or 1.26% rather than the 2% rate imposed on insurance companies generally.

A tax rate of 1% applies to the premiums of farmers' mutual and township mutual insurance companies and to mutual property and casualty insurance companies with total assets of $5 million or less. A tax rate of 1.26% applies to the premiums of other mutual property and casualty companies with total assets of $1.6 billion or less on December 31, 1989.

From 1905 to 1987, mutual property and casualty insurance companies paid the 2% gross premiums tax only on their fire, lightning, and sprinkler leakage premiums and were exempt from paying the tax on all other types of premiums. In 1987 the exemption was repealed so that they were subject to the 2% tax on all their premiums. In 1988 the rate of tax was reduced to 1.5% for 1988, 1% for 1989 through 1991, and 0.5% for 1992 and after. In 1995 the rate was increased from 0.5% to either 1% or 1.26%, depending upon the type and size of the company.

The reduced rates apply to about 145 mutual insurance companies.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$4,900,000	$5,000,000	$5,200,000	$5,400,000

CREDIT

12.06 CREDIT FOR GUARANTY ASSOCIATION ASSESSMENTS

Minnesota Statutes, Section 60A.15, Subd. 15

An insurance company is allowed a credit against the premiums tax based on guaranty association assessments paid in one or more prior years.

When an insurance company becomes insolvent, any amounts that remain unpaid to its policyholders are paid through assessments that are imposed on solvent companies by a guaranty association. One guaranty association is authorized by Minnesota law to make assessments for property and casualty companies and another for life and health companies.

When an insurance company pays an assessment to either of these associations, a credit equal to 20% of the assessment is allowed for each of the five calendar years following the year in which the assessment was paid. Therefore, the credit allows the company to recover the total of any assessment over the next five years.

A similar credit is allowed against the corporate franchise tax (Item 2.43). If the credit exceeds the greater of the company's corporate franchise tax or premiums tax for that year, the excess may be carried forward.

Beginning in 1999, the total amount of credits allowed to all companies is restricted if the total guaranty assessments levied over the preceding five years exceed the sum of revenues from the premiums tax and the corporate franchise tax on insurance companies in the preceding year.

The credit was enacted in 1994. It applies to assessments for insolvencies of property and casualty companies which occur after July 31, 1994, and to assessments made after July 31, 1994, for life and health companies.

	Fiscal Year Impact			
	2000	2001	2002	2003
State General Fund	$3,400,000	$2,600,000	$2,200,000	$2,100,000

CHAPTER 13: PROPERTY TAX

Collections and History

Net property tax collections were $4.6 billion for property taxes payable in 1999. The property tax is collected by the counties and is distributed to the local units of government which impose the tax - counties, cities, townships, school districts, and special taxing districts. Although the property tax is entirely a local source of revenue, nearly all aspects of the tax are controlled by state statute.

The property tax was already in place when the first book of statutes was compiled for the Territory of Minnesota in 1851. The classification system was enacted in 1913 with four classes of property. In 1933 the number of classes was expanded to provide preferential treatment for homestead property, both platted and unplatted.

In 1967 the state property tax levy was eliminated, and a portion of the revenues from the newly-enacted sales tax was distributed to local units of government. The state-paid homestead credit, the rent credit, and the senior citizen credit also were enacted in 1967.

Changes in the treatment of business personal property began in 1967 when livestock and farm machinery were exempted, and businesses were given the option to have either their inventories or their tools and machinery exempted. In 1971 the exemption for business property was expanded to include both inventories and tools and machinery. Commercial and industrial equipment attached to and considered as real property, known as attached machinery, was exempted in 1973.

In 1971 levy limitations and local government aids were enacted which were important in determining the amount of the property tax levy. Modifications have been made to both of these programs since that time. Beginning with taxes payable in 1993, the general levy limit for county and city governments was repealed, and a "truth-in-taxation" system of reporting proposed levies to taxpayers and conducting levy hearings was established. In 1997 levy limitations were reinstated for counties and for cities with population over 2,500, and these limitations are in effect through taxes payable in 2000.

In 1988 several provisions were enacted that significantly altered some of the features of the property tax system. Assessed value, calculated by multiplying classification percentages times estimated market value, was replaced by tax capacity. Tax capacities are based on class rates applied to market values, and local tax rates now are expressed as percentages of total tax capacity in a taxing area, rather than as mill rates. Agricultural credit and state-paid homestead credit were replaced by homestead and agricultural credit aid in 1990. Disparity reduction aid began in 1989 and provides aid to areas with high tax rates.

In 1991 a change was enacted which specified that referendum levies are spread against market value instead of tax capacity. Beginning with taxes payable in 1995 for schools and in 1997 for other local governments, the market value against which referendum levies are spread is reduced for certain agricultural property. The resulting value is referred to as referendum market value

Tax Base

For purposes of this study, the tax base for the property tax is the market value of real property. Generally, market value is the estimated selling price of the property. Other approaches to determining market value are considered to be substitutes for selling price and, therefore, are not considered to be tax expenditures.

It should be noted that the impact of a property tax expenditure affects the *distribution* of the tax rather than the total *yield* of the tax. The fiscal year impact represents a shift in tax burden rather than a reduction in revenue. This effect occurs because of the way in which the property tax is computed.

Computation of the Tax

For the property tax, the taxable amount (tax capacity, which is market value times the class rate, or referendum market value) is determined by statute. The total yield of the tax is determined by the unit of government which imposes the tax. The governing body of the local unit, such as the school board, the county board, or the city council, determines the amount of the levy and in so doing must take into account many factors, including the level of services provided, mandated programs, debt service, any levy limitations, and other sources of revenue such as local government aids. Since 1990, the county auditors also subtract the homestead and agricultural credit aid, disparity reduction aid, and equalization aid from the levies certified by taxing districts to determine the final levy based on tax capacity.

The final levy based on tax capacity is divided by the total taxable tax capacity of the taxing district to determine the district's local tax rate. For each parcel, the tax capacity is multiplied by the aggregate local tax rate of the county, city or township, school district, and any special taxing districts to determine the gross tax. An exemption, class rate, or other preferential provision lowers the total tax capacity and results in a higher local tax rate applicable to all taxable property. Although the total yield from the tax is not affected, the tax is shifted from preferential to nonpreferential property.

The final referendum levy is divided by referendum market value to determine the district's local referendum market value tax rate. For each parcel, the referendum market value is multiplied by the referendum tax rate for the school district and any other district applicable to that property. The referendum and tax capacity taxes are combined to obtain the total gross tax on the parcel.

Net tax is determined by subtracting from gross tax any applicable credits, including disaster credit, power line credit, agricultural preserves credit, enterprise zone credit, disparity reduction credit, education homestead credit, taconite homestead credit, and supplemental homestead credit.

Additional tax relief is provided to qualifying homeowners and renters through the property tax refund. The property tax refund is based on the net homestead tax or 19% of rent and on household income, with the amount of refund phasing out as income increases. Another special refund is available to homeowners whose net property tax increases by more than a set percentage from the previous year. These refunds are paid directly to the claimants by the state.

EXEMPTIONS

13.01 EXEMPT REAL PROPERTY

Minnesota Statutes, Sections 272.02, Subd. 1 and 273.18

Certain types of property are exempt from the property tax by statute, and they are included in the estimates below. Certain other types of property are exempt under either the Minnesota Constitution or federal law, and their exemption is not included in the tax expenditure estimates. These properties are churches, academies, colleges, universities, and Indian reservations.

Since 1926 the county assessors have been required to value exempt real property every six years. The most recent valuation of exempt property took place in 1998. The estimates are based on the 1998 values with growth assumed in the subsequent years. The values were multiplied by a class rate of 3.5% for taxes payable in 1999 and 3.4% for 2000, 2001, and 2002. A statewide average tax capacity rate was computed or estimated for each year to arrive at the estimated net property tax figures shown below. In computing the estimates, the tax capacity rates were adjusted to take into account the additional taxable value which would result if the property were not exempt.

Most types of personal property are also exempt, but exempt personal property is not required to be valued. Therefore, the estimates reflect only real property. Exempt personal property includes household goods, commercial and industrial personal property (tools, machinery, inventories), farm machinery and livestock, agricultural products, and attached machinery.

Certain types of property have been exempt from taxation since at least 1851 when the first book of statutes was compiled for the Territory of Minnesota. The exempt property provisions were last changed in 1999.

	Fiscal Year Impact			
Type of Property	2000	2001	2002	2003
Elementary and secondary schools	$327,900,000	$326,900,000	$346,500,000	$360,300,000
Public burying grounds	8,100,000	8,100,000	8,500,000	8,900,00
Hospitals	92,400,000	92,100,000	97,600,000	101,500,000
Charitable institutions	47,700,000	47,500,000	50,400,000	52,400,000
Federal and state forests, parks, and wildlife refuges	13,900,000	13,900,000	14,700,000	15,300,000
Public property used for public purposes	455,500,000	454,100,000	481,200,000	500,500,000
Total	$945,500,000	$942,600,000	$998,900,000	$1,038,900,000

13.02 LIMITED MARKET VALUE

Minnesota Statutes, Section 273.11, Subd. 1a

Annual increases in market value are limited by formula for property classified as residential homestead or nonhomestead, agricultural homestead or nonhomestead, or noncommercial seasonal recreational residential. The amount of increase is limited to the greater of: 8.5% of the value in the preceding year's assessment; or 15% of the difference between the current assessment and the preceding assessment. Value increases due to improvements are not eligible for limitation. This provision will be in effect through assessment year 2001.

Limited market value was enacted in 1993 and was last changed in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Limited Market Value	$17,700,000	$25,000,000	$32,700,000	$43,100,000

13.03 CERTAIN IMPROVEMENTS TO OLDER HOMES

Minnesota Statutes, Section 273.11, Subd. 16

Improvements to older homes may be fully or partially excluded from the value of property for up to ten years, if certain conditions are met. The property must be a homestead at least 45 years old at the time of the improvement, and a building permit must have been issued for the improvement. The estimated market value of the house must be less than $400,000, and the improvements must add at least $5,000 to the value of the property. The exclusion applies to improvements made before January 2, 2003.

For a home at least 70 years old, the value added by the improvements is excluded, up to a maximum of $50,000. For a home from 45 to less than 70 years old, the exclusion is equal to 50% of the value added by the improvements, up to a maximum exclusion of $25,000.The exclusion terminates ten years after the improvement is made or sooner if the property is sold or is reclassified as nonhomestead. After termination, 20% of the excluded value is added back in each of the five subsequent years if the excluded value exceeds $10,000. Otherwise the excluded value is added back in equal parts in two years.

This provision, known as "This Old House", was enacted in 1993 and was last changed in 1999.

Approximately 37,100 properties benefited from this provision for taxes payable in 1998. Some of the eligibility requirements have changed since then.

	Fiscal Year Impact			
	2000	2001	2002	2003
Certain Improvements to Older Homes	$6,200,000	$8,600,000	$11,900,000	$16,400,000

PREFERENTIAL VALUATIONS

13.04 CLASSIFICATION SYSTEM

Minnesota Statutes, Section 273.13

Each parcel of taxable property is classified by type. The market value of the property is multiplied by the appropriate class rate(s), depending upon the type of property.

Due to the classification system, some types of property are treated preferentially compared to other types of property. The classification system is considered a tax expenditure because properties with the same market value are not treated the same.

To illustrate the impact of the classification system, it was assumed that, instead of having many different class rates, all types of property would be subject to the same rate. The estimates reflect the difference in tax that would result from uniform treatment. The sum of the increases and decreases does not equal zero due to lower tax increment finance levies and an increase in the credits on some types of property.

The first section of the table below includes types of property that benefit from the classification system. The positive dollar amounts are the tax expenditures, that is, the tax increases that would occur if one class rate applied to all types of property. The negative amounts are not tax expenditures but show the other side of the shifts in tax burden.

The property tax classification system was enacted in 1913 and was last changed in 1999.

	Fiscal Year Impact			
Type of Property	2000	2001	2002	2003
Residential Homestead 1st Tier	$502,000,000	$444,000,000	$444,000,000	$444,000,000
Residential Nonhomestead	8,200,000	7,400,000	7,400,000	7,400,000
Farm Homestead	82,000,000	156,500,000	156,500,000	156,500,000
Farm Nonhomestead	(18,400,000)	6,500,000	6,500,000	6,500,000
Timber	200,000	1,200,000	1,200,000	1,200,000
Seasonal Recreational Commercial	(300,000)	300,000	300,000	300,000
Subsidized Housing	(1,100,000)	3,000,000	3,000,000	3,000,000
Seasonal Recreational Residential	(6,800,000)	6,700,000	6,700,000	6,700,000
Residential Homestead 2nd Tier	(24,200,000)	(6,300,000)	(6,300,000)	(6,300,000)
Commercial/Industrial				
1st Tier	(52,000,000)	(59,600,000)	(59,600,000)	(59,600,000)
2nd Tier	(458,700,000)	(519,700,000)	(519,700,000)	(519,700,000)
Public Utility	(41,300,000)	(57,800,000)	(57,800,000)	(57,800,000)
Apartments	(67,200,000)	(73,800,000)	(73,800,000)	(73,800,000)
Railroad	(9,100,000)	(9,800,000)	(9,800,000)	(9,800,000)
Mineral	(200,000)	(100,000)	(100,000)	(100,000)
Personal	(66,900,000)	(70,600,000)	(70,600,000)	(70,600,000)

13.05 GREEN ACRES TREATMENT OF AGRICULTURAL LAND

Minnesota Statutes, Section 273.111

The Minnesota Agricultural Property Tax Law, known as "green acres", provides for preferential and deferred assessment of qualifying agricultural land consisting of ten or more acres. A qualifying parcel is valued according to its agricultural use rather than a higher value that would result from nonagricultural use.

When green acres property no longer qualifies as such or is sold, a tax is due equal to the amount by which the preferential valuation has reduced the property tax for the previous three years.

The estimates below show the increase in net property tax that would result from valuing the green acres property at its highest and best use, as opposed to its agricultural use, computed with the municipal average tax rate.

This provision was enacted in 1967 and was last revised in 1999.

In 1999 approximately 1,260,000 acres received green acres treatment.

	Fiscal Year Impact			
	2000	2001	2002	2003
Green Acres	$14,900,000	$17,600,000	$20,800,000	$24,600,000

13.06 OPEN SPACE PROPERTY

Minnesota Statutes, Section 273.112

Private recreational, social, open space, and park land is given preferential valuation and tax deferment as long as it meets certain criteria. For property tax purposes, the property is valued at its current use rather than at a higher value that would reflect its potential use. Golf courses are the primary beneficiaries of this provision, but ski areas and archery and firearms ranges also qualify.

When the open space property no longer qualifies for preferential valuation, taxes are due equal to the amount by which the preferential valuation reduced the tax for the previous seven years.

The Minnesota Open Space Property Tax Law was enacted in 1969. Several changes have been made since enactment, many relating to ensuring equal access. This provision was last changed in 1998.

About 300 parcels of property receive preferential valuation under this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
Open Space Property	$4,300,000	$5,200,000	$5,300,000	$5,400,000

13.07 METROPOLITAN AGRICULTURAL PRESERVES LAND

Minnesota Statutes, Section 473H.10

Agricultural land in the seven-county metropolitan area is eligible for preferential valuation if it is within an agricultural preserve. To qualify, the owner of land that is in long term agricultural use must apply to and receive approval from the local unit of government that exercises planning and zoning authority for the land. With certain exceptions, the land must be at least forty acres and must be used in the production for sale of agricultural products. Wetlands, pasture, and woodlands accompanying such land also qualify.

Agricultural preserve land is valued solely according to its agricultural use, rather than at a higher value that would reflect its potential use. A tax credit is also allowed (Item 13.12).

The owner must sign a covenant that the land will remain in agricultural use. The preferential valuation continues indefinitely, even if ownership changes. The expiration of an agricultural preserve can not take place until eight years after an expiration notice is filed. Previous tax reductions are not repaid.

The Metropolitan Preserves Act was adopted in 1980, effective for taxes payable in 1983 and after. It was last amended in 1994.

Preferential valuation was given to approximately 260,000 acres in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Metropolitan Agricultural Preserves	$2,700,000	$2,900,000	$3,100,000	$3,300,000

13.08 TAX INCREMENT FINANCING

Minnesota Statutes, Sections 469.174 to 469.179

Tax increment financing allows the increase in property taxes attributable to increased value to be used for development costs. The tax expenditure is equal to the levy that goes to the tax increment district rather than the general property tax.

A tax increment financing district can be established by an authorized entity, such as a municipality or a housing and redevelopment authority, to finance economic development, housing, redevelopment, or other projects. Bonds may be issued for specified costs of the project, or the local authority and the developer may enter into a "pay-as-you-go" financing agreement. In such an agreement, the developer initially incurs all or a portion of the developmentcosts, and the authority then reimburses the developer out of the available tax increments over a period of years.

The original value of the property is certified when the district is established. An amount equal to the property tax on the current-year market value is imposed on the property, but only the portion based on its original value actually is used for the general property tax. The difference is used to pay debt service on the bonds or to reimburse development costs based on an agreement. The duration of a district is limited to a specified number of years, depending upon the type of project.

After the project debt is paid or the district expires, whichever comes first, the property is subject to the regular tax on its market value.

The preferential treatment was enacted in 1947 and was last amended in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Tax Increment Financing	$290,900,000	$297,600,000	$308,300,000	$319,400,000

PREFERENTIAL COMPUTATIONS

13.09 AUXILIARY FOREST TAX AND TREE GROWTH TAX

Minnesota Statutes, Sections 88.47 to 88.53 and 270.31 to 270.39

Forest land is taxed under the general property tax unless the owner applies to be taxed under the auxiliary forest tax or the tree growth tax. The estimates reflect the amount by which the auxiliary forest tax or the tree growth tax is lower than the general property tax would be for those properties.

To be classified as an auxiliary forest, the property must be either a minimum of 35 acres suitable for forestation or a wood lot of from five to forty acres. Qualifying land was designated an auxiliary forest upon application by the owner and approval by the county board. A 1974 law prohibited new auxiliary forest contracts from being issued or existing contracts from being extended after June 30, 1974. The auxiliary forest tax applies for the duration of the contract and when a contract expires, the land automatically is enrolled in the tree growth tax program.

The auxiliary forest tax is 10¢ per acre of land plus a yield tax of from 40% to 10% of the value of the timber, the rate determined by the year of the harvest in relation to the contract period.

To qualify for the tree growth tax, the property must be a minimum of five acres of forest lands used exclusively for the growing of continuous forest crops. The owner must apply to and receive approval from the county board to have qualifying property taxed under the tree growth tax.

The tax rates for the tree growth tax depend upon the type of property involved. Commercial forests pay an annual tax of 30% of the value of annual growth. Temporarily nonproductive forests are taxed at 5¢ per acre or 15¢ per acre for noncompliance with a reforestation agreement. Permanently nonproductive forest lands are taxed at 5¢ per acre.

The auxiliary forest tax was enacted in 1927. The tree growth tax was enacted in 1957.

Approximately 750,000 acres were taxed under these two programs in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
Auxiliary Forest Tax	$100,000	$100,000	$100,000	$100,000
Tree Growth Tax	1,000,000	1,100,000	1,100,000	1,200,000
Total	$1,100,000	$1,200,000	$1,200,000	$1,300,000

CREDITS

13.10 TACONITE HOMESTEAD CREDIT

Minnesota Statutes, Section 273.135

Homestead property within the defined taconite tax relief areas of Minnesota receives a credit against the property tax. Within certain municipalities, the credit is 66% of the net tax, with a maximum credit per homestead of $315.10. Elsewhere, the credit is 57% of the net tax, with a maximum of $289.80.

Taconite mining companies pay the taconite production tax in lieu of the property tax. Most of the proceeds from the production tax are distributed as aid payments to local governments in the taconite tax relief area because the land, buildings, and equipment used in connection with taconite mining, quarrying, or production are not subject to the property tax. The taconite homestead credit is funded from the taconite production tax to provide property tax relief to owner-occupied homes and farms in the taconite tax relief area.

The taconite homestead credit was enacted in 1969 and was last changed in 1998.

Approximately 56,400 homesteads received this credit in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
Taconite Homestead Credit	$14,700,000	$14,700,000	$14,700,000	$14,700,000

13.11 POWER LINE CREDIT

Minnesota Statutes, Sections 273.42 and 273.425

The owner of qualifying property, such as a residence or a farm, receives a property tax credit if the property is crossed by an electric transmission line of 200KV or more which was constructed after July 1, 1974. The credit is limited to 20% of the gross property tax for the parcel. If the parcel exceeds forty acres, the maximum credit is 20% of a portion of the tax. The credit is financed by a portion of the property taxes paid by the transmission lines giving rise to the credit.

The power line credit was enacted in 1979 and was last changed in 1990.

About 1,880 parcels received this credit in 1998.

	Fiscal Year Impact			
	2000	2001	2002	2003
Power Line Credit	$100,000	$100,000	$100,000	$100,000

13.12 AGRICULTURAL PRESERVES CREDIT

Minnesota Statutes, Section 473H.10

A credit against the property tax is allowed for agricultural land and nonresidential buildings in the metropolitan agricultural preserves program.The credit is based on the difference in tax computed at the local tax rate and the tax computed at 105% of the previous year's statewide average local tax rate for property in townships. The minimum credit is $1.50 per acre.

Agricultural preserve land is also allowed preferential valuation (Item 13.07, which includes an explanation of the agricultural preserves program).

The credit was enacted as part of the metropolitan agricultural preserves program in 1980. The $1.50 minimum was enacted in 1993.

In 1998 the credit was allowed for approximately 200,000 acres.

	Fiscal Year Impact			
	2000	2001	2002	2003
Agricultural Preserves Credit	$300,000	$300,000	$300,000	$300,000

13.13 CONSERVATION TAX CREDIT

Minnesota Statutes, Section 273.119

A credit of $1.50 per acre is allowed against the property tax for land located in an agricultural preserve created under Minnesota Statutes, Chapter 40A. This program is for counties outside the seven-county metropolitan area.

This credit was enacted in 1986 and was last amended in 1990.

In 1998, the credit was allowed for 138,000 acres.

	Fiscal Year Impact			
	2000	2001	2002	2003
Conservation Tax Credit	$200,000	$200,000	$200,000	$200,000

CHAPTER 14: AIRFLIGHT PROPERTY TAX

Collections and History

Revenues from the airflight property tax were $8.7 million in fiscal year 1999. The proceeds from this tax go to the state airports fund.

The airflight property tax was enacted in 1945. Originally the assessment ratio was 40%, but it was reduced to 33 1/3% in 1953. In 1987 the one assessment ratio was replaced by a schedule of ratios, and the use of the statewide average property tax mill rate was replaced by a revenue yield for each year specified by statute and the tax rate determined therefrom. In 1992 the calculation of the tax rate was changed to yield the difference between the total state airports fund appropriation and the fund revenues from other sources.

Tax Base

The tax base is the value of airflight property of airline companies engaged in air commerce.

Because the yield of the tax is a fixed amount for each year, the tax expenditure estimates represent a shift in tax rather than a revenue loss.

Computation of the Tax

The property subject to the tax is the aircraft and flight equipment, including spare flight equipment, of airline companies. Airline companies are defined as those that engage in the business of air commerce, and air commerce is defined as the transportation by aircraft of persons or property for hire on flights by airline companies operating under authorization of the United States Department of Transportation.

Privately-used aircraft are subject to the aircraft registration tax (Chapter 16) and not the airflight property tax. A privately-used aircraft that is used occasionally in transportation for hire is not subject to the airflight property tax if the person furnishing the transportation is not in the business of transportation for hire.

The value of the airflight property is determined by the Department of Revenue. The value is apportioned to Minnesota by a three-factor formula. The apportioned value is multiplied by a tax capacity rate according to the following schedule:

40% for quiet aircraft (Item 14.02)
70% for other airflight property
50% of the above rates for the airflight property of certain airlines (Item 14.03)

The tax capacity is multiplied by a tax rate which is determined by dividing the revenue needed for the state airports fund by the total tax capacity. For taxes payable in 1999 the tax rate was approximately 4.58%.

The tax is paid by the airline company to the Department of Revenue.

Under a provision in the Minnesota Constitution, the airflight property tax is in lieu of other property taxes on airflight property. Therefore, airflight property is exempt from the local property tax. However, the property tax does apply to the other property of an airline company.

PREFERENTIAL COMPUTATION

14.01 COMMUTER AIRLINES

Minnesota Statutes, Sections 270.072, Subd. 2 and 360.521

Generally, commercial aircraft are taxed under the airflight property tax, and noncommercial aircraft are taxed under the aircraft registration tax. However, commuter airlines have the option of having their aircraft taxed under one tax or the other, whichever is lower.

Because commuter airlines could be considered commercial, the exemption of commuter airlines from the airflight property tax is considered a tax expenditure. The estimates reflect the difference between the aircraft registration tax paid by commuter airlines and the airflight property tax they would pay if subject to that tax.

This provision was enacted in 1969.

About 45 aircraft have a reduced tax due to this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State Airports Fund	$100,000	$100,000	$100,000	$100,000

PREFERENTIAL VALUATIONS

14.02 QUIET AIRCRAFT

Minnesota Statutes, Section 270.074, Subd. 3(a)

Airflight property is generally assessed at 70% of market value for the airflight property tax. However, quiet aircraft are assessed at 40% of market value. Aircraft owned by certain airlines are assessed at 35% of market value, but quiet aircraft of these companies are assessed at 20%. The tax expenditure is measured as the difference in tax between the 40% and 70% tax capacity rates (the difference between 20% and 35% for certain airlines).

Quiet aircraft include turboprops and aircraft defined as stage III by the Federal Aeronautics Administration. The classification may be extended to other types of qualifying aircraft through rules adopted by the commissioner of Revenue.

This provision was enacted in 1987.

Thirty-three airline companies had qualifying quiet aircraft for taxes payable in 1999.

	Fiscal Year Impact			
	2000	2001	2002	2003
State Airports Fund	$300,000	$200,000	$200,000	$200,000

14.03 CERTAIN AIRLINES

Minnesota Statutes, Section 270.074, Subd. 3(b)

Quiet aircraft are assessed at 40% of market value and other airflight property is assessed at 70% of market value. If the airflight property is owned by a qualifying airline, the tax capacity rate is 50% of the above rates (20% for quiet aircraft and 35% for other airflight property).

In order for an airline to qualify, the majority of the aircraft that it owns or leases must be turboprops, and the airline company must provide scheduled passenger service to three or more airports that serve cities or towns with a population of 100,000 or less outside the seven-county Minneapolis-St. Paul metropolitan area.

This provision was enacted in 1987.

Four airline companies qualify under this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State Airports Fund	$1,100,000	$1,100,000	$1,100,000	$1,100,000

CHAPTER 15: MOTOR VEHICLE REGISTRATION TAX

Collections and History

In fiscal year 1999, a total of $548 million in motor vehicle registration tax was collected. All the proceeds from this tax are deposited in the highway user tax distribution fund.

A motor vehicle registration tax was first enacted in 1911 at a rate of $1.50 per vehicle. In 1921 a tax of 2% of value was enacted, with the minimum tax determined by the weight category of the passenger car or truck.

From 1921 to 1949 the tax was based primarily on value. In 1949 a tax based solely on weight was adopted, and for trucks the tax continues to be determined by weight. For passenger cars, however, a tax of $10 plus 1.25% of the base value was adopted in 1971 and remains in effect. The last major change to the tax was a change in the depreciation schedule in 1989.

Tax Base

The tax base for the motor vehicle registration tax is motor vehicles that use the public streets and highways in Minnesota. The exemption of off-road vehicles, such as farm machinery, is therefore not considered to be a tax expenditure.

The tax on passenger cars is based on value, and the tax on trucks and buses is based on weight. Although arguments could be made for using either the weight system or the value system in the definition of the tax base, for purposes of this study one system is considered to be a replacement for the other. Therefore, neither the weight system nor the value system is considered to be a tax expenditure.

Computation of the Tax

The tax on passenger cars, pickup trucks, and vans is $10 plus 1.25% of the base value. Base value is the manufacturer's suggested retail price, including destination charges but excluding separately-stated options. The percentage of base value used to compute the tax decreases with the age of the vehicle, as follows: 100% in the first and second year of vehicle life; 90% in the third and fourth year; 75% in the fifth and sixth year; 60% in the seventh year; 40% in the eighth; 30% in the ninth; and 10% in the tenth year.

The flat tax for vehicles over ten years old and the minimum tax for all vehicles are both $35 ($10 plus $25 minimum additional tax).

The tax on trucks, tractors, and buses is based on the type, weight, and age of the vehicle. A minimum tax applies, the amount of which is determined by the type of vehicle.

The tax is paid when the vehicle is first registered and annually thereafter upon renewal.

EXEMPTIONS

15.01 LOCAL GOVERNMENT VEHICLES

Minnesota Statutes, Section 168.012, Subd. 1, 6, and 10

Vehicles owned or leased by a political subdivision of the state are exempt from the motor vehicle registration tax. Exempt vehicles include ambulances, fire equipment, utility fleets, police vehicles, and buses owned by city transit companies. Publicly-owned school buses are estimated separately in Item 15.02.

The exemption for government vehicles was enacted in 1921 and was last changed in 1996.

An estimated 25,000 vehicles qualify for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$5,600,000	$5,800,000	$6,000,000	$6,200,000

15.02 SCHOOL BUSES

Minnesota Statutes, Section 168.012, Subd. 1(a)(2) and 10

Vehicles owned and used by educational institutions for the sole purpose of transporting students to and from those institutions are exempt from the motor vehicle registration tax.

Publicly owned or leased buses other than school buses are included in the exemption for government vehicles (Item 15.01). Privately-owned school buses used exclusively for student transportation under contract with a school district are not exempt but are taxed at a preferential rate (Item 15.09).

This exemption was enacted in 1933 and was extended to leased vehicles in 1982.

In 1998 about 5,500 buses qualified for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$500,000	$500,000	$500,000	$500,000

15.03 NONRESIDENT MILITARY PERSONNEL

Minnesota Statutes, Section 168.04, Subd. 1

Vehicles of nonresident military personnel stationed in Minnesota are exempt from the motor vehicle registration tax if they meet the following four conditions: the vehicle is properly registered in another state; the owner is a resident of the state in which the vehicle is registered; the vehicle is used only for the owner's personal transportation; and the vehicle is subject to all other provisions of law applicable to vehicles owned by Minnesota residents.

This provision was enacted in 1967 and was last changed in 1981.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

15.04 MEDAL OF HONOR RECIPIENTS AND FORMER PRISONERS OF WAR

Minnesota Statutes, Sections 168.124, 168.125, and 168.031

Congressional medal of honor recipients may obtain special license plates with "Medal of Honor" on them, and former prisoners of war may obtain special license plates with "EX-POW" on them. In each case, the recipient is issued these plates, as well as all subsequent tabs, stickers, or replacement plates, free of any charges or tax.

The exemption for medal of honor recipients was enacted in 1983; the exemption for former prisoners of war was enacted in 1993.

Approximately 500 vehicles qualify for these exemptions.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

15.05 DISABLED VETERANS

Minnesota Statutes, Section 168.031

Any motor vehicle which has been paid for, in whole or in part, by the United States government for a disabled war veteran is exempt from the motor vehicle registration tax.

This provision was enacted in 1941 and was last changed in 1971.

Approximately 165 vehicles qualify for this exemption.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	*	*	*	*

*Less Than $50,000

15.06 NONPROFIT CHARITIES

Minnesota Statutes, Section 168.012, Subd. 1(a)(4)

An exemption from the motor vehicle registration tax is provided for vehicles owned by nonprofit charities and used exclusively to transport disabled persons for educational purposes.

This exemption was enacted in 1987.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	*	*	*	*

15.07 DRIVER EDUCATION PROGRAMS AT NONPUBLIC HIGH SCHOOLS

Minnesota Statutes, Section 168.012, Subd. 1(a)(3)

Vehicles used solely in driver education programs at nonpublic high schools are exempt from the motor vehicle registration tax.

This provision was enacted in 1990.

Twenty-one nonpublic high schools have approved driver education programs.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	*	*	*	*

15.08 AMBULANCES OWNED BY PRIVATE AMBULANCE SERVICES

Minnesota Statutes, Section 168.012, Subd. 1(a)(6)

Ambulances owned by private ambulance services licensed under Minnesota Statutes, Section 144.802, are exempt from the motor vehicle registration tax. To qualify, the appearance of the ambulance must be unmistakable.

This exemption was enacted in 1990. Ambulances owned by local units of government have been exempt since 1921 and are included in Item 15.01.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

PREFERENTIAL COMPUTATION

15.09 PRIVATELY-OWNED BUSES USED FOR STUDENT TRANSPORTATION

Minnesota Statutes, Section 168.013, Subd. 18

An annual flat tax of $25 applies to privately-owned school buses used exclusively for student transportation under contract with a school district or used for nonprofit educational institutions. The $25 tax is lower than the tax on buses which is based on weight.

School buses owned by the educational institutions are exempt from the registration tax (Item 15.02).

This provision was enacted in 1971 and has not been changed.

In 1998 approximately 5,900 school buses qualified for the $25 flat tax.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$400,000	$400,000	$400,000	$400,000

CREDIT

15.10 PHYSICALLY DISABLED PERSONS

Minnesota Statutes, Section 168.021, Subd. 2

A motor vehicle, motorcycle, or self-propelled recreational vehicle owned or operated primarily by a physically disabled person is eligible for special license plates bearing the international wheelchair symbol. The special license plates are also available to the custodial parent or guardian of a physically disabled minor and to an employer who owns a motor vehicle that is furnished to a disabled employee for that person's exclusive use in the course of employment. The disability must be permanent, and a physician's statement must accompany the application.

The special license plates are subject to the full motor vehicle registration tax, but a one dollar credit is allowed for each month the vehicle is registered.

This provision was enacted in 1975. Eligibility was extended to parents and employers in 1989. The provision was last changed in 1999.

In 1998 approximately 26,300 vehicles were allowed this credit.

	Fiscal Year Impact			
	2000	2001	2002	2003
Highway User Tax Distribution Fund	$300,000	$300,000	$300,000	$300,000

CHAPTER 16: AIRCRAFT REGISTRATION TAX

Collections and History

In fiscal year 1999, the revenues from the aircraft registration tax were $3.8 million. All the proceeds from this tax go into the state airports fund of the state treasury.

The aircraft registration tax was enacted in 1945, and the basic structure and rate of the tax have remained the same since that time. In 1987 the minimum tax was increased from $10 to $50.

Tax Base

The tax base for the aircraft registration tax is the value of noncommercial aircraft which regularly use the airspace over and the airports in Minnesota. Technically, the base applies to aircraft operating without a certificate of convenience and necessity issued by the United States Department of Transportation.

Computation of the Tax

The aircraft registration tax is imposed upon aircraft which are used privately and which use the airspace over Minnesota or the airports in Minnesota.

The tax is 1% of value. The value used in the computation begins with the base price of the aircraft, which is the manufacturer's list price, or, if the list price is not available, the Commissioner of Transportation's estimate of such. After the first year, the base price is reduced for depreciation/- 10% in the second year and 15% for the third and each succeeding year, subject to the minimum tax. The minimum tax is the greater of: 25% of the tax computed on the original base price; or $50.

The tax is paid when the aircraft is first registered and annually thereafter.

*Less Than $50,000

EXEMPTION

16.01 CIVIL AIR PATROL AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 3

Aircraft owned and used solely in the transaction of official business by the Civil Air Patrol are exempt from the aircraft registration tax.

This exemption was enacted in 1957.

Seventeen aircraft currently are allowed an exemption under this provision.

	Fiscal Year Impact			
	2000	2001	2002	2003
State Airports Fund	*	*	*	*

PREFERENTIAL COMPUTATION

16.02 MAXIMUM TAX FOR AGRICULTURAL AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 8

A maximum aircraft registration tax of $500 applies to aircraft registered with the Federal Aviation Administration as restricted category aircraft used for agricultural purposes. To qualify, the aircraft must be owned and operated solely for agricultural operations and purposes.

This provision was enacted in 1999, effective July 1, 1999.

This provision reduces the tax on about 220 aircraft.

	Fiscal Year Impact			
	2000	2001	2002	2003
State Airporst Fund	*	*	*	*

*Less Than $50,000

APPENDIX A: MINNESOTA STATUTE REQUIRING THE TAX EXPENDITURE BUDGET

270.067 TAX EXPENDITURE BUDGET.

Subdivision 1. **Statement of purpose.** State governmental policy objectives are sought to be achieved both by direct expenditure of governmental funds and by the granting of special and selective tax relief or tax expenditures. Both direct expenditures of governmental funds and tax expenditures have an effect on the ability of the state and local governments to lower tax rates or to increase expenditures. As a result, tax expenditures should receive a regular and comprehensive review by the legislature as to (a) their total cost, (b) their effectiveness in achieving their objectives, (c) their effect on the fairness and equity of the distribution of the tax burden, and (d) the public and private cost of administering tax expenditure financed programs. This section is intended to facilitate a regular review of the state and local tax expenditure budget by the legislature by providing for the preparation of a regular biennial tax expenditure budget.

Subd. 2. **Preparation; submission.** The commissioner of revenue shall prepare a tax expenditure budget for the state. The tax expenditure budget report shall be submitted to the legislature by February 1 of each even-numbered year.

Subd. 3. **Period covered.** The report shall include estimates of annual tax expenditures for, at a minimum, a three-year period including the two-year period covered in the governor's budget submitted in the preceding January pursuant to section 16A.11.

Subd. 4. **Contents.** The report shall detail for each tax expenditure item the amount of tax revenue foregone, a citation of the statutory or other legal authority for the expenditure, and the year in which it was enacted or the tax year in which it became effective. The report may contain additional information which the commissioner considers relevant to the legislature's consideration and review of individual tax expenditure items. This may include, but is not limited to, statements of the intended purpose of the tax expenditure, analysis of whether the expenditure is achieving that objective, and the effect of the expenditure device on the distribution of the tax burden and administration of the tax system.

Subd. 5. **Revenue estimates; legislative bills.** Upon reasonable notice from the chair of the house or senate tax committee that a bill is scheduled for hearing, the commissioner of revenue shall prepare an estimate of the effect on the state's tax revenues which would result from the passage of a legislative bill establishing, extending, or restricting a tax expenditure. These revenue estimates shall contain the same information as provided in subdivision 4 for expenditure items contained in the tax expenditure budget, as appropriate.

Subd. 6. **Definitions.** For purposes of this section, the following terms have the meanings given:

(1) "Tax expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue.

(2) "Tax" means any tax of statewide application or any tax authorized by state law to be levied by local governments generally. It does not include a special local tax levied pursuant to special law or to a special local tax levied pursuant to general authority that is no longer applicable to local governments generally.

History: 1983 c 301 s 176; 1986 c 444; 1Sp1989 c 1 art 17 s 1, 2; 1991 c 291 art 21 s 8, 9; 1996 c 471 art 13 s 5