State of Minnesota

Tax Expenditure Budget

Fiscal Years 2002-2005

Minn. Stat. 270.067 Subd. 2

Minnesota Department of Revenue
Tax Research Division

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The report is also available on our
web site at www.taxes.state.mn.us

STATE OF MINNESOTA

TAX EXPENDITURE BUDGET

FISCAL YEARS 2002 - 2005

A REPORT TO THE MINNESOTA LEGISLATURE

STATUTORY REQUIREMENT: MINNESOTA STATUTES, SECTION 270.067

Minnesota Department of Revenue
Tax Research Division

February 2002

MINNESOTA · REVENUE

February 2002

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

It is my pleasure to submit to you the 2002 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 $95,000.

The report is available on the Department of Revenue web site at
http://www.taxes.state.mn.us/reports/reports.html

Sincerely,

Matt Smith

Matthew G. Smith
Commissioner

PREFACE

This report is the eighth tax expenditure budget prepared and submitted as required by Minnesota Statutes, Section 270.067. It reflects Minnesota law after changes enacted in the regular and first special sessions of the 2001 Minnesota Legislature.

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.

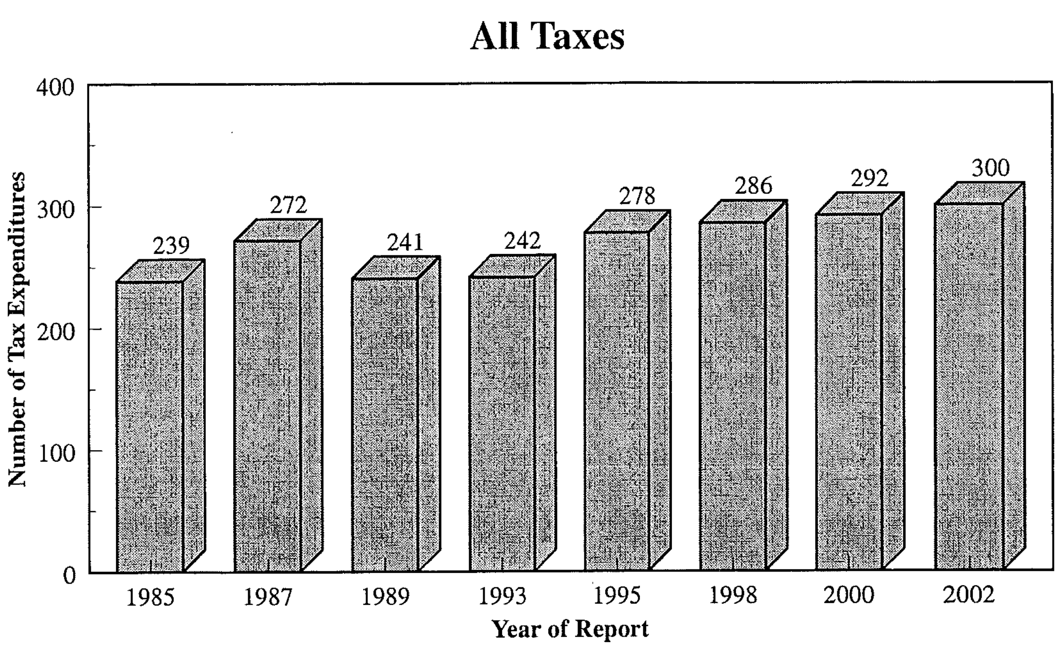
The report is organized into chapters, with one chapter for each tax. Each chapter contains descriptive information on the tax and detailed information on each tax expenditure provision in that tax. Tax expenditure estimates are provided for fiscal years 2002 through 2005.

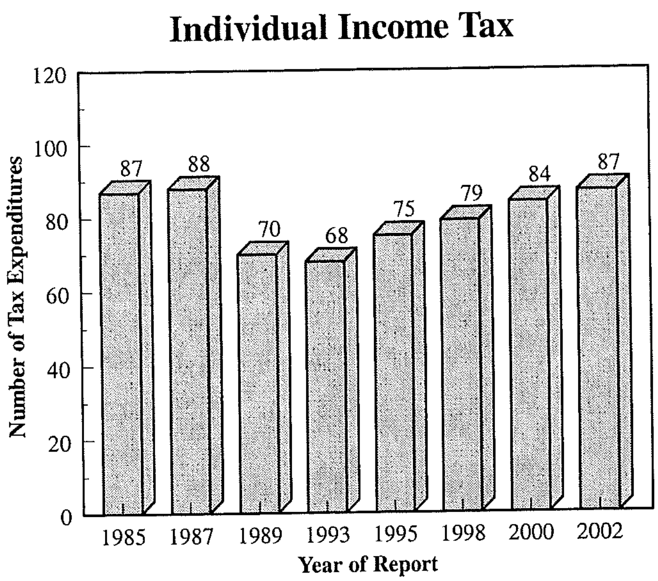
SUMMARY

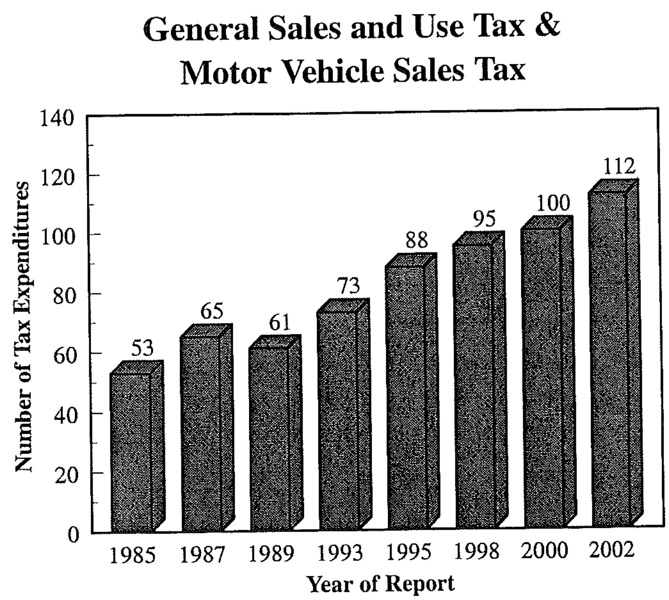
The 2002 Minnesota Tax Expenditure Budget contains exactly 300 tax expenditure provisions. The net increase of only eight items compared to the 2000 report obscures the fact that a considerable amount of activity took place in the last two years. Law changes resulted in 28 new items, offset by the deletion of twenty provisions for various reasons, including repeal, expiration, or no activity.

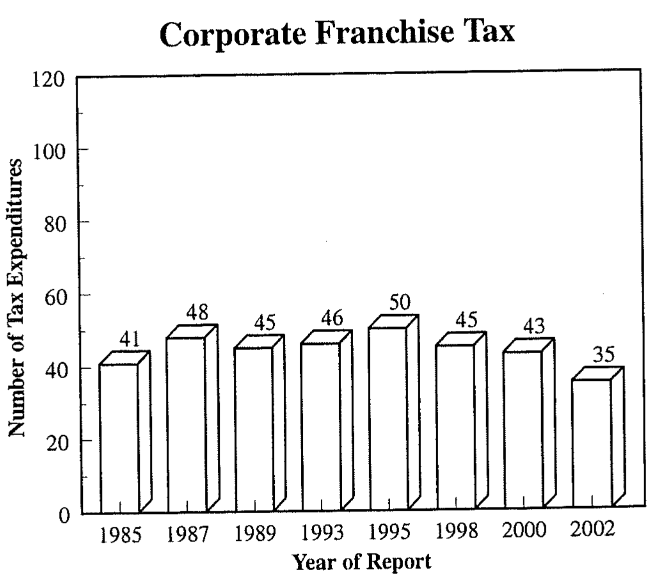
Most of the new provisions were in the general sales and use tax and the motor vehicle sales tax. A total of sixteen items were added to the sales taxes, six of which were for specific construction projects. The number of tax expenditure provisions in the sales taxes has more than doubled - from 53 to 112 - since the first tax expenditure report in 1985. Because the number of provisions in the other taxes has increased at a slower rate, the items in the sales taxes represent a larger proportion of the total now than they did in the first report: 37% in this report compared to 22% in the 1985 report.

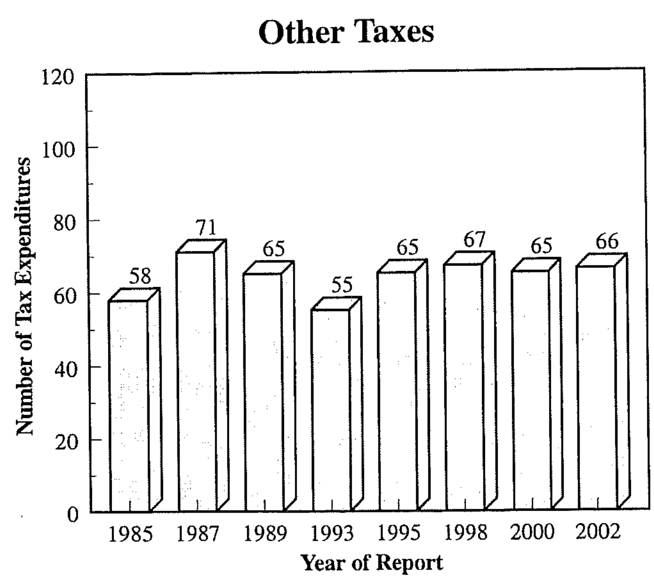
One 2001 law change in the corporate franchise tax was the reason that the number of items in that tax decreased. The new exemption for all insurance companies replaced eight previous provisions, including two narrower exemptions, two credits, and four federal provisions relating to the treatment of insurance companies. The fact that one new item resulted in the deletion of eight existing ones was a major reason that the net increase in the total number of items from the 2000 report was fairly small.




Individual Income Tax
Number of Tax Expenditures
0
20
40
60
80
100
120
87
88
70
68
75
79
84
87
1985
1987
1989
1993
1995
1998
2000
2002
Year of Report


General Sales and Use Tax &
Motor Vehicle Sales Tax
Number of Tax Expenditures
0
20
40
60
80
100
120
140
53
65
61
73
88
95
100
112
1985
1987
1989
1993
1995
1998
2000
2002
Year of Report


Corporate Franchise Tax
Number of Tax Expenditures
0
20
40
60
80
100
120
41
48
45
46
50
45
43
35
1985
1987
1989
1993
1995
1998
2000
2002
Year of Report


Other Taxes
Number of Tax Expenditures
0
20
40
60
80
100
120
58
71
65
55
65
67
65
66
1985
1987
1989
1993
1995
1998
2000
2002
Year of Report

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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 2002 through 2005.

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.

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 2002 through 2005

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, income tax revenues are reduced by the total amount of refundable tax credits. Therefore these credits are 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 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 numerous other sources of data for Minnesota and the nation.

TAX EXPENDITURE SUMMARY LIST

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
INDIVIDUAL INCOME TAX						
Federal Exclusions						
1.01	Employer-Provided Meals and Lodging	1933	$5,500,000	$5,800,000	$6,000,000	$6,200,000
1.02	Housing Allowances for Ministers	1945	2,100,000	2,300,000	2,400,000	2,600,000
1.03	Employer-Provided Dependent Care	1982	4,900,000	5,100,000	5,400,000	5,600,000
1.04	Employee Awards	1987	900,000	900,000	900,000	900,000
1.05	Employer Pension Plans	1933	454,400,000	449,100,000	458,600,000	478,900,000
1.06	Contributions by Employers for Medical Insurance Premiums and Medical Care	1933	439,900,000	478,400,000	518,200,000	559,200,000
1.07	Employer-Paid Accident and Disability Premiums	1955	15,100,000	15,800,000	17,100,000	17,700,000
1.08	Employer-Paid Group Term Life Insurance Premiums	1933	11,900,000	12,400,000	12,900,000	13,500,000
1.09	Cafeteria Plans	1975	63,100,000	67,000,000	71,000,000	75,600,000
1.10	Employer-Paid Transportation Benefits	1985	22,600,000	23,000,000	23,400,000	23,700,000
1.11	Medical Savings Accounts	1997	200,000	100,000	100,000	100,000
1.12	Employer-Provided Adoption Assistance	1997	100,000	200,000	300,000	400,000
1.13	Employer-Provided Educational Assistance	1979	2,600,000	4,100,000	4,400,000	4,600,000
1.14	Miscellaneous Employee Fringe Benefits	1985	48,800,000	51,900,000	55,600,000	60,000,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
1.15	Income Earned Abroad by U.S. Citizens and Foreign Housing Costs	1933	12,000,000	13,000,000	13,900,000	14,400,000
1.16	Certain Allowances for Federal Employees Abroad	1945	600,000	800,000	900,000	1,000,000
1.17	Benefits and Allowances to Armed Forces Personnel	1933	4,900,000	4,900,000	4,900,000	5,000,000
1.18	Veterans' Benefits	1933	12,800,000	13,100,000	13,500,000	13,800,000
1.19	Military Disability Pensions	1933	300,000	300,000	300,000	400,000
1.20	Workers' Compensation Benefits	1933	45,700,000	45,300,000	44,800,000	44,400,000
1.21	Special Benefits For Disabled Coal Miners	1971	*	*	*	*
1.22	Social Security Benefits	1939	158,800,000	165,400,000	172,600,000	181,800,000
1.23	Medicare Benefits	1965	126,300,000	136,600,000	148,200,000	161,700,000
1.24	Foster Care Payments	1983	2,500,000	2,600,000	2,700,000	2,900,000
1.25	Public Assistance	1933	2,900,000	3,100,000	3,000,000	3,000,000
1.26	Scholarship and Fellowship Income	1955	8,300,000	8,800,000	9,300,000	9,800,000
1.27	Education Savings Accounts	1998	900,000	2,600,000	3,000,000	3,700,000
1.28	Qualified Tuition Plans	1997	200,000	500,000	700,000	1,000,000
1.29	Certain Agricultural Cost-Sharing Payments	1979	200,000	200,000	200,000	200,000
1.30	Discharge of Indebtedness Income for Certain Farmers	1987	400,000	400,000	400,000	400,000
1.31	Investment Income on Life Insurance and Annuity Contracts	1933	127,200,000	130,400,000	134,200,000	137,400,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
1.32	Interest on General Obligation State and Local Government Bonds	1933	31,900,000	33,100,000	34,300,000	35,600,000
1.33	Interest on Nonguaranteed State and Local Government Bonds	1933	27,500,000	28,900,000	30,300,000	31,600,000
1.34	Capital Gains on Home Sales	1998	99,900,000	102,900,000	106,000,000	109,100,000
1.35	Capital Gains at Death	1933	103,600,000	110,700,000	116,000,000	131,700,000
1.36	Capital Gains on Gifts	1933	8,800,000	9,700,000	10,700,000	11,300,000
1.37	Permanent Exemptions from Imputed Interest Rules	1985	1,200,000	1,500,000	1,700,000	1,900,000
1.38	Like-Kind Exchanges	1933	2,100,000	2,300,000	2,500,000	2,700,000
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	Accelerated Depreciation	1959	67,500,000	70,000,000	69,900,000	68,100,000
1.42	Expensing Depreciable Business Property	1983	7,000,000	4,200,000	2,400,000	1,200,000
1.43	Excess of Percentage Over Cost Depletion	1933	300,000	300,000	300,000	300,000
1.44	Five-Year Amortization of Business Organizational and Start-Up Costs	1977	2,200,000	2,200,000	2,200,000	2,200,000
1.45	Seven-Year Amortization of Reforestation Expenditures	1981	*	*	*	*
1.46	Expensing of Research and Development Costs	1955	200,000	200,000	200,000	200,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
1.47	Expensing of Magazine Circulation Expenditures	1951	100,000	100,000	100,000	100,000
1.48	Expensing of Exploration and Development Costs	1933	*	*	*	*
1.49	Cash Accounting and Expensing for Agriculture	1933	4,900,000	5,500,000	6,000,000	6,500,000
1.50	Expensing of Multiperiod Timber Growing Costs	1933	1,900,000	1,900,000	1,900,000	2,000,000
1.51	Special Rules for Mining and Solid Waste Reclamation Reserves	1985	*	*	*	*
1.52	Cash Accounting Other than Agriculture	1933	600,000	600,000	600,000	600,000
1.53	Installment Sales	1933	2,200,000	2,200,000	2,300,000	2,300,000
1.54	Completed Contract Rules	1933	100,000	100,000	100,000	100,000
1.55	Employee Stock Ownership Plans	1975	1,000,000	1,300,000	1,600,000	1,900,000
1.56	Individual Retirement Accounts	1975	95,500,000	101,600,000	107,100,000	119,200,000
1.57	Keogh Plans	1963	29,500,000	28,400,000	27,900,000	28,900,000
1.58	Interest on Education Loans	1998	3,600,000	4,400,000	4,500,000	4,700,000
1.59	Higher Education Tuition Expenses	2001	4,500,000	13,500,000	14,700,000	16,600,000
1.60	Per Diem Amounts Paid to State Legislators	1959	*	*	*	*
1.61	Treatment of Clean-Fuel Vehicles	1993	*	*	*	*
Federal Personal Deductions						
1.62	Additional Standard Deduction for the Elderly and Blind	1987	12,400,000	12,800,000	13,600,000	14,100,000
1.63	Medical and Dental Expenses	1933	26,800,000	29,700,000	32,600,000	35,000,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
1.64	Real Estate Taxes	1933	97,300,000	76,700,000	80,500,000	84,600,000
1.65	Other Taxes	1933	8,400,000	8,800,000	9,300,000	9,700,000
1.66	Interest on Home Mortgages	1933	297,300,000	323,500,000	348,600,000	372,900,000
1.67	Charitable Contributions	1933	161,200,000	175,100,000	190,900,000	201,700,000
1.68	Casualty and Theft Losses	1933	1,300,000	1,400,000	1,400,000	1,500,000
Minnesota Subtractions						
1.69	K-12 Education Expenses	1955	16,700,000	17,500,000	18,400,000	19,300,000
1.70	Charitable Contributions for Nonitemizers	1999	4,000,000	4,400,000	4,700,000	5,100,000
1.71	Income of the Elderly or Disabled	1988	2,100,000	1,700,000	1,400,000	1,200,000
1.72	Self-Employed Health Insurance	1988	16,000,000	17,100,000	18,500,000	19,600,000
1.73	Urban Homestead Program	1995	400,000	400,000	0	0
1.74	Youth Works Postservice Benefits	1997	*	*	*	*
1.75	Small Ethanol Producers	2000	*	*	*	*
1.76	Disposition of Farm Property	1985	100,000	100,000	100,000	100,000
Preferential Computations						
1.77	Five-Year Averaging of Lump Sum Distributions	1975	300,000	100,000	*	*
1.78	Active Duty Military Personnel	2001	4,400,000	4,400,000	4,400,000	4,400,000
Credits						
1.79	Credit for Income Tax Paid to Other States	1959	81,700,000	87,900,000	94,600,000	101,900,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
1.80	Credit for Income Tax Paid by a Nonresident Partner	2000	200,000	200,000	200,000	200,000
1.81	Marriage Credit	1999	57,600,000	60,500,000	64,200,000	67,300,000
1.82	Credit for Long-Term Care Insurance	1997	4,500,000	4,900,000	5,200,000	5,700,000
1.83	Employer Transit Pass Credit	2000	*	*	*	*
1.84	Child and Dependent Care Credit	1977	12,400,000	12,600,000	15,900,000	16,000,000
1.85	Working Family Credit	1991	102,700,000	107,800,000	109,900,000	112,000,000
1.86	Credit for K-12 Education Expenses	1997	22,100,000	17,400,000	18,300,000	19,200,000
1.87	Employer Tax Credits (Enterprise Zones)	1983	200,000	200,000	200,000	200,000
CORPORATE FRANCHISE TAX						
Exempt Organizations						
2.01	Credit Unions	1937	3,700,000	3,900,000	4,200,000	4,500,000
2.02	Insurance Companies	1989	17,300,000	19,100,000	20,200,000	21,500,000
Federal Exclusions						
2.03	Permanent Exemptions from Imputed Interest Rules	1985	*	*	*	*
2.04	Investment Income on Life Insurance and Annuity Contracts	1933	4,100,000	4,400,000	4,600,000	4,900,000
2.05	Like-Kind Exchanges	1933	4,200,000	4,500,000	4,500,000	4,800,000
2.06	Special Rules for Magazine, Paperback, and Record Returns	1979	*	*	*	*
Federal Deductions						
2.07	Accelerated Depreciation	1959	102,400,000	104,600,000	102,300,000	99,700,000

	Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
2.08 Expensing Depreciable Business Property	1983	800,000	700,000	500,000	200,000
2.09 Excess of Percentage Over Cost Depletion (Mining Occupation Tax)	1989	300,000	300,000	300,000	300,000
2.10 Amortization of Organizational and Start-up Costs	1955	100,000	100,000	100,000	100,000
2.11 Expensing of Research and Development Costs	1955	8,400,000	8,100,000	8,100,000	8,100,000
2.12 Expensing of Magazine Circulation Expenditures	1951	100,000	100,000	100,000	100,000
2.13 Expensing of Exploration and Development Costs	1967	1,100,000	1,100,000	800,000	600,000
2.14 Cash Accounting and Expensing for Agriculture	1933	400,000	400,000	400,000	400,000
2.15 Expensing of Multiperiod Timber Growing Costs	1933	1,100,000	1,100,000	1,200,000	1,200,000
2.16 Special Rules for Mining and Solid Waste Reclamation Reserves	1987	100,000	100,000	100,000	100,000
2.17 Cash Accounting Other than Agriculture	1933	100,000	100,000	100,000	100,000
2.18 Installment Sales	1933	3,700,000	3,100,000	2,400,000	2,200,000
2.19 Completed Contract Rules	1933	600,000	600,000	600,000	600,000
2.20 Employee Stock Ownership Plans	1975	5,400,000	5,500,000	5,700,000	5,900,000
2.21 Capital Construction Funds of Shipping Companies	1987	*	*	*	*
2.22 Treatment of Clean-Fuel Vehicles	1993	100,000	100,000	*	*

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
Apportionment						
2.23	Weighted Apportionment	1939	110,900,000	122,600,000	129,800,000	137,800,000
2.24	Throwback Sales	1973	24,900,000	27,500,000	29,100,000	30,900,000
2.25	Single-Factor Apportionment for Mail Order Companies	1985	3,600,000	4,000,000	4,200,000	4,500,000
Minnesota Subtractions						
2.26	Dividend Received Deduction	1947	96,100,000	106,200,000	112,400,000	119,400,000
2.27	Charitable Contributions	1933	11,600,000	12,800,000	13,600,000	14,400,000
2.28	Foreign Source Income	1988	61,700,000	68,200,000	72,200,000	76,600,000
2.29	Small Ethanol Producers	2000	300,000	300,000	300,000	300,000
2.30	Disposition of Farm Property	1985	*	*	*	*
Credits						
2.31	Research and Development Credit	1981	20,200,000	22,300,000	23,700,000	25,100,000
2.32	Credit for Tax Paid to Other States	1999	0	500,000	500,000	2,000,000
2.33	Employer Transit Pass Credit	2000	1,800,000	2,200,000	2,500,000	2,800,000
2.34	Employer Tax Credits (Enterprise Zones)	1983	300,000	300,000	300,000	300,000
2.35	Aircraft Maintenance and Engine Repair Facilities Job Credit	1991	2,100,000	$0	$0	$0
ESTATE TAX						
Preferential Valuation						
3.01	Special Use Valuation	1979	200,000	200,000	300,000	300,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
Exclusions						
3.02	Life Insurance Proceeds	1979	6,200,000	6,700,000	7,200,000	7,800,000
3.03	Annuities	1979	*	*	*	*
3.04	Social Security Benefits	1979	*	*	*	*
Deductions						
3.05	Marital Deduction	1979	57,900,000	62,900,000	68,500,000	74,500,000
3.06	Charitable Gifts	1979	27,200,000	28,200,000	29,300,000	30,000,000
GENERAL SALES AND USE TAX						
Exemptions - Particular Goods and Services						
4.01	Food Products	1967	448,000,000	461,800,000	480,400,000	501,000,000
4.02	Clothing and Wearing Apparel	1967	375,400,000	404,600,000	434,200,000	463,900,000
4.03	Drugs and Medicines	1967	192,000,000	217,400,000	244,100,000	271,800,000
4.04	Therapeutic and Prosthetic Devices	1967	8,700,000	9,200,000	9,800,000	10,400,000
4.05	Prescription Eyeglasses	1967	17,700,000	18,500,000	19,100,000	19,700,000
4.06	Baby Products	1967	800,000	900,000	900,000	900,000
4.07	Feminine Hygiene Items	1981	2,500,000	2,600,000	2,700,000	2,800,000
4.08	Caskets and Burial Vaults	1967	5,900,000	5,900,000	5,900,000	5,900,000
4.09	Publications	1967	50,100,000	51,900,000	54,400,000	57,100,000
4.10	Textbooks Required for School Use	1973	7,800,000	8,100,000	8,500,000	8,900,000
4.11	Personal Computers Required for School Use	1994	300,000	300,000	300,000	300,000
4.12	Motor Fuels	1967	282,800,000	281,600,000	286,600,000	292,500,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
4.13	Residential Heating Fuels	1978	79,400,000	80,400,000	82,600,000	84,100,000
4.14	Residential Water Services	1979	10,900,000	11,200,000	11,500,000	11,800,000
4.15	Sewer Services	1967	26,100,000	27,400,000	28,900,000	30,400,000
4.16	Used Manufactured Homes	1984	600,000	600,000	700,000	700,000
4.17	Selected Services	1967	1,183,600,000	1,251,000,000	1,328,300,000	1,409,700,000
4.18	YMCA, YWCA, and JCC Membership Dues	1987	2,200,000	2,200,000	2,300,000	2,300,000
4.19	Cross Country Ski Passes for Public Trails	1988	*	*	*	*
4.20	Admission to the Minnesota Zoo	2001	200,000	200,000	200,000	200,000
4.21	Personal Property Brought into Minnesota	1967	9,400,000	9,700,000	10,000,000	10,200,000
4.22	De Minimis Use Tax Exemption for Individuals	1996	4,400,000	4,700,000	5,000,000	5,400,000
4.23	Capital Equipment	1984	210,000,000	195,900,000	198,800,000	213,100,000
4.24	Accessory Tools	1973	7,500,000	7,600,000	7,800,000	7,900,000
4.25	Special Tooling	1984	4,800,000	4,800,000	4,900,000	4,900,000
4.26	Telecommunications Equipment	2001	24,500,000	30,200,000	31,300,000	32,600,000
4.27	Resource Recovery Equipment	1984	500,000	200,000	100,000	*
4.28	Used Motor Oil	1988	300,000	300,000	300,000	300,000
4.29	Taconite Production Materials	1971	*	*	*	*
4.30	Wind Energy Conversion Systems	1992	400,000	300,000	300,000	300,000
4.31	Air Cooling Equipment	1992	300,000	*	200,000	200,000
4.32	Energy Efficient Products	2001	500,000	600,000	600,000	700,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
4.33	Airflight Equipment	1967	23,100,000	24,000,000	17,900,000	16,500,000
4.34	Large Ships	1992	100,000	100,000	100,000	100,000
4.35	Repair and Replacement Parts for Ships and Vessels	1990	100,000	100,000	100,000	100,000
4.36	Light Rail Transit Vehicles	2001	800,000	1,000,000	1,000,000	1,000,000
4.37	Petroleum Products Used by Transit Systems	1992	900,000	900,000	900,000	900,000
4.38	Petroleum Products Used in Passenger Snowmobiles	1993	*	*	*	*
4.39	Ski Area Equipment	2000	200,000	200,000	200,000	200,000
4.40	Logging Equipment	1984	700,000	800,000	800,000	800,000
4.41	Farm Machinery	1981	18,900,000	19,200,000	19,400,000	19,600,000
4.42	Repair and Replacement Parts for Farm Machinery	1985	7,400,000	7,400,000	7,400,000	7,400,000
4.43	Petroleum Products Used to Improve Agricultural Land	1985	*	*	*	*
4.44	Farm Conservation Program Items	1991	500,000	500,000	500,000	500,000
4.45	Used Farm Tires	1994	*	*	*	*
4.46	Horses	1994	1,100,000	1,100,000	1,100,000	1,200,000
4.47	Prizes at Carnivals and Fairs	1999	600,000	600,000	600,000	600,000
4.48	Television Commercials	1999	1,100,000	1,200,000	1,200,000	1,200,000
4.49	Advertising Materials	1973	7,000,000	7,400,000	7,900,000	8,400,000
4.50	Court Reporter Documents	1997	400,000	400,000	500,000	500,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
4.51	Patent, Trademark, and Copyright Drawings	2000	100,000	100,000	100,000	100,000
4.52	Certain Interstate Telephone Service	1987	7,100,000	7,500,000	8,000,000	8,400,000
4.53	Metropolitan Public Safety Radio Systems	1997	1,100,000	700,000	0	0
4.54	Packing Materials	1973	*	*	*	*
4.55	Property for Business Use Outside Minnesota	1967	*	*	*	*
4.56	Automatic Fire-Safety Sprinkler Systems	1992	700,000	700,000	600,000	500,000
4.57	Building Materials for Residences of Disabled Veterans	1971	*	*	*	*
4.58	Chair Lifts, Ramps, and Elevators in Homesteads	1989	*	*	*	*
4.59	Ambulances Leased to Licensed Ambulance Services	1990	*	*	*	*
4.60	Firefighter Personal Protective Equipment	1994	700,000	700,000	700,000	700,000
4.61	Parts and Accessories to Make Motor Vehicles Handicapped Accessible	1993	700,000	800,000	900,000	900,000
4.62	Maintenance of Cemetery Grounds	2000	*	*	*	*
4.63	Price Reduced by Value of Trade In	1967	6,100,000	6,300,000	6,500,000	6,600,000
Exemptions - Sales to Particular Groups						
4.64	Certain Sales to Local Governments	1967	65,800,000	67,000,000	68,000,000	69,100,000
4.65	Sales to Nonprofit Organizations	1967	41,000,000	42,000,000	43,000,000	44,000,000
4.66	Hospitals and Outpatient Surgical Centers	1967	48,500,000	49,700,000	50,800,000	52,000,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
4.67	Certain Purchases by Ambulance Services	2001	100,000	100,000	100,000	100,000
4.68	Sales to Veterans' Organization	1980	300,000	300,000	300,000	300,000
4.69	Construction Materials for Low-Income Housing	2001	300,000	300,000	400,000	400,000
4.70	Biosolids Processing Equipment	1998	500,000	900,000	600,000	600,000
4.71	District Heating and Cooling Facility	1997	200,000	100,000	0	0
4.72	Lake Superior Center	1997	*	0	0	0
4.73	Minneapolis Convention Center	1998	*	0	0	0
4.74	Yellow Medicine County Law Enforcement and Family Service Center	2001	*	0	0	0
4.75	Biomass Electrical Generating Facility	1999	200,000	*	0	0
4.76	Electric Generating Facility Using Poultry Litter Biomass	2001	400,000	400,000	0	0
4.77	Electric Generating Facility Using Waste Tires	2001	300,000	200,000	0	0
4.78	Agricultural Processing Facility	1999	400,000	200,000	0	0
4.79	Soybean Processing Facility	1998	200,000	1,000,000	200,000	0
4.80	Pork Processing Facility	2000	100,000	0	0	0
4.81	Soybean Processing Facility in a Smaller County	2001	0	800,000	0	0
Exemptions - Sales by Particular Groups						
4.82	Isolated or Occasional Sales	1967	30,500,000	32,100,000	33,800,000	35,600,000
4.83	Institutional Meals	1967	41,200,000	42,600,000	43,900,000	45,300,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
4.84	Fundraising Sales by Nonprofit Organizations	1985	7,500,000	7,700,000	7,800,000	8,000,000
4.85	Candy Sales by Certain Organizations	1984	*	*	*	*
4.86	Minnesota Amateur Sports Commission Events	1994	*	*	*	*
4.87	Admission to Charitable Golf Tournaments	1994	*	*	*	*
4.88	Admission to School Sponsored Events	1985	700,000	700,000	700,000	700,000
4.89	Admission to Artistic Events	1980	5,700,000	5,900,000	6,000,000	6,200,000
4.90	Sacramental Wine Sold by Religious Organizations	1991	*	*	*	*
Reduced Sales Price						
4.91	New Manufactured Homes	1984	3,700,000	3,800,000	3,900,000	3,900,000
Reduced Rates						
4.92	Tax Paid to Other States	1967	3,700,000	3,800,000	3,900,000	4,000,000
MOTOR VEHICLE SALES TAX						
Exemptions						
5.01	Gifts Between Individuals	1971	15,800,000	16,100,000	16,400,000	16,700,000
5.02	Vehicles Acquired by Inheritance	1971	2,200,000	2,200,000	2,300,000	2,300,000
5.03	Vehicles of Persons Moving into Minnesota	1971	8,300,000	8,400,000	8,500,000	8,600,000
5.04	Transfers Between Joint Owners	1971	3,000,000	3,000,000	3,100,000	3,200,000
5.05	Transfers in Divorce Proceedings	1974	800,000	800,000	800,000	800,000
5.06	Sales to Disabled Veterans	1971	*	*	*	*

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
5.07	Corporate and Partnership Transfers	1975	1,100,000	1,200,000	1,200,000	1,200,000
5.08	Transit Vehicles	2001	2,800,000	3,100,000	3,100,000	3,200,000
5.09	Town Road Maintenance Vehicles	1998	600,000	600,000	600,000	600,000
5.10	Bookmobiles	1994	*	*	*	*
5.11	Ambulances Purchased by Private Ambulance Services	1990	400,000	400,000	400,000	400,000
5.12	Ready-Mixed Concrete Trucks	1998	800,000	800,000	800,000	800,000
5.13	Vehicles Used in Automotive Training Programs	1988	100,000	100,000	100,000	100,000
5.14	Vehicles Donated to Exempt Organizations	1997	100,000	100,000	100,000	100,000
5.15	Trucks, Buses, and Vans Purchased by Charities	2000	1,400,000	1,400,000	1,500,000	1,500,000
Reduced Purchase Price						
5.16	Federal Excise Taxes	1983	1,100,000	1,000,000	1,000,000	1,000,000
5.17	Price Reduced by Value of Trade in	1971	75,800,000	78,200,000	80,700,000	83,300,000
5.18	Handicapped-Accessible Modifications	1992	200,000	200,000	200,000	200,000
Preferential Computations						
5.19	Flat Taxes on Older Cars and Collector Vehicles	1985	35,500,000	36,100,000	36,800,000	37,400,000
Credit						
5.20	Credit for Taxes Paid to Other States	1971	2,700,000	2,800,000	2,800,000	2,800,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
HIGHWAY FUELS EXCISE TAXES						
Exemptions						
6.01	Transit Systems Receiving State Financial Assistance	1977	3,200,000	3,200,000	3,200,000	3,200,000
6.02	Motor Vehicles Not Requiring Registration (Special Fuels)	1951	600,000	600,000	600,000	600,000
6.03	Ambulance Services	2001	100,000	100,000	100,000	100,000
6.04	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	*	*	*	*
7.04	Consumption on Brewery Premises	1941	*	*	*	*
7.05	Wine for Sacramental Purposes	1937	*	*	*	*
7.06	Shipments of Wine for Personal Use	1993	*	*	*	*
Credit						
7.07	Small Brewers' Credit	1985	300,000	300,000	300,000	300,000

	Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
CIGARETTE AND TOBACCO TAXES					
Exemption					
8.01 Consumer Purchases Made Out of State	1949	3,800,000	4,000,000	4,300,000	4,600,000
MORTGAGE REGISTRY TAX					
Exemptions					
9.01 Agricultural Loans	2001	1,500,000	1,500,000	1,600,000	1,600,000
9.02 Government Housing Programs	2001	100,000	100,000	100,000	100,000
DEED TRANSFER TAX					
Exemptions					
10.01 Deeds Partitioning Property of Co-Owners	1984	*	*	*	*
10.02 Deeds of Distribution by Personal Representatives	1975	100,000	100,000	100,000	100,000
10.03 Deeds for Cemetery Lots	1961	100,000	100,000	100,000	100,000
10.04 Exchange of Permanent School Fund Lands	1991	*	*	*	*
10.05 Mortgage or Lien Foreclosure Sales	1993	1,100,000	1,100,000	1,200,000	1,300,000
10.06 Decree of Marriage Dissolution	1997	100,000	100,000	100,000	100,000

		Year Enacted	Fiscal Year Impact			
			2002	2003	2004	2005
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	400,000	400,000	400,000	400,000
Credit						
11.07	Credit for Certain Raffles	2000	*	*	*	*
INSURANCE PREMIUMS TAXES						
Exemptions						
12.01	Fraternal Benefit Societies	1907	4,100,000	4,200,000	4,300,000	4,500,000
12.02	Farmers' Mutual and Township Mutual Fire Insurance Companies (Fire Marshal Tax)	1915	200,000	200,000	300,000	300,000
12.03	Minnesota Comprehensive Health Insurance Plan Premiums	1976	1,400,000	1,400,000	1,500,000	1,500,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
Exemption/Reduced Rate						
12.04	Health Maintenance Organizations and Nonprofit Health Service Plan Corporations	1971	72,200,000	76,900,000	64,600,000	43,200,000
Reduced Rates						
12.05	Smaller Mutual Property and Casualty Insurance Companies	1988	5,800,000	6,000,000	6,200,000	6,400,000
Credit						
12.06	Credit for Guaranty Association Assessments	1994	1,500,000	1,400,000	2,500,000	5,000,000
PROPERTY TAX						
Exemptions						
13.01	Exempt Real Property	1851	991,100,000	754,300,000	801,300,000	841,400,000
13.02	Limited Market Value	1993	57,400,000	45,900,000	21,600,000	13,600,000
13.03	Certain Improvements to Older Homes	1993	6,600,000	7,100,000	8,700,000	8,700,000
Preferential Valuations						
13.04	Classification System	1913	N/A	N/A	N/A	N/A
13.05	Green Acres Treatment of Agricultural Land	1967	21,100,000	26,400,000	33,000,000	41,200,000
13.06	Open Space Property	1969	5,300,000	5,600,000	6,400,000	7,200,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
13.07	Metropolitan Agricultural Preserves Land	1980	2,900,000	3,100,000	3,300,000	3,600,000
13.08	Tax Increment Financing	1947	331,000,000	214,000,000	220,100,000	226,500,000
Preferential Computations						
13.09	Auxiliary Forest Tax and Tree Growth Tax	1927	1,300,000	1,300,000	100,000	100,000
Credits						
13.10	Taconite Homestead Credit	1969	15,200,000	11,100,000	11,300,000	11,500,000
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 Valuation						
14.02	Certain Airlines	1987	1,000,000	1,000,000	1,000,000	1,000,000
MOTOR VEHICLE REGISTRATION TAX						
Exemptions						
15.01	Local Government Vehicles	1921	7,000,000	7,100,000	7,200,000	7,400,000
15.02	School Buses	1933	400,000	400,000	400,000	400,000

		Year Enacted	Fiscal Year Impact 2002	2003	2004	2005
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	*	*	*	*
15.08	Commercial Driving Schools	1999	*	*	*	*
15.09	Ambulances Owned by Private Ambulance Services	1990	100,000	100,000	100,000	100,000
Preferential Computation						
15.10	Privately-Owned Buses Used for Student Transportation	1971	400,000	400,000	400,000	400,000
AIRCRAFT REGISTRATION TAX						
Exemption						
16.01	Civil Air Patrol Aircraft	1957	*	*	*	*
Preferential Computation						
16.02	Maximum Tax For Agricultural Aircraft	1999	*	*	*	*

*Less Than $50,000

CHAPTER 1: INDIVIDUAL INCOME TAX

Collections and History

Fiscal year 2001 net collections from the individual income tax were $5.9 billion, which was 44.9% 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. The rates were reduced in 1999 and in 2000 and are currently 5.35%, 7.05%, and 7.85%.

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 tax expenditure 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 2002 are as follows:

	5.35%	7.05%	7.85%
Married Joint	$1 - $27,350	$27,351 - $108,660	Over $108,660
Married Separate	$1 - $13,680	$13,681 - $54,330	Over $54,330
Single	$1 - $18,710	$18,711 - $61,460	Over $61,460
Head of Household	$1 - $23,040	$23,041 - $92,560	Over $92,560

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 6.4% 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 2002:

	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 5.35%, 7.05%, and 7.85%
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 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			
	2002	2003	2004	2005
State General Fund	$5,500,000	$5,800,000	$6,000,000	$6,200,000

1.02 HOUSING ALLOWANCES FOR MINISTERS

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			
	2002	2003	2004	2005
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 1.84).

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,900,000	$5,100,000	$5,400,000	$5,600,000

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			
	2002	2003	2004	2005
State General Fund	$900,000	$900,000	$900,000	$900,000

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 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$454,400,000	$449,100,000	$458,600,000	$478,900,000

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			
	2002	2003	2004	2005
State General Fund	$439,900,000	$478,400,000	$518,200,000	$559,200,000

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 insurance plan are excluded from the gross income of the employee.

This provision was enacted in 1954.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$15,100,000	$15,800,000	$17,100,000	$17,700,000

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			
	2002	2003	2004	2005
State General Fund	$11,900,000	$12,400,000	$12,900,000	$13,500,000

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; transportation benefits; 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 1998.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$63,100,000	$67,000,000	$71,000,000	$75,600,000

1.10 EMPLOYER-PAID TRANSPORTATION BENEFITS

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

Certain employer-proved 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. The maximum exclusion for the combined amount of transit passes and transportation in a commuter vehicle is $100 per month in 2002. The $175 and $100 are adjusted annually for inflation.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$22,600,000	$23,000,000	$23,400,000	$23,700,000

1.11 MEDICAL SAVINGS ACCOUNTS

Internal Revenue Code, Section 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. In 2000 the program was extended by two years to 2002.

The national MSA limit of 750,000 has not been reached. Fewer than 55,000 MSA returns had been established by June 30, 1999, which makes it likely that about 1,000 MSA returns will be filed by Minnesota taxpayers.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$200,000	$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. Beginning with tax year 2002, the exclusion is allowed up to $10,000 per child and is phased out for income over $150,000.

This exclusion was enacted federally in 1996 and was last changed in 2001. Prior to the 2001 law change, the exclusion was limited to $5,000 for the adoption of a child ($6,000 for a child with special needs).

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$100,000	$200,000	$300,000	$400,000

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 as a temporary provision and was renewed a number of times over the years. In 2001 the exclusion was made permanent, effective with tax year 2002.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$2,600,000	$4,100,000	$4,400,000	$4,600,000

1.14 MISCELLANEOUS EMPLOYEE FRINGE BENEFITS

Internal Revenue Code, Sections 117(d) and 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. Also excluded from income is a tuition reduction received by an employee of an educational institution. The tuition reduction may also be for the employee's spouse or dependent.

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 the Internal Revenue Code is now considered taxable compensation. This provision was last changed in 1997.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$48,800,000	$51,900,000	$55,600,000	$60,000,000

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 earned in a foreign country up to a maximum of $78,000 in 2001 and $80,000 thereafter. A separate exclusion applies to federal employees (Item 1.16).

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. A $70,000 exclusion was enacted in 1986. In 1997 the maximum exclusion was increased to $72,000 for 1998 and increased by $2,000 per year to $80,000 in 2002 and thereafter.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$12,000,000	$13,000,000	$13,900,000	$14,400,000

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. They 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			
	2002	2003	2004	2005
State General Fund	$600,000	$800,000	$900,000	$1,000,000

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 1986. In 1996 the limit on the exclusion for combat pay of commissioned officers was increased from $500 per month.

About 10,000 Minnesota residents are active duty members of the Armed Forces.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,900,000	$4,900,000	$4,900,000	$5,000,000

1.18 VETERANS' BENEFITS

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

All benefits administered by the Department of Veterans Affairs 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.

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

Approximately 47,000 Minnesotans receive exempt veterans' benefits.

	Fiscal Year Impact			
	2002	2003	2004	2005
Disability Compensation	$11,800,000	$12,100,000	$12,500,000	$12,800,000
Pensions	500,000	500,000	500,000	500,000
Education and Training	500,000	500,000	500,000	500,000
Total - State General Fund	$12,800,000	$13,100,000	$13,500,000	$13,800,000

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 excluded from income until the exclusion was limited in 1976.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$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.

About 166,000 workers' compensation claims were paid in 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$45,700,000	$45,300,000	$44,800,000	$44,400,000

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 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 1999 approximately 725,000 people in Minnesota received social security benefits.

	Fiscal Year Impact			
	2002	2003	2004	2005
Retired Workers	$115,900,000	$119,300,000	$122,400,000	$127,000,000
Disability Benefits	18,400,000	20,300,000	22,700,000	25,300,000
Benefits for Dependents and Survivors	24,500,000	25,800,000	27,500,000	29,500,000
Total - State General Fund	$158,800,000	$165,400,000	$172,600,000	$181,800,000

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 revenue ruling in 1970 upheld the exclusion of these benefits.

In 1999 approximately 647,000 people in Minnesota received Medicare benefits.

	Fiscal Year Impact			
	2002	2003	2004	2005
Hospital Insurance	$79,700,000	$85,300,000	$91,800,000	$100,200,000
Supplementary Medical Insurance	46,600,000	51,300,000	56,400,000	61,500,000
Total - State General Fund	$126,300,000	$136,600,000	$148,200,000	$161,700,000

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 18, but this limitation does not apply to payments for foster children under age 19.

This provision was enacted in 1982. Prior to 1986, foster care payments that exceeded documented expenses were included as income. In 1986 the exclusion was broadened to include all qualified foster care payments and was extended to foster care payments made for qualifying adults.

Minnesota has 3,500 licensed adult foster care and 5,400 licensed child foster care households.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$2,500,000	$2,600,000	$2,700,000	$2,900,000

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, 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 1930s the Internal Revenue Service issued a series of Revenue Rulings on the definition of federal gross income which explicitly excluded these benefits.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$2,900,000	$3,100,000	$3,000,000	$3,000,000

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 155,000 Minnesota students receive scholarship, fellowship, or grant money that qualifies for the exclusion.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$8,300,000	$8,800,000	$9,300,000	$9,800,000

1.27 EDUCATION SAVINGS ACCOUNTS

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

A taxpayer may establish an education savings account for the purpose of paying qualified education expenses of a named beneficiary. Beginning with tax year 2002, qualified expenses include those for elementary and secondary school, in addition to higher education expenses. Annual contributions to an account cannot exceed $2,000 and cannot be made after the beneficiary reaches age eighteen. The maximum contribution is reduced for taxpayers with income over $95,000 ($190,000 for a joint return).

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

This provision was enacted in 1997 and expanded in 2001 by increasing the contribution limit from $500 to $2,000, increasing the phaseout threshold for joint returns, and including expenses for elementary and secondary school.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$900,000	$2,600,000	$3,000,000	$3,700,000

1.28 QUALIFIED TUITION PLANS

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

Under a qualified 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 distributions are excluded from income to the extent that they are used for qualified higher education expenses.

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 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$200,000	$500,000	$700,000	$1,000,000

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			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$200,000	$200,000

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 adjusted basis and the adjusted tax attributes of qualifying property. 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			
	2002	2003	2004	2005
State General Fund	$400,000	$400,000	$400,000	$400,000

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 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 to the annuitant.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$127,200,000	$130,400,000	$134,200,000	$137,400,000

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			
	2002	2003	2004	2005
State General Fund	$31,900,000	$33,100,000	$34,300,000	$35,600,000

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 $75 per resident or $225 million in calendar year 2002. The limits are increased annually for inflation 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. A 1984 federal law 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 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$27,500,000	$28,900,000	$30,300,000	$31,600,000

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 was enacted in 1964, expanded several times, and repealed in 1997.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$99,900,000	$102,900,000	$106,000,000	$109,100,000

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			
	2002	2003	2004	2005
State General Fund	$103,600,000	$110,700,000	$116,000,000	$131,700,000

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			
	2002	2003	2004	2005
State General Fund	$8,800,000	$9,700,000	$10,700,000	$11,300,000

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,200,000	$1,500,000	$1,700,000	$1,900,000

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			
	2002	2003	2004	2005
State General Fund	$2,100,000	$2,300,000	$2,500,000	$2,700,000

1.39 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

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

Generally, when goods are returned to the seller, the income of the seller is reduced in the year the items are returned. However, distributors and publishers of magazines, paperbacks, and sound recordings may elect to exclude from gross income for a tax year the income from the sale of goods that are returned after the close of the tax year. The taxpayer must have a legal obligation to provide a refund or credit for unsold copies. The exclusion applies to magazines returned within two months and fifteen days after the end of the tax year and to paperbacks and records returned within four months and fifteen days after the end of the tax year.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

1.40 ENERGY CONSERVATION SUBSIDIES PROVIDED BY PUBLIC UTILITIES

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

Gross income does not include the value of a subsidy provided by a public utility to a residential customer for the purchase or installation of an energy conservation measure.

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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

*Less Than $50,000

FEDERAL DEDUCTIONS

1.41 ACCELERATED 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 equal to the deduction allowed federally under the modified accelerated cost recovery system (MACRS).

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.

Depreciation was claimed on about 295,000 income tax returns for 1998.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$67,500,000	$70,000,000	$69,900,000	$68,100,000

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 $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 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			
	2002	2003	2004	2005
State General Fund	$7,000,000	$4,200,000	$2,400,000	$1,200,000

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. The excess of percentage depletion over 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			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

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			
	2002	2003	2004	2005
State General Fund	$2,200,000	$2,200,000	$2,200,000	$2,200,000

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			
	2002	2003	2004	2005
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 or at the time of sale. 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			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$200,000	$200,000

*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			
	2002	2003	2004	2005
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

Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses but are capitalized and recovered through depreciation or depletion. However, 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. Expensing is allowed only for domestic properties.

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			
	2002	2003	2004	2005
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

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.

A taxpayer engaged in the business of farming may deduct certain expenditures made during the tax year rather than capitalize them. Qualifying expenditures include soil and water conservation expenses, the purchase and application of fertilizer, and costs associated with raising dairy and breeding cattle. The expensing of capital outlays is a tax expenditure because normally the cost of a capital outlay would not be deductible.

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			
	2002	2003	2004	2005
State General Fund	$4,900,000	$5,500,000	$6,000,000	$6,500,000

1.50 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 costs associated with maintaining a timber stand after it is established. The costs include disease and pest control, brush clearing, and property taxes. This 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.

These costs have always been allowed to be expensed. When the uniform capitalization rules were adopted as part of the Tax Reform Act of 1986, an exception was allowed for timber.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,900,000	$1,900,000	$1,900,000	$2,000,000

1.51 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. 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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

1.52 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			
	2002	2003	2004	2005
State General Fund	$600,000	$600,000	$600,000	$600,000

*Less Than $50,000

1.53 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 later 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. In 1999 the use of installment sales was restricted, but that restriction was retroactively repealed in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$2,200,000	$2,200,000	$2,300,000	$2,300,000

1.54 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 1933. 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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

1.55 EMPLOYEE STOCK OWNERSHIP PLANS

Internal Revenue Code, Sections 401(a)(28), 404(a)(9), 415(c), and 1042
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			
	2002	2003	2004	2005
State General Fund	$1,000,000	$1,300,000	$1,600,000	$1,900,000

1.56 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 maximum contribution is increased to $3,000 for tax years 2002 through 2004, to $4,000 for 2005 through 2007, and $5,000 thereafter.

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 2002 is $54,000 or less for a married-joint return or $34,000 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. Several significant changes have occurred over the years. In 1997 the income limits were increased for deductible IRAs, and provisions for nondeductible IRAs were replaced by the Roth IRA. In 2001 the maximum contribution limit was increased.

A deduction for IRA contributions was taken on approximately 88,000 returns in 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$95,500,000	$101,600,000	$107,100,000	$119,200,000

1.57 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 28,000 Minnesota taxpayers took this deduction for tax year 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$29,500,000	$28,400,000	$27,900,000	$28,900,000

1.58 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. A person claimed as a dependent on someone else's return cannot take the deduction. The maximum deduction is $2,500. The deduction is phased out for taxpayers with modified adjusted gross income of $50,000 to $65,000 ($100,000 to $130,000 for joint returns). The income thresholds are adjusted for inflation beginning in tax year 2003.

This deduction was enacted federally in 1997. In 2001, the income limits were increased, and limiting the deduction to the interest paid during the first sixty months that payments are required was eliminated, beginning with tax year 2002.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$3,600,000	$4,400,000	$4,500,000	$4,700,000

1.59 HIGHER EDUCATION TUITION EXPENSES

Internal Revenue Code, Section 222
Minnesota Statutes, Section 290.01, Subd. 19

For tax years 2002 through 2005, a deduction is allowed for qualified higher education tuition and related expenses paid by the taxpayer. For tax years 2002 and 2003, the maximum deduction is $3,000 and is allowed to taxpayers whose adjusted gross income does not exceed $65,000 ($130,000 for a joint return). For tax years 2004 and 2005, two maximums apply: $4,000 for taxpayers whose adjusted gross income does not exceed $65,000 ($130,000 for a joint return) and $2,000 for taxpayers whose adjusted gross income does not exceed $80,000 ($160,000 for a joint return). No deduction is allowed to a taxpayer whose income exceeds these limits.

Education expenses for the taxpayer, spouse, or a dependent can be used for the deduction. This deduction cannot be taken in the same year that the taxpayer claims the federal Hope Credit or Lifetime Learning Credit for that individual.

This deduction was enacted at both the federal and state level in 2001. It is scheduled to expire after tax year 2005.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,500,000	$13,500,000	$14,700,000	$16,600,000

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. Since 1987 Minnesota has conformed to the federal treatment.

	Fiscal Year Impact			
	2002	2003	2004	2005
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, or ether.

This provision was enacted in 1992.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

FEDERAL PERSONAL DEDUCTIONS

1.62 ADDITIONAL STANDARD DEDUCTION FOR THE ELDERLY AND BLIND

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

A taxpayer or spouse who is age 65 and over or blind is allowed an additional standard deduction. For tax year 2001, the additional amount for married couples is $900 for each person who is elderly or blind ($1,800 if elderly and blind). The additional amount for a single person or head of household is $1,100 for a taxpayer who is elderly or blind ($2,200 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 is on an estimated 157,500 returns will be reduced by this provision in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$12,400,000	$12,800,000	$13,600,000	$14,100,000

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. 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 89,800 returns will have their tax reduced by this provision in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$26,800,000	$29,700,000	$32,600,000	$35,000,000

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 on owner-occupied residences. 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. In 2001 the limitation was phased out, starting in tax year 2006, and repealed in 2010.

Due to this deduction, the income tax is reduced on an estimated 728,000 returns in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$97,300,000	$76,700,000	$80,500,000	$84,600,000

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 located 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. In 2001 the limitation was phased out, starting in tax year 2006, and repealed in 2010.

An estimated 600,000 returns benefit from this provision for tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$8,400,000	$8,800,000	$9,300,000	$9,700,000

1.66 INTEREST ON HOME MORTGAGES

Internal Revenue Code, Sections 63(d) and 163(h)
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.

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 until the current restrictions were enacted in 1987. The limitation of certain itemized deductions was made permanent in 1993. In 2001 the limitation was phased out, starting in tax year 2006, and repealed in 2010.

This deduction will reduce state income tax on an estimated 697,500 returns in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$297,300,000	$323,500,000	$348,600,000	$372,900,000

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 federally-allowed deduction, mainly in regard to the maximum deduction and carry forward provision. The limitation of certain itemized deductions was made permanent in 1993. In 2001 the limitation was phased out, starting in tax year 2006, and repealed in 2010.

An estimated 709,000 returns will benefit from this deduction in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$161,200,000	$175,100,000	$190,900,000	$201,700,000

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. The $100 floor on the deduction was added in 1964, and in 1982 the deduction was restricted to losses exceeding 10% of adjusted gross income. The requirement for filing a timely insurance claim was added in 1986.

An estimated 2,500 Minnesota taxpayers will benefit from this provision in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,300,000	$1,400,000	$1,400,000	$1,500,000

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 certain education expenses paid for a qualifying child 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.

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 used to claim the K-12 education credit (Item 1.86).

An education deduction was first enacted in 1955. In 1997 the deduction was expanded, beginning with tax year 1998. This provision was last changed in 2001.

This subtraction is claimed on an estimated 200,000 returns.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$16,700,000	$17,500,000	$18,400,000	$19,300,000

1.70 CHARITABLE CONTRIBUTIONS FOR NONITEMIZERS

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

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. The contributions must meet the requirements for deductible contributions under the Internal Revenue Code.

This subtraction was enacted in 1999.

An estimated 94,000 returns used this provision in tax year 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,000,000	$4,400,000	$4,700,000	$5,100,000

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 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 for pension income was allowed, limited to a maximum amount with qualifying offsets. The elderly or disabled subtraction was enacted in 1988, and in 1994 the base amounts and income thresholds were increased by 20%.

An estimated 16,400 taxpayers will benefit from this provision in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$2,100,000	$1,700,000	$1,400,000	$1,200,000

1.72 SELF-EMPLOYED HEALTH INSURANCE

Internal Revenue Code, Section 162(l)
Minnesota Statutes, Sections 290.01, Subd. 19b(7)

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.

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.

The federal deduction was enacted in 1987 and was last changed in 1998. The Minnesota subtraction was enacted in 1992, and it was last changed in 2000.

Approximately 80,000 taxpayers are estimated to benefit from these provisions.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$16,000,000	$17,100,000	$18,500,000	$19,600,000

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 of $60,000 for married-joint returns, $40,000 for single persons, and $50,000 for head of household.

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. 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.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$400,000	$400,000	$0	$0

1.74 YOUTH WORKS POSTSERVICE BENEFITS

Minnesota Statutes, Section 290.01, Subd. 19b (9)

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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

1.75 SMALL ETHANOL PRODUCERS

Minnesota Statutes, Section 290.01, Subd. 19b (13)

A subtraction from federal taxable income is allowed for the amount of the federal small ethanol producer credit which is included in gross income. The federal credit is equal to ten cents per gallon of ethanol produced, used, or sold as a transportation fuel. A small producer is defined as having production capacity under 30 million gallons and may claim the federal credit for a maximum of 15 million gallons per year. Federal law requires that the credit be added to gross income.

This subtraction was enacted in 2000. The subtraction and the federal credit are scheduled to expire on January 1, 2008.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

1.76 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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

PREFERENTIAL COMPUTATIONS

1.77 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 800 returns for tax year 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$100,000	*	*

*Less Than $50,000

1.78 ACTIVE DUTY MILITARY PERSONNEL

Minnesota Statutes, Section 290.01, Subd. 7

A Minnesota resident is considered a nonresident for income tax purposes for the period of time that they are on active duty stationed outside Minnesota in the armed forces of the United States or the United Nations.

This provision was enacted in 2001.

About 10,000 active duty military personnel are Minnesota residents.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,400,000	$4,400,000	$4,400,000	$4,400,000

CREDITS

1.79 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 2001.

This credit was claimed on 29,000 returns for tax year 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$81,700,000	$87,900,000	$94,600,000	$101,900,000

1.80 CREDIT FOR INCOME TAX PAID BY A NONRESIDENT PARTNER

Minnesota Statutes, Section 290.06, Subd. 22a

A nonresident who is subject to Minnesota income tax on the gain from the sale of a partnership interest is allowed a nonrefundable credit for tax paid to the state of domicile if that state does not allow a credit for tax paid to Minnesota. The credit may not reduce the tax to an amount less than would apply if the gain were excluded from taxable income.

This credit was enacted in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$200,000	$200,000

1.81 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 taxable pension or social security 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 credit is based on two variables: the joint taxable income of the couple and the earned income and taxable pension or social security income of the lesser-earning spouse. For 2001, the credit does not apply unless taxable income is at least $26,480 and the earned income of the lesser-earning spouse is at least $15,000. The maximum credit for tax year 2001 is $276.

This credit was enacted in 1999 and was modified in 2000.

Approximately 400,000 returns benefit from the credit.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$57,600,000	$60,500,000	$64,200,000	$67,300,000

1.82 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 each beneficiary (taxpayer or spouse), equal to 25% of premiums paid to the extent not deducted in determining federal taxable income. The maximum credit is $200 for married couples filing joint returns and $100 for all other filers. The long-term care insurance policy must meet the requirements under specified sections of the Internal Revenue Code and have a lifetime benefit of at least $100,000.

This credit was enacted in 1997, effective with tax year 1999, and was last changed in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,500,000	$4,900,000	$5,200,000	$5,700,000

1.83 EMPLOYER TRANSIT PASS CREDIT

Minnesota Statutes, Section 290.06, Subd. 28

A nonrefundable credit is allowed against the individual income tax equal to 30% of the expense incurred by the taxpayer to provide transit passes to the taxpayer's employees. The transit pass must be for use in Minnesota. If the employer purchases the transit passes from the transit system and resells them to the employees, the expenses used for the credit are the difference between the amount the employer paid for passes and the amount charged to employees.

This credit was enacted in 2000.

For tax year 2000, this credit was claimed on about 170 returns.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

1.84 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. Beginning in tax year 2003, the federal credit is equal to eligible expenses up to $3,000 for one dependent and $6,000 for two or more multiplied by a percentage ranging from 35% to 20%.

The maximum state credit is reduced as income increases. For tax year 2001 the maximum amounts were reduced for taxpayers with total household income over $18,600, so that a taxpayer with total household income over $32,250 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 in 1991 to operators of licensed family day care homes and in 1994 to married couples with a child under age one. This provision was last changed in 2001 when the 2001 federal changes were adopted.

This credit was claimed on approximately 38,000 returns filed for tax year 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$12,400,000	$12,600,000	$15,900,000	$16,000,000

1.85 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 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 $2,450 for tax year 2001 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 the state credit is separate. All the dollar amounts in the calculation are indexed annually for inflation. The following calculations apply to tax year 2001.

- For a taxpayer with no children, the credit is 1.9125% of the first $4,760 of earned income. The credit is reduced by 1.9125% of earned income or modified adjusted gross income, whichever is greater, in excess of $5,950. The maximum credit is $91. The credit is phased out by income of $10,710.
- For a taxpayer with one child, the credit is 8.5% of the first $7,140 of earned income, plus 8.5% of earned income over $12,460 but less than $13,870. The credit is reduced by 5.73% of earned income or modified adjusted gross income, whichever is greater, in excess of $15,550. The maximum credit is $727. The credit is phased out by income of $28,281.
- For a taxpayer with two or more children, the credit is 10% of the first $10,020 of earned income, plus 20% of earned income over $15,320 but less than $17,320. The credit is reduced by 10.3% of earned income or modified adjusted gross income, whichever is greater, in excess of $18,450. The maximum credit is $1,402. The credit is phased out by income of $32,121.

In tax year 2002 through 2004, the beginning and ending of the phase-out range is increased by $1,000 for married-joint returns. The increase is $2,000 for 2005 through 2007 and $3,000 thereafter.

The working family credit was first enacted in 1991 and was equal to 10% of the federal earned income credit. In 1998 the credit was changed from a percentage of the federal credit to a separate calculation. The credit was increased several times, and federal changes were adopted. The credit was changed in 2001 when 2001 federal changes were adopted, including a higher phase-out range for joint returns.

The working family credit was claimed on about 204,000 returns for tax year 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$102,700,000	$107,800,000	$109,900,000	$112,000,000

1.86 CREDIT FOR K-12 EDUCATION EXPENSES

Minnesota Statutes, Section 290.0674

A refundable credit is allowed equal to eligible education-related expenses for a qualifying child 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 house hold income between $33,500 and $37,500. Beginning in tax year 2002, the credit is 75% of expenses rather than 100%.

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 (Item 1.69). 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. In 2001 the credit was reduced from 100% to 75% of expenses.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$22,100,000	$17,400,000	$18,300,000	$19,200,000

1.87 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(2) and Subd. 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			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$200,000	$200,000

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 2001. 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.

Income Class	Total Returns Filed: Number of Returns	Total Returns Filed: Percent	Tax After All Credits: Number of Returns	Tax After All Credits: Amount: Total (000's)	Tax After All Credits: Amount: Percent Of Total	Tax After All Credits: Amount: Average
$ 9,999 or Less	411,853	16.8%	248,246	$(8,426)	(0.1)%	$(34)
10,000 - $ 19,999	310,939	12.7	272,942	21,504	0.4	79
20,000 - 29,999	317,948	13.0	297,539	159,263	2.7	535
30,000 - 39,999	286,200	11.7	278,529	297,862	5.1	1,069
40,000 - 49,999	220,477	9.0	219,740	348,094	5.9	1,584
50,000 - 74,999	417,319	17.1	415,800	1,015,695	17.2	2,443
75,000 - 99,999	216,453	8.9	216,109	823,154	14.0	3,809
100,000 - 149,999	154,136	6.3	153,315	878,970	14.9	5,733
150,000 - 199,999	42,335	1.7	42,069	369,501	6.3	8,783
200,000 - 499,999	50,041	2.1	49,680	784,995	13.3	15,801
500,000 or More	17,916	0.7	17,074	1,198,367	20.3	70,187
Total	2,445,617	100.0%	2,211,043	$5,888,979	100.0%	$2,663

Selected Tax Expenditures - Refundable Credits

Income Class	Working Family Credit: Number of Returns	Working Family Credit: Amount: Total (000's)	Working Family Credit: Amount: Percent Of Total	Working Family Credit: Amount: Average	Child Care Credit: Number of Returns	Child Care Credit: Amount: Total (000's)	Child Care Credit: Amount: Percent of Total	Child Care Credit: Amount: Average
$ 9,999 or Less	72,400	$22,111	21.5%	$305	4,638	$1,674	13.5%	$360
10,000 - $ 19,999	66,177	49,779	48.5	752	11,268	3,436	27.6	305
20,000 - 29,999	60,017	29,321	28.6	489	17,766	6,696	53.9	377
30,000 - 39,999	5,406	1,489	1.4	275	4,758	624	5.0	131
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	204,000	$102,700	100.0%	$503	38,430	$12,430	100.0%	$323

Appendix to Chapter 1 (Continued)

Selected Tax Expenditures - Itemized Deductions

Income Class	Real Estate Taxes: Number of Returns	Real Estate Taxes: Amount Total (000's)	Real Estate Taxes: Amount Percent of Total	Real Estate Taxes: Amount Average	Mortgage Interest: Number of Returns	Mortgage Interest: Amount Total (000's)	Mortgage Interest: Amount Percent of Total	Mortgage Interest: Amount Average
$ 9,999 or Less	510	$54	0.1%	$106	1,111	$63	-	$57
10,000 - $19,999	9,406	508	0.5	54	9,532	1,623	0.5%	170
20,000 - 29,999	29,225	1,581	1.6	54	31,635	5,527	1.9	175
30,000 - 39,999	58,749	3,666	3.8	62	55,067	11,125	3.7	202
40,000 - 49,999	70,880	5,503	5.7	78	67,716	17,749	6.0	262
50,000 - 74,999	203,597	20,086	20.7	99	195,418	63,566	21.4	325
75,000 - 99,999	149,077	18,942	19.5	127	145,569	61,547	20.7	423
100,000 - 149,999	121,519	20,733	21.3	171	115,714	66,606	22.4	576
150,000 - 199,999	34,196	7,738	8.0	226	31,622	24,262	8.2	767
200,000 - 499,999	39,996	12,351	12.7	309	35,719	34,273	11.5	960
500,000 or More	10,626	6,088	6.3	573	8,447	10,983	3.7	1,300
Total	727,781	$97,250	100.0%	$134	697,550	$297,324	100.0%	$426

Income Class	Charitable Contributions: Number of Returns	Charitable Contributions: Amount Total (000's)	Charitable Contributions: Amount Percent of Total	Charitable Contributions: Amount Average	Medical and Dental Expenses: Number of Returns	Medical and Dental Expenses: Amount Total (000's)	Medical and Dental Expenses: Amount Percent of Total	Medical and Dental Expenses: Amount Average
$ 9,999 or Less	507	$2	-	$4	-	-	-	-
10,000 - $19,999	8,589	553	0.3%	64	5,272	$471	1.8%	$89
20,000 - 29,999	26,817	1,349	0.8	50	12,890	1,766	6.6	137
30,000 - 39,999	55,578	4,386	2.7	79	17,489	3,075	11.5	176
40,000 - 49,999	66,961	4,775	3.0	71	13,563	2,852	10.7	210
50,000 - 74,999	197,246	21,654	13.4	110	26,921	10,257	38.3	381
75,000 - 99,999	147,560	21,724	13.5	147	7,970	4,127	15.4	518
100,000 - 149,999	121,057	26,972	16.7	223	4,206	2,177	8.1	518
150,000 - 199,999	34,103	11,413	7.1	335	695	508	1.9	731
200,000 - 499,999	39,763	21,304	13.2	536	774	1,464	5.5	1,891
500,000 or More	10,895	47,109	29.2	4,324	56	79	0.3	1,411
Total	709,076	$161,241	100.0%	$227	89,836	$26,776	100.0%	$298

Source: Distributions by income based on the House Income Tax Simulation Model using information from a sample of 1998 Minnesota individual income tax returns which was projected for tax year 2001.

CHAPTER 2: CORPORATE FRANCHISE TAX

Collections and History

For fiscal year 2001, net revenues from the corporate franchise tax were $729 million, equaling 5.5% 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, at the same time and at the same rates as the individual income tax. Several changes have been 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 tax benefit from deducting the portion that exceeds actual depreciation is considered to be a tax expenditure.

Computation of the Tax

The computation of the corporate franchise tax for tax year 2002 is as follows:

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

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, but only to the extent they exceed the state research credit - for a foreign sales corporation that was a foreign operating corporation in 1992, the extraterritorial income excluded federally multiplied by 1.23.
equals:	net income
times:	apportionment factor
equals:	taxable net income
minus:	Minnesota deductions - net operating loss - dividends received
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
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 12.5% of the Minnesota property ratio, 12.5% of the Minnesota payroll ratio, and 75% of the Minnesota sales ratio. With special permission or under certain conditions, separate accounting or a single factor of sales may be used.

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 2001 were $1.1 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 2.09 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 2000 there were about 187 credit unions in Minnesota with approximately 1,420,000 members.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$3,700,000	$3,900,000	$4,200,000	$4,500,000

2.02 INSURANCE COMPANIES

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

Insurance companies are exempt from the corporate franchise tax.

An exemption for all insurance companies was enacted in 2001. The broader exemption replaced exemptions for insurance companies domiciled in retaliatory states and smaller mutual property and casualty companies that were enacted in 1989.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$17,300,000	$19,100,000	$20,200,000	$21,500,000

FEDERAL EXCLUSIONS

2.03 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.

The exceptions to the imputed interest rules include 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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

2.04 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.

*Less Than $50,000

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,100,000	$4,400,000	$4,600,000	$4,900,000

2.05 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			
	2002	2003	2004	2005
State General Fund	$4,200,000	$4,500,000	$4,500,000	$4,800,000

2.06 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

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

Generally, when goods are returned to the seller, the income of the seller is reduced in the year the items are returned. However, distributors and publishers of magazines, paperbacks, and sound recordings may elect to exclude from gross income for a tax year the income from the sale of goods that are returned after the close of the tax year. The taxpayer must have a legal obligation to provide a refund or credit for unsold copies. The exclusion applies to magazines returned within two months and fifteen days after the end of the tax year and to paperbacks and records returned within four months and fifteen days after the end of the tax year.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

FEDERAL DEDUCTIONS

2.07 ACCELERATED DEPRECIATION

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

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).

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.

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 2000 when adjustments for differences between state and federal laws for property placed in service before 1988 were allowed to be taken in full in tax year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$102,400,000	$104,600,000	$102,300,000	$99,700,000

2.08 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 $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			
	2002	2003	2004	2005
State General Fund	$800,000	$700,000	$500,000	$200,000

2.09 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. 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, percentage depletion 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. 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			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

2.10 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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

2.11 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 or at the time of sale. 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 (Item 2.31).

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$8,400,000	$8,100,000	$8,100,000	$8,100,000

2.12 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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

2.13 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

Generally, amounts paid for permanent improvements or betterments to income-producing property are not deductible as current year expenses but are capitalized and recovered through depreciation or depletion. However, 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. Expensing is allowed only for domestic properties.

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			
	2002	2003	2004	2005
State General Fund	$1,100,000	$1,100,000	$800,000	$600,000

2.14 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

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.

A farm corporation may deduct certain expenditures made during the tax year rather than capitalize them. Qualifying expenditures include soil and water conservation expenses, the purchase and application of fertilizer, or costs associated with raising dairy and breeding cattle. 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.

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			
	2002	2003	2004	2005
State General Fund	$400,000	$400,000	$400,000	$400,000

2.15 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 costs associated with maintaining a timber stand after it is established. The costs include disease and pest control, brush clearing, and property taxes. This 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.

These costs have always been allowed to be expensed. When the uniform capitalization rules were adopted as part of the Tax Reform Act of 1986, an exception was allowed for timber.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,100,000	$1,100,000	$1,200,000	$1,200,000

2.16 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. 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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

2.17 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 has average annual gross receipts of $5 million or less or is a qualified personal service corporation. A qualified personal service corporation is an employee-owned service business in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.

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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

2.18 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 later 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. In 1999 the use of installment sales was restricted, but that restriction was repealed retroactively in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$3,700,000	$3,100,000	$2,400,000	$2,2 00,000

2.19 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 1933. 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			
	2002	2003	2004	2005
State General Fund	$600,000	$600,000	$600,000	$600,000

2.20 EMPLOYEE STOCK OWNERSHIP PLANS

Internal Revenue Code, Sections 401(a)(28), 404(a)(9) and (k), 415(c)(6), and 1042
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.

Employer contributions to an ESOP are deductible. An employer is allowed to deduct from its income dividends paid to an ESOP and dividends used to make payments on ESOP loans. The recongition of gain from the sale of qualified stock to an employee organization may be deferred if certain conditions are met. After the sale is completed, the ESOP must own at least 30% of the company stock.

The federal provisions were enacted in 1974 and were amended by the 1986 Tax Reform Act. Minnesota adopted the dividend deduction and the nonrecognition of gain on stock sales in 1984. These provision were last changed in 1997.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$5,400,000	$5,500,000	$5,700,000	$5,900,000

2.21 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.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

2.22 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, or ether.

This provision was enacted in 1992.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	*	*

APPORTIONMENT

2.23 WEIGHTED APPORTIONMENT

Minnesota Statutes, Section 290.191

A multi-state 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 12.5% of the Minnesota property ratio, 12.5% of the payroll ratio, and 75% of the sales ratio.

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.

*Less Than $50,000

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 15% property, 15% payroll, and 70% sales until they were changed in 1999, effective for tax years beginning after December 31, 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$110,900,000	$122,600,000	$129,800,000	$137,800,000

2.24 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 32.5% under existing law but would have a factor of 100% under the throwback rule. The other 67.5% 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			
	2002	2003	2004	2005
State General Fund	$24,900,000	$27,500,000	$29,100,000	$30,900,000

2.25 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 2.23). 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			
	2002	2003	2004	2005
State General Fund	$3,600,000	$4,000,000	$4,200,000	$4,500,000

MINNESOTA SUBTRACTIONS

2.26 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.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$96,100,000	$106,200,000	$112,400,000	$119,400,000

2.27 CHARITABLE CONTRIBUTIONS

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

A deduction is allowed for contributions made to organizations that are charitable, religious, scientific, literary, artistic, or educational in purpose. A corporation can deduct up to 10% of taxable income, with some adjustments. Excess contributions may be carried forward for up to five years.

A charitable deduction was enacted in 1933. In 2001 the separate charitable contribution deduction for the Minnesota tax was repealed, and the federal deduction was adopted.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$11,600,000	$12,800,000	$13,600,000	$14,400,000

2.28 FOREIGN SOURCE INCOME

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

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. 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 2,000 corporations benefit from these provisions.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$61,700,000	$68,200,000	$72,200,000	$76,600,000

2.29 SMALL ETHANOL PRODUCERS

Minnesota Statutes, Section 290.01, Subd. 19d (17)

A subtraction from federal taxable income is allowed for the amount of the federal small ethanol producer credit which is included in gross income. The federal credit is equal to ten cents per gallon of ethanol produced, used, or sold as a transportation fuel. A small producer is defined as having production capacity under 30 million gallons and may claim the federal credit for a maximum of 15 million gallons per year. Federal law requires that the credit be added to gross income.

This subtraction was enacted in 2000. The subtraction and the federal credit are scheduled to expire on January 1, 2008.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

2.30 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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

CREDITS

2.31 RESEARCH AND DEVELOPMENT CREDIT

Minnesota Statutes, Section 290.068

A corporation 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 was last changed in 1990.

In recent years the credit has been claimed on about 260 returns per year.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$20,200,000	$22,300,000	$23,700,000	$25,100,000

2.32 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.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$0	$500,000	$500,000	$2,000,000

2.33 EMPLOYER TRANSIT PASS CREDIT

Minnesota Statutes, Section 290.06, Subd. 28

A nonrefundable credit is allowed against the corporate franchise tax equal to 30% of the expense incurred by the taxpayer to provide transit passes to the taxpayer's employees. The transit pass must be for use in Minnesota. If the employer purchases the transit passes from the transit system and resells them to the employees, the expenses used for the credit are the difference between the amount the employer paid for passes and the amount charged to employees.

This credit was enacted in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,800,000	$2,200,000	$2,500,000	$2,800,000

2.34 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(2) and Subd. 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			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

2.35 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 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			
	2002	2003	2004	2005
State General Fund	$2,100,000	$0	$0	$0

CHAPTER 3: ESTATE TAX

Collections and History

Revenues from the Minnesota estate tax were $53 million in fiscal year 2001. 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 change for state tax purposes. At the time that this report is being prepared, none of the 2001 federal law changes to the estate tax have been adopted for the Minnesota estate tax.

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 $700,000 for deaths occurring in 2002 and 2003. 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 a specified amount which is indexed for inflation and is $820,000 for deaths in 2002. 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			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$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			
	2002	2003	2004	2005
State General Fund	$6,200,000	$6,700,000	$7,200,000	$7,800,000

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			
	2002	2003	2004	2005
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			
	2002	2003	2004	2005
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			
	2002	2003	2004	2005
State General Fund	$57,900,000	$62,900,000	$68,500,000	$74,500,000

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			
	2002	2003	2004	2005
State General Fund	$27,200,000	$28,200,000	$29,300,000	$30,000,000

CHAPTER 4: GENERAL SALES AND USE TAX

Collections and History

Revenues from the general sales and use tax totaled $3.8 billion in fiscal year 2001 (before reduction for the $791 million rebate), making it the second largest source of state revenue with 28.5% 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, and 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, for machinery, equipment, and tools used in agricultural or industrial production, the sale to the business is considered the sale to the final consumer.

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. These additional taxes are scheduled to expire after 2005.

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 furnishing of meals or drinks for a consideration; the furnishing for a consideration of lodging for less than thirty days; the admission to places of amusement or athletic events; the furnishing for a consideration 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.67, 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, coffee, tea, spices, and sugar.

Food and drinks served by a restaurant are taxable, as are all food and drinks sold in vending machines. Also taxable is prepared food which includes food that is heated by the seller and two or more food ingredients mixed or combined by the seller for sale as a single item. Taxable items also include candy, chewing gum, and soft drinks.

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 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$448,000,000	$461,800,000	$480,400,000	$501,000,000

4.02 CLOTHING AND WEARING APPAREL

Minnesota Statutes, Section 297A.67, Subd. 8 and 27

Clothing for general use 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, 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. It was last changed in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$375,400,000	$404,600,000	$434,200,000	$463,900,000

4.03 DRUGS AND MEDICINES

Minnesota Statutes, Section 297A.67, Subd. 7 (a) and (b)

Prescribed drugs or medicine for internal or external use in human beings are exempt from the sales and use tax. Over-the-counter drugs prescribed by a licensed physician are included as "prescribed drugs." Also exempt are insulin and nonprescription analgesics.

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			
	2002	2003	2004	2005
State General Fund	$192,000,000	$217,400,000	$244,100,000	$271,800,000

4.04 THERAPEUTIC AND PROSTHETIC DEVICES

Minnesota Statutes, Section 297A.67, Subd. 7 (c)

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

A therapeutic device 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. Prosthetic devices include hearing aids, wheelchairs, crutches, and artificial limbs.

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

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$8,700,000	$9,200,000	$9,800,000	$10,400,000

4.05 PRESCRIPTION EYEGLASSES

Minnesota Statutes, Section 297A.67, Subd. 7 (c)

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			
	2002	2003	2004	2005
State General Fund	$17,700,000	$18,500,000	$19,100,000	$19,700,000

4.06 BABY PRODUCTS

Minnesota Statutes, Section 297A.67, Subd. 9

Lotion, oil, powder, shampoo, and similar products designed for babies are exempt from the sales and use tax. Also exempt are baby bottles and nipples, pacifiers, teething rings, thumb sucking preventatives, and infant syringes.

This exemption was enacted in 1967 and was last changed in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$800,000	$900,000	$900,000	$900,000

4.07 FEMININE HYGIENE ITEMS

Minnesota Statutes, Section 297A.67, Subd. 17

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			
	2002	2003	2004	2005
State General Fund	$2,500,000	$2,600,000	$2,700,000	$2,800,000

4.08 CASKETS AND BURIAL VAULTS

Minnesota Statutes, Section 297A.67, Subd. 10

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

This provision was enacted in 1967.

Approximately 38,700 deaths occurred in Minnesota in 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$5,900,000	$5,900,000	$5,900,000	$5,900,000

4.09 PUBLICATIONS

Minnesota Statutes, Section 297A.68, 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			
	2002	2003	2004	2005
State General Fund	$50,100,000	$51,900,000	$54,400,000	$57,100,000

4.10 TEXTBOOKS REQUIRED FOR SCHOOL USE

Minnesota Statutes, Section 297A.67, Subd. 13

A sales tax exemption is allowed for sales of textbooks required for a course of study at a public or private school, college, university, business, or trade school if they are purchased by students enrolled at the institution.

This provision was enacted in 1973.

There were about 291,000 post-secondary students in Minnesota for the 2000-2001 school year.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$7,800,000	$8,100,000	$8,500,000	$8,900,000

4.11 PERSONAL COMPUTERS REQUIRED FOR SCHOOL USE

Minnesota Statutes, Section 297A.67, Subd. 14

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.

In the 2000-2001 school year, approximately 5,000 students attended a school which required that they rent personal computers from the school.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

4.12 MOTOR FUELS

Minnesota Statutes, Section 297A.68, Subd. 19 (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			
	2002	2003	2004	2005
State General Fund	$282,800,000	$281,600,000	$286,600,000	$292,500,000

4.13 RESIDENTIAL HEATING FUELS

Minnesota Statutes, Section 297A.67, Subd. 15

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 exemption was enacted in 1978 and was expanded in 1984 to include hot water.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$79,400,000	$80,400,000	$82,600,000	$84,100,000

4.14 RESIDENTIAL WATER SERVICES

Minnesota Statutes, Section 297A.67, Subd. 16

The furnishing of water for residential use is exempt from the Minnesota sales and use tax.

This provision was enacted in 1979.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$10,900,000	$11,200,000	$11,500,000	$11,800,000

4.15 SEWER SERVICES

Minnesota Statutes, Section 297A.61, Subd. 3

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			
	2002	2003	2004	2005
State General Fund	$26,100,000	$27,400,000	$28,900,000	$30,400,000

4.16 USED MANUFACTURED HOMES

Minnesota Statutes, Section 297A.67, Subd. 20

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 4.91). 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			
	2002	2003	2004	2005
State General Fund	$600,000	$600,000	$700,000	$700,000

4.17 SELECTED SERVICES

Minnesota Statutes, Section 297A.61, Subd. 3

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 on the next page 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. In 2001 the base was expanded to include nearly all telecommunications services.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,183,600,000	$1,251,000,000	$1,328,300,000	$1,409,700,000

Note: detailed list is on the next page.

	Fiscal Year Impact			
	2002 (000's)	2003 (000's)	2004 (000's)	2005 (000's)
Personal Services:				
Beauty and Barber Shops	$36,700	$38,200	$39,700	$41,200
Shoe and Leather Goods Repair	500	500	500	500
Funeral Services	10,700	11,100	11,600	12,000
Tax Preparation	4,000	4,200	4,300	4,500
Diet and Weight Reducing	800	800	900	900
Miscellaneous Personal Services	2,000	2,200	2,200	2,300
Personal Services Total	$54,700	$57,000	$59,200	$61,400
Business Services:				
Advertising and Public Relations	$83,000	$89,900	$97,900	$106,900
Consumer Credit and Mercantile Reporting,	7,500	8,200	8,900	9,700
Collection Agencies	8,300	9,000	9,800	10,700
Office Administrative Services	51,300	55,600	60,600	66,100
Computer System Design and Related Services	167,600	181,500	197,900	215,900
Other Business Services	7,000	7,600	8,300	9,000
Business Services Total	$324,700	$351,800	$383,400	$418,300
Automotive Repair and Maintenance	$136,000	$141,700	$147,200	$152,700
Miscellaneous Repair Services	$75,900	$79,100	$82,200	$85,300
Legal Services	$188,700	$198,000	$209,100	$220,500
Engineering, Architectural, and Drafting Services	$123,800	$129,900	$137,200	$144,700
Accounting, Bookkeeping, and Payroll Services	$90,200	$94,600	$99,900	$105,300
Commercial Testing Services	$8,900	$9,300	$9,800	$10,400
Management, Scientific, and Technical Consulting Services	$93,600	$98,200	$103,700	$109,300
Scientific Research and Development	$23,900	$25,100	$26,500	$27,900
Surveying and Mapping Services	$6,100	$6,400	$6,800	$7,100
Industrial Design Services	$2,200	$2,300	$2,500	$2,600
Other Professional, Scientific, and Technical Services	$54,900	$57,600	$60,800	$64,200

4.18 YMCA, YWCA, AND JCC MEMBERSHIP DUES

Minnesota Statutes, Section 297A.70, Subd. 12

One-time 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 from the sales and use tax. 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 imposed on memberships to clubs providing sports and athletic facilities. It was extended to the Jewish Community Centers in 1996.

Approximately 337,500 people belong to one of these organizations.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$2,200,000	$2,200,000	$2,300,000	$2,300,000

4.19 CROSS COUNTRY SKI PASSES FOR PUBLIC TRAILS

Minnesota Statutes, Section 297A.67, Subd. 19

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 62,000 cross country ski passes were purchased in fiscal year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.20 ADMISSION TO THE MINNESOTA ZOO

Minnesota Statutes, Section 297A.70, Subd. 10 (b)

Admissions or tickets to the premises of the Minnesota Zoo are exempt from the sales and use tax. Also exempt are admissions or tickets to events or performances held on the premises if sponsored and conducted exclusively by the Minnesota Zoological Board or employees of the Minnesota Zoo.

This exemption was enacted in 2001.

*Less Than $50,000

There were about 750,000 paid admissions to the zoo in fiscal year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$200,000	$200,000

4.21 PERSONAL PROPERTY BROUGHT INTO MINNESOTA

Minnesota Statutes, Section 297A.67, Subd. 22

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 4.92).

This provision was enacted in 1967.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$9,400,000	$9,700,000	$10,000,000	$10,200,000

4.22 DE MINIMIS USE TAX EXEMPTION FOR INDIVIDUALS

Minnesota Statutes, Section 297A.67, Subd. 21

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 4.92).

This exemption was enacted in 1996.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,400,000	$4,700,000	$5,000,000	$5,400,000

4.23 CAPITAL EQUIPMENT

Minnesota Statutes, Sections 297A.68, Subd. 5

Certain capital equipment purchases are exempt from the sales and use tax. To qualify, the capital equipment 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 machinery and equipment that is essential to the integrated production process, including machinery and equipment used to operate or control the production equipment. Repair and replacement parts and accessories are included in the exemption. The exemption also applies to materials and supplies used to construct and install the equipment and to construct special purpose buildings used in the production process.

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 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.

About 2,400 refund claims were paid under these provisions in fiscal year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$210,000,000	$195,900,000	$198,800,000	$213,100,000

4.24 ACCESSORY TOOLS

Minnesota Statutes, Section 297A.68, Subd. 2 (6)

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			
	2002	2003	2004	2005
State General Fund	$7,500,000	$7,600,000	$7,800,000	$7,900,000

4.25 SPECIAL TOOLING

Minnesota Statutes, Sections 297A.68, Subd. 6

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 4.24.

A reduced rate for special tooling was enacted in 1984. In 1994 the reduced rate was replaced with the exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,800,000	$4,800,000	$4,900,000	$4,900,000

4.26 TELECOMMUNICATIONS EQUIPMENT

Minnesota Statutes, Section 297A.68, Subd. 35

An exemption from the sales and use tax is allowed for telecommunications equipment purchased or leased for use directly by a telecommunications service provider in providing telecommunications services that are ultimately sold at retail. The exemption applies regardless of whether purchases are made by the owner, a contractor, or a subcontractor.

The exemption includes machinery, equipment, and fixtures and also repair and replacement parts and accessories for qualifying equipment. The exemption does not include wire, cable, fiber, poles, or conduit used in transporting telecommunications services.

This exemption was enacted in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$24,500,000	$30,200,000	$31,300,000	$32,600,000

4.27 RESOURCE RECOVERY EQUIPMENT

Minnesota Statutes, Section 297A.68, Subd. 24

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 in 1996 was extended to include pollution control equipment.

Twelve facilities are expected to benefit from this exemption in fiscal years 2002 through 2005.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$500,000	$200,000	$100,000	*

4.28 USED MOTOR OIL

Minnesota Statutes, Section 297A.67, Subd. 18

The gross receipts from the sale of used motor oil are exempt from the sales and use tax.

This exemption was enacted in 1988.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

4.29 TACONITE PRODUCTION MATERIALS

Minnesota Statutes, Section 297A.68, Subd. 4

Sales of mill liners, grinding rods, and grinding balls to taconite mining companies are exempt from the sales and use tax. To qualify, the items must be substantially consumed in the production of taconite. The estimates do not include items that would qualify as accessory tools (Item 4.24).

This exemption was enacted in 1971.

Six taconite companies are located in Minnesota.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

4.30 WIND ENERGY CONVERSION SYSTEMS

Minnesota Statutes, Sections 297A.68, Subd. 12

The gross receipts from the sale of 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 4.23).

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			
	2002	2003	2004	2005
State General Fund	$400,000	$300,000	$300,000	$300,000

4.31 AIR COOLING EQUIPMENT

Minnesota Statutes, Sections 297A.68, Subd. 7

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.

Seven systems are scheduled for conversion or replacement in fiscal years 2002 through 2005.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	*	$200,000	$200,000

*Less Than $50,000

4.32 ENERGY EFFICIENT PRODUCTS

Minnesota Statutes, Section 297A.67, Subd. 29

Certain products are exempt from the sales and use tax if they meet the specifications for energy efficiency. The exemption applies to a residential lighting fixture with an energy star label, a compact fluorescent bulb with an energy star label, an electric heat pump water heater with an energy factor of at least 1.9, a natural gas water heater with an energy factor of at least 0.62, a natural gas furnace with an annual fuel utilization efficiency greater than 92%, and any photovoltaic device, as defined.

This exemption was enacted in 2001 and is scheduled to expire on August 1, 2005.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$500,000	$600,000	$600,000	$700,000

4.33 AIRFLIGHT EQUIPMENT

Minnesota Statutes, Section 297A.82, Subd. 4 (d)

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.

This exemption benefits primarily the 32 airline companies subject to the airflight property tax.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$23,100,000	$24,000,000	$17,900,000	$16,500,000

4.34 LARGE SHIPS

Minnesota Statutes, Section 297A.68, Subd. 17

The gross receipts from the sale of, and use, storage, or consumption of, 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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

4.35 REPAIR AND REPLACEMENT PARTS FOR SHIPS AND VESSELS

Minnesota Statutes, Section 297A.68, Subd. 17

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			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

4.36 LIGHT RAIL TRANSIT VEHICLES

Minnesota Statutes, Section 297A.70, Subd. 2 (a)(4)

Sales to the Metropolitan Council of vehicles and repair parts used to equip the operation of light rail transit are exempt from the sales and use tax.

This exemption was enacted in 2001.

The exemption applies to one entity.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$800,000	$1,000,000	$1,000,000	$1,000,000

4.37 PETROLEUM PRODUCTS USED BY TRANSIT SYSTEMS

Minnesota Statutes, Section 297A.68, Subd. 19 (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 100 transit systems.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$900,000	$900,000	$900,000	$900,000

4.38 PETROLEUM PRODUCTS USED IN PASSENGER SNOWMOBILES

Minnesota Statute, Section 297A.68, Subd. 19 (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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.39 SKI AREA EQUIPMENT

Minnesota Statutes, Section 297A.68, Subd. 34

An exemption from the sales and use tax is allowed for tangible personal property used or consumed primarily and directly for tramways at ski areas or in snowmaking and snow grooming at ski hills, ski slopes, or ski trails. Included in the exemption are machinery, equipment, fuel, electricity, and water additives used in the production and maintenance of machine-made snow.

This exemption was enacted in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$200,000	$200,000

*Less Than $50,000

4.40 LOGGING EQUIPMENT

Minnesota Statutes, Sections 297A.61, Subd. 12(b)(4) and 297A.69, Subd. 4

Logging equipment is exempt from the sales and use tax. 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			
	2002	2003	2004	2005
State General Fund	$700,000	$800,000	$800,000	$800,000

4.41 FARM MACHINERY

Minnesota Statutes, Sections 297A.69, Subd. 4

All farm machinery is exempt from the Minnesota sales and use tax. Qualifying farm machinery includes machinery, equipment, implements, and accessories used directly and principally in the production for sale of agricultural products, including livestock. Irrigation systems also qualify for exemption.

A reduced 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. Used farm machinery was exempted in 1994 as a temporary provision, and the exemption was made permanent in 1997. The definition of farm machinery eligible for exemption has been expanded several times and was last changed in 2001.

There are about 80,000 farms in Minnesota.

	Fiscal Year Impact			
	2002	2003	2004	2005
New Machinery	$14,200,000	$14,300,000	$14,400,000	$14,500,000
Used Machinery	$4,700,000	$4,900,000	$5,000,000	$5,100,000
Total - State General Fund	$18,900,000	$19,200,000	$19,400,000	$19,600,000

4.42 REPAIR AND REPLACEMENT PARTS FOR FARM MACHINERY

Minnesota Statutes, Section 297A.69, Subd. 3

Repair and replacement parts, except tires, used for maintenance or repair of farm machinery are exempt from the sales and use tax. The machinery must be used in agricultural production and the part must replace a part assigned a specific or generic part number by the manufacturer of the machinery.

This exemption was enacted in 1985.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$7,400,000	$7,400,000	$7,400,000	$7,400,000

4.43 PETROLEUM PRODUCTS USED TO IMPROVE AGRICULTURAL LAND

Minnesota Statutes, Section 297A.68, Subd. 19 (2)

Petroleum products used to improve agricultural land are exempt from the sales and use tax. Qualifying products 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.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.44 FARM CONSERVATION PROGRAM ITEMS

Minnesota Statutes, Section 297A.69, Subd. 2 (1)

Seeds, trees, fertilizers, and herbicides purchased by farmers for use in a federal or state conservation program are exempt from the sales and use tax. 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. The programs include the federal Conservation Reserve Program, the Stewardship Incentive Program, and the Forestry Incentive Program, and the State Reinvest in Minnesota Program.

This provision was enacted in 1991.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$500,000	$500,000	$500,000	$500,000

*Less Than $50,000

4.45 USED FARM TIRES

Minnesota Statutes, Section 297A.69, Subd. 5

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.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.46 HORSES

Minnesota Statutes, Section 297A.69, Subd. 6 (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			
	2002	2003	2004	2005
State General Fund	$1,100,000	$1,100,000	$1,100,000	$1,200,000

4.47 PRIZES AT CARNIVALS AND FAIRS

Minnesota Statutes, Section 297A.68, Subd. 29

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			
	2002	2003	2004	2005
State General Fund	$600,000	$600,000	$600,000	$600,000

*Less Than $50,000

4.48 TELEVISION COMMERCIALS

Minnesota Statutes, Section 297A.68, Subd. 30

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			
	2002	2003	2004	2005
State General Fund	$1,100,000	$1,200,000	$1,200,000	$1,200,000

4.49 ADVERTISING MATERIALS

Minnesota Statutes, Section 297A.68, Subd. 11

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			
	2002	2003	2004	2005
State General Fund	$7,000,000	$7,400,000	$7,900,000	$8,400,000

4.50 COURT REPORTER DOCUMENTS

Minnesota Statutes, Section 297A.68, Subd. 22

An exemption from the sales and use tax is allowed for 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.

This exemption was enacted in 1997.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$400,000	$400,000	$500,000	$500,000

4.51 PATENT, TRADEMARK, AND COPYRIGHT DRAWINGS

Minnesota Statutes, Section 297A.68, Subd. 33

An exemption from the sales and use tax is allowed for a drawing, diagram, or similar document or copy of such a document if it produced and sold by a patent drafter. A "patent drafter" is defined as a person who prepares illustrative documents required in the preparation of intellectual property applications. The document must be for use in: a patent, trademark, or copyright application to be filed with a government agency; an application to the federal Food and Drug Administration for approval of a medical device; or a judicial or quasi-judicial proceeding relating to the validity of or legal rights under a patent, trademark, or copyright.

This exemption was enacted in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

4.52 CERTAIN INTERSTATE TELEPHONE SERVICE

Minnesota Statutes, Section 297A.68, Subd. 26

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			
	2002	2003	2004	2005
State General Fund	$7,100,000	$7,500,000	$8,000,000	$8,400,000

4.53 METROPOLITAN PUBLIC SAFETY RADIO SYSTEMS

Minnesota Statutes, Section 297A.70, Subd. 8

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			
	2002	2003	2004	2005
State General Fund	$1,100,000	$700,000	$0	$0

4.54 PACKING MATERIALS

Minnesota Statutes, Section 297A.68, Subd. 16

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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.55 PROPERTY FOR BUSINESS USE OUTSIDE MINNESOTA

Minnesota Statutes, Section 297A.68, Subd. 13

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 the item is used for business and one of the following conditions is met: it is not subject to 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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

4.56 AUTOMATIC FIRE-SAFETY SPRINKLER SYSTEMS

Minnesota Statutes, Section 297A.68, Subd. 23

The gross receipts from the sale of certain automatic fire-safety sprinkler systems are exempt from the sales and use tax. 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			
	2002	2003	2004	2005
State General Fund	$700,000	$700,000	$600,000	$500,000

4.57 BUILDING MATERIALS FOR RESIDENCES OF DISABLED VETERANS

Minnesota Statutes, Section 297A.71, Subd. 11

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 2101 to 2105.

This exemption was enacted in 1971.

The number of beneficiaries is fewer than ten per year.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.58 CHAIR LIFTS, RAMPS, AND ELEVATORS IN HOMESTEADS

Minnesota Statutes, Section 297A.71, Subd. 12

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.

*Less Than $50,000

This exemption was enacted in 1989.

Fewer than 100 homesteads benefit from this provision each year.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.59 AMBULANCES LEASED TO LICENSED AMBULANCE SERVICES

Minnesota Statutes, Section 297A.70, Subd. 6

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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.60 FIREFIGHTER PERSONAL PROTECTIVE EQUIPMENT

Minnesota Statutes, Section 297A.70, Subd. 3 (a) (6) and (b)

An exemption from the sales and use tax is allowed for firefighter personal protective equipment purchased or authorized by an organized fire department, fire protection district, or qualifying fire company. 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			
	2002	2003	2004	2005
State General Fund	$700,000	$700,000	$700,000	$700,000

*Less Than $50,000

4.61 PARTS AND ACCESSORIES TO MAKE MOTOR VEHICLES HANDICAPPED ACCESSIBLE

Minnesota Statutes, Section 297A.67, Subd. 12

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 5.18) applies to the purchase price of a vehicle that has already been modified.

This exemption was enacted in 1993.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$700,000	$800,000	$900,000	$900,000

4.62 MAINTENANCE OF CEMETERY GROUNDS

Minnesota Statutes, Section 297A.67, Subd. 25

Lawn care and related services used in the maintenance of cemetery grounds are exempt from the sales and use tax. The estimates do not include purchases for cemeteries owned by churches or other religious organizations because they are covered under the nonprofit exemption (Item. 4.65).

This exemption was enacted in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.63 PRICE REDUCED BY VALUE OF TRADE IN

Minnesota Statutes, Section 297A.67, Subd. 26

The amount allowed as credit for tangible personal property taken in trade for resale is exempt from the sales and use tax.

This provision was enacted in 1967 and was last changed in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$6,100,000	$6,300,000	$6,500,000	$6,600,000

*Less Than $50,000

EXEMPTIONS - SALES TO PARTICULAR GROUPS

4.64 CERTAIN SALES TO LOCAL GOVERNMENTS

Minnesota Statutes, Sections 297A.70, Subd. 2 and 3 and 297A.71, Subd. 3

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			
	2002	2003	2004	2005
School Districts	$46,200,000	$46,800,000	$47,500,000	$48,100,000
Hospitals	9,700,000	10,000,000	10,200,000	10,500,000
Nursing Homes	900,000	1,000,000	1,000,000	1,000,000
Libraries	2,900,000	3,000,000	3,100,000	3,100,000
Fire Trucks, Ambulances, Patrol Cars	3,500,000	3,600,000	3,600,000	3,800,000
Motor Fuel in These Vehicles	300,000	300,000	300,000	300,000
Ambulance Medical Supplies	100,000	100,000	100,000	100,000
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	1,900,000	1,900,000	1,900,000	1,900,000
Town Road Maintenance Equipment	100,000	100,000	100,000	100,000
Total - State General Fund	$65,800,000	$67,000,000	$68,000,000	$69,100,000

4.65 SALES TO NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.70, Subd. 4

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.

Nonprofit hospitals and surgical centers are estimated separately in Item 4.66.

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 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$41,000,000	$42,000,000	$43,000,000	$44,000,000

4.66 HOSPITALS AND OUTPATIENT SURGICAL CENTERS

Minnesota Statutes, Section 297A.70, Subd. 7

An exemption from the sales and use tax is allowed for sales to hospitals if the purchases are used in providing hospital services. Likewise, an exemption applies to sales to outpatient surgical centers if the purchases are used in providing outpatient surgical services. To qualify, the hospital or outpatient surgical center must be organized and operated for charitable purposes within the meaning of Section 501 (c)(3) of the Internal Revenue Code and must be licensed under Chapter 144.

Hospitals were exempt under the provisions for nonprofit organizations when the sales tax was enacted in 1967. In 1997 a separate exemption for hospitals was enacted, and it was extended to outpatient surgical centers in 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$48,500,000	$49,700,000	$50,800,000	$52,000,000

4.67 CERTAIN PURCHASES BY AMBULANCE SERVICES

Minnesota Statutes, Sections 297A.67, Subd. 28 and 297A.68, Subd. 19 (4)

Purchases by a licensed ambulance service of supplies and equipment used to provide medical care, repair and replacement parts for ambulances, and petroleum products are exempt from the sales and use tax. Because purchases by municipal ambulance services are exempt under another provision (Item 4.64), the estimates include only purchases by private ambulance services.

This exemption was enacted in 2001.

There are 55 private ambulance services in Minnesota.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$100,000	$100,000	$100,000	$100,000

4.68 SALES TO VETERANS' ORGANIZATIONS

Minnesota Statutes, Section 297A.70, Subd. 5

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 880 organizations qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

4.69 CONSTRUCTION MATERIALS FOR LOW-INCOME HOUSING

Minnesota Statutes, Section 297A.71, Subd. 23

Materials and supplies used or consumed in and equipment incorporated into the construction, improvement, or expansion of qualified low-income housing projects are exempt from the sales and use tax. The exemption applies regardless of whether the purchases are made by the owner or a contractor.

The owner of the project must be a public housing agency, a housing and redevelopment authority within a political subdivision, an entity exercising the powers of a housing and redevelopment authority, or a qualifying nonprofit corporation. The project must qualify under one of the specified state or federal low-income housing programs.

This exemption was enacted in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$400,000	$400,000

4.70 BIOSOLIDS PROCESSING EQUIPMENT

Minnesota Statutes, Section 297A.70, Subd. 3(a)(9)

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.

The equipment exemption was enacted in 1998.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$500,000	$900,000	$600,000	$600,000

4.71 DISTRICT HEATING AND COOLING FACILITY

Minnesota Statutes, Section 297A.71, Subd. 8

Building materials and supplies for 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. 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			
	2002	2003	2004	2005
State General Fund	$200,000	$100,000	$0	$0

4.72 LAKE SUPERIOR CENTER

Minnesota Statutes, Section 297A.71, Subd. 4

Building 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			
	2002	2003	2004	2005
State General Fund	*	$0	$0	$0

4.73 MINNEAPOLIS CONVENTION CENTER

Minnesota Statutes, Section 297A.71, Subd. 15

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. In 2001 it was repealed, effective July 1, 2002.

One facility is the beneficiary of this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	$0	$0	$0

*Less Than $50,000

4.74 YELLOW MEDICINE COUNTY LAW ENFORCEMENT AND FAMILY SERVICE CENTER

Minnesota Statutes, Section 297A.71, Subd. 26

Materials and supplies used or consumed in and fixtures, furnishings, and equipment incorporated into the construction, improvement, or expansion of the Yellow Medicine County law enforcement and family service center are exempt from the sales and use tax. The exemption expires January 1, 2003.

This exemption was enacted in 2001.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	$0	$0	$0

4.75 BIOMASS ELECTRICAL GENERATING FACILITY

Minnesota Statutes, Section 297A.71, Subd. 21

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. 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. In 2001 the original expiration date was extended to July 1, 2003.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$200,000	*	$0	$0

*Less Than $50,000

4.76 ELECTRIC GENERATING FACILITY USING POULTRY LITTER BIOMASS

Minnesota Statutes, Section 297A.71, Subd. 25

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 facility must be designed to utilize poultry litter biomass as a primary fuel source and must generate power that will be sold under a contract approved by the Public Utilities Commission in accordance with the biomass mandate in Minnesota Statutes, Section 216B.2424.

This exemption was enacted in 2001.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$400,000	$400,000	$0	$0

4.77 ELECTRIC GENERATING FACILITY USING WASTE TIRES

Minnesota Statutes, Section 297A.71, Subd. 27

Materials and supplies used or consumed in and equipment incorporated into the construction, improvement, or expansion of a facility using waste tires to generate electricity are exempt from the sales and use tax. The facility must be a cogeneration facility which uses waste tires as a primary fuel and has an installed capacity of one to 25 megawatts.

This exemption was enacted in 2001.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$200,000	$0	$0

4.78 AGRICULTURAL PROCESSING FACILITY

Minnesota Statutes, Section 297A.71, Subd. 20

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 expected 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			
	2002	2003	2004	2005
State General Fund	$400,000	$200,000	$0	$0

4.79 SOYBEAN PROCESSING FACILITY

Minnesota Statutes, Section 297A.71, Subd. 18

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 purchases are made 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			
	2002	2003	2004	2005
State General Fund	$200,000	$1,000,000	$200,000	$0

4.80 PORK PROCESSING FACILITY

Laws 2000, Chapter 490, Article 8, Section 17 (Uncodified) as Amended by
Laws 2001, First Special Session, Chapter 5, Article 12, Section 89

An exemption from the sales and use tax is allowed for materials, supplies, and equipment used or consumed in the construction and initial equipping of an agricultural pork processing facility. The exemption applies regardless of whether the purchases are made by the owner, a contractor, subcontractor, or builder. The exemption expires December 31, 2001.

The facility must meet certain conditions. The construction and equipping of the facility must be at least $4 million. The facility must be owned and operated by a cooperative organized under Chapter 308A and have a maximum daily processing capacity of at least 400 hogs.

This exemption was enacted in 2000. In 2001 the expiration date was extended by one year.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$100,000	$0	$0	$0

4.81 SOYBEAN PROCESSING FACILITY IN A SMALLER COUNTY

Minnesota Statutes, Section 297A.71, Subd. 24

Materials and supplies used or consumed in and machinery and equipment incorporated into the construction, improvement, or expansion of a soybean oilseed processing facility are exempt from the sales and use tax. The facility must be owned and operated by a cooperative organized under Chapter 308A and must be located in a county with a population of less than 21,000. The exemption expires July 1, 2004.

This exemption was enacted in 2001.

One facility is expected to benefit from this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$0	$800,000	$0	$0

EXEMPTIONS - SALES BY PARTICULAR GROUPS

4.82 ISOLATED OR OCCASIONAL SALES

Minnesota Statutes, Sections 297A.67, Subd. 23 and 297A.68, Subd. 25

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: 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.

An exemption for all isolated or occasional sales 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 the exceptions listed above. This provision was last changed in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$30,500,000	$32,100,000	$33,800,000	$35,600,000

4.83 INSTITUTIONAL MEALS

Minnesota Statutes, Section 297A.67, Subd. 4, 5, and 6

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			
	2002	2003	2004	2005
State General Fund	$41,200,000	$42,600,000	$43,900,000	$45,300,000

4.84 FUNDRAISING SALES BY NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.70, Subd. 13 (a) (1) and (2) and Subd. 14

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 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$7,500,000	$7,700,000	$7,800,000	$8,000,000

4.85 CANDY SALES BY CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 297A.70, Subd. 13 (a)(4)

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 4.84).

This exemption was enacted in 1984 and was last changed in 1997.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

4.86 MINNESOTA AMATEUR SPORTS COMMISSION EVENTS

Minnesota Statutes, Section 297A.70, Subd. 15

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 of tangible personal property made by the nonprofit corporation are also exempt.

This exemption was enacted in 1994.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.87 ADMISSION TO CHARITABLE GOLF TOURNAMENTS

Minnesota Statutes, Section 297A.70, Subd. 13 (a) (3)

Tickets or admissions 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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

4.88 ADMISSION TO SCHOOL-SPONSORED EVENTS

Minnesota Statutes, Section 297A.70, Subd. 11

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 4.89) or under the fundraising exemption (Item 4.84).

This exemption was enacted in 1985.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$700,000	$700,000	$700,000	$700,000

*Less Than $50,000

4.89 ADMISSION TO ARTISTIC EVENTS

Minnesota Statutes, Section 297A.70, Subd. 10

Tickets or admissions to events sponsored by an organization that provides opportunities for participation in the creation, performance, or appreciation of the arts are exempt from the sales tax. The sponsoring organization must be either a qualifying 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. It was last changed in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$5,700,000	$5,900,000	$6,000,000	$6,200,000

4.90 SACRAMENTAL WINE SOLD BY RELIGIOUS ORGANIZATIONS

Minnesota Statutes, Section 297A.70, Subd. 9

Wine for sacramental purposes in religious ceremonies is exempt from the sales and use tax if it 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			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

REDUCED SALES PRICE

4.91 NEW MANUFACTURED HOMES

Minnesota Statutes, Section 297A.62, Subd. 3

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 on 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 determining the tax was changed from sales price to dealer's cost.

Approximately 2,800 manufactured homes were placed in Minnesota in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$3,700,000	$3,800,000	$3,900,000	$3,900,000

REDUCED RATES

4.92 TAX PAID TO OTHER STATES

Minnesota Statutes, Section 297A.80

Tangible personal property on which sales tax was paid to another state or subdivision thereof is taxed at a rate equal to the difference between the Minnesota rate and the total rate in the other state. 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 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$3,700,000	$3,800,000	$3,900,000	$4,000,000

CHAPTER 5: MOTOR VEHICLE SALES TAX

Collections and History

Total revenues from the motor vehicle sales tax were $545 million in fiscal year 2001. All revenues from this tax went in the state general fund in fiscal year 2001. Starting in fiscal year 2002, a portion of the proceeds goes to the highway user tax distribution fund. Starting in fiscal year 2003, portions also go to two transit funds.

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 GIFTS BETWEEN INDIVIDUALS

Minnesota Statutes, Section 297B.01, Subd. 7 (c)(3)

The transfer of a vehicle in the form of a gift between individuals is exempt from the motor vehicle sales tax. To qualify, there must be no monetary or other consideration or expectation with the transfer, and the parties to the transfer must submit an affidavit to that effect.

An exemption for transfers between certain family members was enacted in 1971. In 2000 the exemption was expanded to include gifts between any individuals.

An estimated 51,000 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$15,800,000	$16,100,000	$16,400,000	$16,700,000

5.02 VEHICLES ACQUIRED BY INHERITANCE

Minnesota Statutes, Section 297B.01, Subd. 7 (c)(1)

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 5,200 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$2,200,000	$2,200,000	$2,300,000	$2,300,000

5.03 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 38,800 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$8,300,000	$8,400,000	$8,500,000	$8,600,000

5.04 TRANSFERS BETWEEN JOINT OWNERS

Minnesota Statutes, Section 297B.01, Subd. 7 (c)(2)

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 7,100 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$3,000,000	$3,000,000	$3,100,000	$3,200,000

5.05 TRANSFERS IN DIVORCE PROCEEDINGS

Minnesota Statutes, Section 297B.01, Subd. 7 (c)(4)

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 5.04), the estimates for this item include only transfers involving a vehicle previously registered to one person.

This provision was enacted in 1974.

An estimated 1,800 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$800,000	$800,000	$800,000	$800,000

5.06 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 3901, 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			
	2002	2003	2004	2005
All Funds	*	*	*	*

5.07 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 1,700 vehicle transfers qualify for this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$1,100,000	$1,200,000	$1,200,000	$1,200,000

*Less Than $50,000

5.08 TRANSIT VEHICLES

Minnesota Statutes, Sections 297B.03 (12) and 473.448

The purchase of a motor vehicle for use by a transit provider exclusively to provide transit service is exempt from the motor vehicle sales tax if the provider receives financial assistance or reimbursement under Minnesota Statutes, Section 174.24 or 473.374 or operates under Minnesota Statutes, Section 174.29, 473.388, or 473.405. Vehicles purchased by the Metropolitan Council for the Metro Transit System and for Metro Mobility are also exempt.

Purchases of transit vehicles by the Metropolitan Council have never been taxed. The exemption was extended to other transit providers in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$2,800,000	$3,100,000	$3,100,000	$3,200,000

5.09 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 140 vehicles are purchased under this exemption in an average year.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$600,000	$600,000	$600,000	$600,000

5.10 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			
	2002	2003	2004	2005
All Funds	*	*	*	*

5.11 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

About 75 vehicles qualify under this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$400,000	$400,000	$400,000	$400,000

*Less Than $50,000

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 150 vehicles annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$800,000	$800,000	$800,000	$800,000

5.13 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 and was last changed in 1993. These vehicles had previously been included under the exemptions for local government units and nonprofit organizations which were repealed in 1987.

An estimated 350 transfers qualify under this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$100,000	$100,000	$100,000	$100,000

5.14 VEHICLES DONATED TO EXEMPT ORGANIZATIONS

Minnesota Statutes, Section 297B.01, Subd. 7 (c)(5)

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. 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 500 vehicle transfers qualify under this exemption annually.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$100,000	$100,000	$100,000	$100,000

5.15 TRUCKS, BUSES, AND VANS PURCHASED BY CHARITIES

Minnesota Statutes, Section 297B.03 (11)

An exemption from the motor vehicle sales tax applies to the purchase or use of certain types of vehicles by a corporation, society, association, foundation, or institution organized exclusively for charitable, religious, or education purposes. A public school, university, or library is not eligible for the exemption.

The exemption applies to trucks and buses and also to passenger automobiles designed and used to carry more than nine persons including the driver. The vehicle must used primarily to transport tangible personal property or individuals, other than employees, to whom the organization provides service.

This exemption was enacted in 2000 and was changed in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$1,400,000	$1,400,000	$1,500,000	$1,500,000

REDUCED PURCHASE PRICE

5.16 FEDERAL EXCISE TAXES

Minnesota Statutes, Section 297B.01, Subd. 8

When computing the motor vehicle sales tax, any federal taxes imposed on the retail sale of a vehicle are excluded from the purchase price. Three federal excise taxes are levied upon new motor vehicles. For trucks in excess of 33,000 pounds and for trailers or semi-trailers in excess of 26,000 pounds, the tax is 12% of retail price. The luxury tax on passenger vehicles is 3% of retail price over $40,000 for 2002. The tax is repealed after 2002.

This provision was enacted in 1983.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$1,100,000	$1,000,000	$1,000,000	$1,000,000

5.17 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			
	2002	2003	2004	2005
All Funds	$75,800,000	$78,200,000	$80,700,000	$83,300,000

5.18 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 applies to the parts and accessories used to modify a vehicle after it is purchased (Item 4.61).

This provision was enacted in 1992.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$200,000	$200,000	$200,000	$200,000

PREFERENTIAL COMPUTATIONS

5.19 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.

The transfer of 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 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 last changed in 1995.

The tax on an estimated 520,000 vehicles is reduced by these provisions

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$35,500,000	$36,100,000	$36,800,000	$37,400,000

CREDIT

5.20 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 or use 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 5.03), 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			
	2002	2003	2004	2005
All Funds	$2,700,000	$2,800,000	$2,800,000	$2,800,000

CHAPTER 6: HIGHWAY FUELS EXCISE TAXES

Collections and History

The net revenues from the taxes on highway gasoline and special fuels were $606 million in fiscal year 2001. 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 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.

EXEMPTIONS

6.01 TRANSIT SYSTEMS RECEIVING STATE FINANCIAL ASSISTANCE

Minnesota Statutes, Sections 296A.07, Subd. 4(1) and 296A.08, Subd. 3(1)

The highway fuels excise taxes are not imposed on gasoline and special fuel purchased by a transit system or transit provider that receives financial assistance from the Metropolitan Council or the Public Transit Subsidy Program. The exemption also applies to qualifying providers of medical transportation services.

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 1994.

About 100 companies are eligible for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$3,200,000	$3,200,000	$3,200,000	$3,200,000

6.02 MOTOR VEHICLES NOT REQUIRING REGISTRATION (SPECIAL FUELS)

Minnesota Statutes, Sections 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.

An estimated 3,100 vehicles qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$600,000	$600,000	$600,000	$600,000

6.03 AMBULANCE SERVICES

Minnesota Statutes, Sections 296A.07, Subd. 4 (2) and 296A.08, Subd. 3 (2)

The purchase of gasoline or special fuel by a licensed ambulance service is exempt from the motor fuels excise tax. Purchases of diesel fuel for municipal ambulances are covered by another exemption (Item 6.02) and are not included in the estimates for this provision.

This exemption was enacted in 2001.

About 440 ambulances are covered by this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

6.04 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			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	*	*	*	*

*Less Than $50,000

CHAPTER 7: ALCOHOLIC BEVERAGE TAXES

Collections and History

In fiscal year 2001, the revenues from the alcoholic beverage taxes were: $42 million from distilled spirits; $16 million from beer; and $3.2 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
Cider: 0.5% to 7% alcohol	.15	.04

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 and was last changed in 1995.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 or 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 last changed in 1985.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 to 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.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 and was last changed in 1985.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

7.05 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 in 1985.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

7.06 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 Minnesota residents 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.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

CREDIT

7.07 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. A credit for beer produced and sold in Minnesota had been in effect from 1973 to 1985.

Thirty-one breweries qualified for this credit in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$300,000	$300,000	$300,000	$300,000

CHAPTER 8: CIGARETTE AND TOBACCO TAXES

Collections and History

In fiscal year 2001, cigarette tax revenues were $170 million and tobacco products tax revenues were $16 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 if the Minnesota cigarette excise tax was not previously paid. Likewise, a use and storage tax equal to the tobacco products tax is imposed on consumers in possession of tobacco products if the tobacco products tax was not paid.

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 was last revised in 1973. The exemption for tobacco products was enacted in 1957 and last changed in 1971.

	Fiscal Year Impact			
	2002	2003	2004	2005
Total - All Funds	$3,800,000	$4,000,000	$4,300,000	$4,600,000

CHAPTER 9: MORTGAGE REGISTRY TAX

Collections and History

In fiscal year 2001, state revenues from the mortgage registry tax were $88.2 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, although the rate is now restated as 0.23%. In 2001 the liability for the tax was changed from the mortgagee (lender) to the mortgagor (borrower)

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 0.23% of principal debt which is secured by any mortgage of real property within Minnesota and which is recorded or registered. The liability for the tax is on the mortgagor. The tax is paid to the county treasurer at or before the time of filing the mortgage for record or registration.

EXEMPTIONS

9.01 AGRICULTURAL LOANS

Minnesota Statutes, Section 287.04 (i)

An exemption from the mortgage registry tax is allowed for an agricultural mortgage if the proceeds are used to acquire or improve real property classified as agricultural for property tax purposes.

This exemption was enacted in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$1,500,000	$1,500,000	$1,600,000	$1,600,000

9.02 GOVERNMENT HOUSING PROGRAMS

Minnesota Statutes, Section 287.04(f)

An exemption from the mortgage registry tax is allowed for a mortgage loan made under a low and moderate income or other affordable housing program if the mortgagee is a federal, state, or local government agency. The estimates exclude mortgages taken by federal agencies where federal law prohibits taxation by the state.

This exemption was enacted in 2001. Prior to that time, these mortgages were exempt under a general exemption for loans by government agencies.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$100,000	$100,000	$100,000	$100,000

CHAPTER 10: DEED TRANSFER TAX

Collections and History

State revenues from the deed transfer tax were $71 million in fiscal year 2001. 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. If the consideration exceeds $500,000, the tax is now restated as 0.33% of consideration.

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 0.33% of consideration. 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.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	*	*	*	*

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.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$100,000	$100,000	$100,000	$100,000

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.

An estimated 26,000 cemetery lots are sold each year.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

	Fiscal Year Impact			
	2002	2003	2004	2005
All Funds	$1,100,000	$1,100,000	$1,200,000	$1,300,000

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.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 2001, revenues from the lawful gambling taxes were: $26 million from the tax on pull-tabs and tipboards; $1.8 million from the tax on bingo, raffles, and paddlewheels; and $28.7 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, 9% in 1999, and 8.5% in 2000.

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 1999, and 2000.

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 8.5% 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 1.7% 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	1.7 %
$700,001	-	$900,000	3.4 %
$900,001		and over	5.1 %

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.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

About 65 organizations qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

About 200 organizations qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

About 700 organizations benefit from this provision.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

	Fiscal Year Impact			
	2002	2003	2004	2005
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.

About 1,000 organizations qualified for this exemption in 1998

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$400,000	$400,000	$400,000	$400,000

CREDIT

11.07 CREDIT FOR CERTAIN RAFFLES

Minnesota Statutes, Section 297E.02 Subd. 2a

An organization may claim a credit against the lawful gambling tax equal to the tax resulting from a raffle if the net proceeds have been used exclusively to relieve the effects of poverty, homelessness, or physical or mental disability for an individual or family.

This credit was enacted in 2000.

Fewer than twenty claims have been filed for this credit.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	*	*	*	*

*Less Than $50,000

CHAPTER 12: INSURANCE PREMIUMS TAXES

Collections and History

In fiscal year 2001, the revenues from the insurance premiums taxes totaled $187 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 from 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.

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.

EXEMPTIONS

12.01 FRATERNAL BENEFIT SOCIETIES

Minnesota Statutes, Section 297I.15 Subd. 10

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 and their beneficiaries.

This exemption was enacted in 1907 and was last changed in 1985.

Forty-two fraternal benefit societies did business in Minnesota in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$4,100,000	$4,200,000	$4,300,000	$4,500,000

12.02 FARMERS' MUTUAL AND TOWNSHIP MUTUAL FIRE INSURANCE COMPANIES (FIRE MARSHAL TAX)

Minnesota Statutes, Section 297I.05, Subd. 6

Farmers' mutual insurance companies 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			
	2002	2003	2004	2005
State General Fund	$200,000	$200,000	$300,000	$300,000

12.03 MINNESOTA COMPREHENSIVE HEALTH INSURANCE PLAN PREMIUMS

Minnesota Statutes, Section 297I.15, Subd. 8

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 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			
	2002	2003	2004	2005
State General Fund	$1,400,000	$1,400,000	$1,500,000	$1,500,000

EXEMPTION/REDUCED RATE

12.04 HEALTH MAINTENANCE ORGANIZATIONS AND NONPROFIT HEALTH SERVICE PLAN CORPORATIONS

Minnesota Statutes, Section 297I.05, Subd. 5

Several sources of revenue fund Minnesota's health care access program, MinnesotaCare. A 1% premiums tax will be imposed on health maintenance organizations and nonprofit health service plan corporations beginning January 1, 2004. Prior to that date, these premiums are exempt from tax.

The tax expenditure measures the exemption through December 31, 2003, 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. The tax has not been imposed since that time due to several law changes, the last of which occurred in 2001.

Eleven health maintenance organizations and three nonprofit health service plan corporations do business in Minnesota.

	Fiscal Year Impact			
	2002	2003	2004	2005
Health Care Access Fund	$72,200,000	$76,900,000	$64,600,000	$43,200,000

REDUCED RATES

12.05 SMALLER MUTUAL PROPERTY AND CASUALTY INSURANCE COMPANIES

Minnesota Statutes, Section 297I.05 Subd. 3 and 4

Instead of the 2% general rate, 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. In 1988 the rate of tax was phased down to 0.5% for 1992 and after. In 1995 the current rates were adopted.

The reduced rates apply to about 140 mutual insurance companies.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$5,800,000	$6,000,000	$6,200,000	$6,400,000

CREDIT

12.06 CREDIT FOR GUARANTY ASSOCIATION ASSESSMENTS

Minnesota Statutes, Section 297I.20

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 subsequent years. If the credit exceeds the company's premiums tax for that year, the excess may be carried forward.

The credit was enacted in 1994.

	Fiscal Year Impact			
	2002	2003	2004	2005
State General Fund	$1,500,000	$1,400,000	$2,500,000	$5,000,000

CHAPTER 13: PROPERTY TAX

Collections and History

Net property tax collections were $5.0 billion for property taxes payable in 2001. 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.

Beginning with taxes payable in 2002, in addition to the local tax, a state general property tax is levied on commercial, industrial, and seasonal recreational property. The tax is collected by the counties and remitted to the state.

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.

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 all inventories, 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. Levy limitations for counties and for cities with population over 2,500 were reinstated for taxes payable in 2000, 2002, and 2003.

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.

A change enacted in 1991 specified that referendum levies are spread against market value instead of tax capacity, which is referred to as referendum market value. Since that time the market value against which referendum levies are spread has been reduced for certain agricultural and other property.

In 2001 the state-determined general education levy was eliminated, and a state general property tax was enacted which is imposed on commercial, industrial and seasonal recreational property.

Tax Base

The tax base for the local 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. 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.

Computation of the 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. Specified state aids are subtracted 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.

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, residential or agricultural market value 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 a "circuit-breaker" program 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 12% from the previous year. These refunds are paid directly to 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 not included in the tax expenditure estimates because they are exempt under either the Minnesota Constitution or federal law. These properties include 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 3.4% for taxes payable in 2001 and 2.0% for 2002, 2003, and 2004. 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 rates were adjusted to take into account the additional taxable value that 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 2001.

	Fiscal Year Impact			
Type of Property	2002	2003	2004	2005
Elementary and secondary schools	$343,700,000	$261,600,000	$277,900,000	$291,800,000
Public burying grounds	8,500,000	6,500,000	6,800,000	7,200,00
Hospitals	96,800,000	73,700,000	78,300,000	82,200,000
Charitable institutions	50,000,000	38,000,000	40,400,000	42,400,000
Federal and state forests, parks, and wildlife refuges	14,600,000	11,100,000	11,800,000	12,400,000
Public property used for public purposes	477,500,000	363,400,000	386,100,000	405,400,000
Total	$991,100,000	$754,300,000	$801,300,000	$841,400,000

13.02 LIMITED MARKET VALUE

Minnesota Statutes, Section 273.11, Subd. 1a

Annual increases in market value are limited for property classified as residential homestead or nonhomestead, agricultural homestead or nonhomestead, or noncommercial seasonal recreational residential. For assessment years 2000 and 2001, 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 limited.

For assessment years 2002 through 2006, limited market value is gradually phased out. For each year, the increase is limited to the greater of a given percent increase over the prior year or a percentage of the difference between the current and prior year. The increase over the prior year is 10% in 2002, 12% in 2003, and 15% in 2004 through 2006. The percentage of the difference is 15% in 2002, 20% in 2003, 25% in 2004, 33% in 2005, and 50% in 2006. Limited market value is eliminated after assessment year 2006.

Limited market value was enacted in 1993. In 2001 limited market value was extended beyond assessment year 2001 by gradually phasing it out.

	Fiscal Year Impact			
	2002	2003	2004	2005
Limited Market Value	$57,400,000	$45,900,000	$21,600,000	$13,600,000

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. The property must be a homestead at least 45 years old, 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 45 to 70 years old, the exclusion is 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.

This provision, known as "This Old House", was enacted in 1993 and was last changed in 1999.

	Fiscal Year Impact			
	2002	2003	2004	2005
Certain Improvements to Older Homes	$6,600,000	$7,100,000	$8,700,000	$8,700,000

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 class rate(s) for that 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 differences in the computation of credits.

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 show the other side of the shifts in tax burden; they are not tax expenditures.

The property tax classification system was enacted in 1913 and was last changed in 2001.

	Fiscal Year Impact			
Type of Property	2002	2003	2004	2005
Residential Homestead				
1st Tier	$678,000,000	$141,000,000	$141,000,000	$141,000,000
2nd Tier	(215,200,000)	101,000,000	101,000,000	101,000,000
Farm Homestead	146,000,000	75,000,000	75,000,000	75,000,000
Farm Nonhomestead	2,000,000	(4,000,000)	(4,000,000)	(4,000,000)
Timber	1,000,000	1,000,000	1,000,000	1,000,000
Seasonal Recreational Commercial	0	1,000,000	1,000,000	1,000,000
Subsidized Housing	14,000,000	8,000,000	8,000,000	8,000,000
Seasonal Recreational Residential	8,000,000	(23,000,000)	(23,000,000)	(23,000,000)
Residential Nonhomestead	9,000,000	(3,000,000)	(3,000,000)	(3,000,000)
Commercial/Industrial				
1st Tier	(60,000,000)	(1,000,000)	(1,000,000)	(1,000,000)
2nd Tier	(549,000,000)	(249,000,000)	(249,000,000)	(249,000,000)
Public Utility	(59,000,000)	(25,000,000)	(25,000,000)	(25,000,000)
Apartments	(83,000,000)	(72,000,000)	(72,000,000)	(72,000,000)
Railroad	(10,000,000)	(5,000,000)	(5,000,000)	(5,000,000)
Mineral	0	0	0	0
Personal	(74,000,000)	(90,000,000)	(90,000,000)	(90,000,000)

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, taxes are 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.

This provision was enacted in 1967 and was last revised in 2001.

In 2001 approximately 1,870,000 acres received green acres treatment.

	Fiscal Year Impact			
	2002	2003	2004	2005
Green Acres	$21,100,000	$26,400,000	$33,000,000	$41,200,000

13.06 OPEN SPACE PROPERTY

Minnesota Statutes, Section 273.112

Private recreational, social, open space, and park land is given preferential valuation and tax deferral 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. Qualifying property includes golf courses, ski areas, and archery and firearms ranges.

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, and this provision was last changed in 1998.

About 310 parcels of property receive preferential valuation under this provision.

	Fiscal Year Impact			
	2002	2003	2004	2005
Open Space Property	$5,300,000	$5,600,000	$6,400,000	$7,200,000

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. The owner must sign a covenant that the land will remain in agricultural use. 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. The preferential valuation continues indefinitely, even if ownership changes. A tax credit is also allowed (Item 13.12). 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 and was last amended in 1994.

Preferential valuation was given to approximately 200,000 acres in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
Metropolitan Agricultural Preserves	$2,900,000	$3,100,000	$3,300,000	$3,600,000

13.08 TAX INCREMENT FINANCING

Minnesota Statutes, Sections 469.174 to 469.1791

Tax increment financing allows the increase in property taxes attributable to increased value resulting from a development project 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 types of 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 development costs, 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 2001.

For taxes payable in 2000, there were 1,673 tax increment financing districts located in 417 communities.

	Fiscal Year Impact			
	2002	2003	2004	2005
Tax Increment Financing	$331,000,000	$214,000,000	$220,100,000	$226,500,000

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. Beginning with property taxes payable in 2003, the tree growth tax is repealed and replaced by a direct spending program.

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. 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 and was repealed in 2001, effective for taxes payable in 2003 and thereafter.

Approximately 740,000 acres were taxed under these two programs in 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
Auxiliary Forest Tax	$100,000	$100,000	$100,000	$100,000
Tree Growth Tax	1,200,000	1,200,000	0	0
Total	$1,300,000	$1,300,000	$100,000	$100,000

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. 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 2001 when the taconite tax relief area was redefined.

Approximately 34,000 homesteads in the newly-defined taconite tax relief area will receive this credit.

	Fiscal Year Impact			
	2002	2003	2004	2005
Taconite Homestead Credit	$15,200,000	$11,100,000	$11,300,000	$11,500,000

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 power line credit was enacted in 1979 and was last changed in 2001.

About 1,860 parcels received this credit in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 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 2001 the credit was allowed for approximately 200,000 acres.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 2001, the credit was allowed for 138,000 acres.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 $8.8 million in fiscal year 2001. 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.

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, 70% for other airflight property, and 50% of the above rates for the airflight property of certain airlines. All aircraft now qualify as quiet aircraft, so the 70% rate is no longer used.

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 2001 the tax rate was approximately 4.35%.

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. The tax expenditure estimates reflect the difference between the aircraft registration tax paid by commuter airlines and the amount they would pay under the airflight property tax.

This provision was enacted in 1969.

Currently two companies benefit from this provision.

	Fiscal Year Impact			
	2002	2003	2004	2005
State Airports Fund	$100,000	$100,000	$100,000	$100,000

PREFERENTIAL VALUATION

14.02 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). All aircraft now qualify as quiet aircraft.

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 in Minnesota with a population of 100,000 or less outside the seven-county Minneapolis-St. Paul metropolitan area.

This provision was enacted in 1987.

Two airline companies currently qualify under this provision.

	Fiscal Year Impact			
	2002	2003	2004	2005
State Airports Fund	$1,000,000	$1,000,000	$1,000,000	$1,000,000

CHAPTER 15: MOTOR VEHICLE REGISTRATION TAX

Collections and History

In fiscal year 2001, a total of $466 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 depreciation schedule for passenger cars was changed significantly in 1989, and in 2000 the tax on passenger cars was limited to a maximum amount based on the renewal period.

Tax Base

The tax base for the motor vehicle registration tax is motor vehicles that use the public streets and highways in Minnesota. The exemptions of farm machinery and other off-road vehicles are therefore not considered tax expenditures.

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 years of vehicle life; 90% in the third and fourth years; 75% in the fifth and sixth years; 60% in the seventh year; 40% in the eighth; 30% in the ninth; and 10% in the tenth year.

The maximum tax is $189 for the first renewal period and $99 for subsequent renewal periods. 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, Subd. 6, and Subd. 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 trucks, 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 37,500 vehicles qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$7,000,000	$7,100,000	$7,200,000	$7,400,000

15.02 SCHOOL BUSES

Minnesota Statutes, Section 168.012, Subd. 1(a)(2) and Subd. 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 15.10).

This exemption was enacted in 1933 and was extended to leased vehicles in 1982.

About 5,600 buses qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$400,000	$400,000	$400,000	$400,000

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			
	2002	2003	2004	2005
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 168.031, 168.124, and 168.125

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 renewals, exempt from the motor vehicle registration tax.

The exemption for medal of honor recipients was enacted in 1983; the exemption for former prisoners of war was enacted in 1993.

Approximately 550 vehicles qualify for these exemptions.

	Fiscal Year Impact			
	2002	2003	2004	2005
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 160 vehicles qualify for this exemption.

	Fiscal Year Impact			
	2002	2003	2004	2005
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			
	2002	2003	2004	2005
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			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	*	*	*	*

15.08 COMMERCIAL DRIVING SCHOOLS

Minnesota Statutes, Section 168.012, Subd. 1 (7)

A vehicle owned by a licensed commercial driving school, or by an employee of the school, and used exclusively for driver education and training is exempt from the motor vehicle registration tax.

This exemption was enacted in 1999 and was extended to vehicles of employees in 2000.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	*	*	*	*

*Less Than $50,000

15.09 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 144E.10, 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			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

PREFERENTIAL COMPUTATION

15.10 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.

Approximately 6,000 school buses qualify under this provision.

	Fiscal Year Impact			
	2002	2003	2004	2005
Highway User Tax Distribution Fund	$400,000	$400,000	$400,000	$400,000

CHAPTER 16: AIRCRAFT REGISTRATION TAX

Collections and History

In fiscal year 2001, the revenues from the aircraft registration tax were $6.2 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.

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			
	2002	2003	2004	2005
State Airports Fund	*	*	*	*

PREFERENTIAL COMPUTATION

16.02 MAXIMUM TAX FOR AGRICULTURAL AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 8

The aircraft registration tax for aircraft registered with the Federal Aviation Administration as restricted category aircraft used for agricultural purposes cannot exceed $500. To qualify, the aircraft must be owned and operated solely for agricultural operations and purposes.

This provision was enacted in 1999.

Eligibility under this provision was certified for twenty aircraft in fiscal year 2001.

	Fiscal Year Impact			
	2002	2003	2004	2005
State Airports 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