STATE OF MINNESOTA

TAX EXPENDITURE BUDGET

FISCAL YEARS 1988 - 1991

JANUARY 1989

Pursuant to Mn Stat 470.067

STATE OF MINNESOTA

TAX EXPENDITURE BUDGET

FISCAL YEARS 1988 - 1991

A REPORT TO THE 1989 MINNESOTA LEGISLATURE

STATUTORY REQUIREMENT: MINNESOTA STATUTES, SECTION 270.067

Commissioner of Revenue
St. Paul, Minnesota

January 1989

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

January 1989

To the Honorable Rudy Perpich, Governor, and Members of the 1989 Legislature of the State of Minnesota:

This Tax Expenditure Budget was prepared and is submitted to you as required by Minnesota Statutes, Section 270.067 (Laws of 1983, Chapter 301). The information provided for each tax expenditure includes the legal citation, explanation, history, and revenue impact for fiscal years 1988 through 1991.

Very truly yours,

John James
Commissioner

PREFACE

This report is the third tax expenditure budget prepared for Minnesota as required by Minnesota Statutes, Section 270.067. The structure and purpose of the report are the same as the earlier reports which were submitted in 1985 and 1987. The report has been updated for law changes made during the 1987 and 1988 legislative sessions, and the fiscal impact estimates have been updated to cover fiscal years 1988 through 1991.

In 1987 Minnesota adopted many of the law changes contained in the federal Tax Reform Act of 1986 and also enacted significant changes in many other tax areas. The law changes had an impact on a large number of tax expenditure provisions: some were repealed; some were changed; and the fiscal impact of all the provisions in some taxes was affected by the changes in tax rates (notably the individual income and corporate franchise taxes).

The law changes that pertain generally to a tax are described in the chapter introduction for that tax. The explanation of each tax expenditure provision contains its history, including the most recent law changes.

The tax expenditure budget covers all state taxes and local taxes that are applied statewide. If a tax is currently not being paid by anyone or if it has no tax expenditures, it is listed in Appendix B or Appendix C, respectively. Fees are not considered to be taxes and are not included in this report.

The tax expenditure budget was prepared by the Tax Research Division of the Minnesota Department of Revenue. The assistance of people in other divisions of the Department of Revenue, in other state agencies, and in the federal government was invaluable in preparing this report and is gratefully acknowledged.

Questions or comments relating to this report may be directed to:

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INTRODUCTION TO THE TAX EXPENDITURE BUDGET

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 that would otherwise be collected.

A tax expenditure is like a direct expenditure in that it can be used to accomplish 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.

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 or subsidized through tax expenditures - the itemized deductions for property taxes and home mortgage interest.

Government provides funds for the health care needs of certain individuals through Medicare, medical assistance, and public health clinics. The government also provides financial assistance through a tax expenditure to persons whose medical bills are high in relation to their income - the itemized deduction for medical expenses that exceed 7.5% of adjusted gross income.

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 forecasted, most tax expenditures have already been excluded from the base. Typically, the fiscal impact of a provision is not estimated unless a proposal is made to change or repeal it.

The tax expenditure budget fills this information gap to reveal, along with the regular budget, all aspects of government programs.

The purpose of this 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.

The tax expenditure budget provides a comprehensive list of tax expenditure provisions so that they are available for review. Prior to the development of the tax expenditure budget, a complete catalogue of these provisions was not available. For each provision there is the legal citation, explanation, history, and the fiscal year impact for 1988 through 1991.

The recent tax reform movement at both the national and state levels has concentrated on broadening the tax bases of the major taxes, that is, eliminating or restricting tax expenditure provisions. The increasing attention in recent years to tax expenditure budgets has coincided with this tax reform movement.

At the federal level, annual tax expenditure budgets have been required by law since 1974. About twenty states prepare tax expenditure budgets, and the number is increasing.

Minnesota Statutes, Section 270.067 (reprinted in Appendix A) was enacted in 1983 and requires a tax expenditure budget to be submitted as a supplement to the governor's biennial budget. Prior to this report, tax expenditure budgets were submitted to the 1985 and 1987 Minnesota Legislatures.

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 evaluate tax expenditure provisions for this report. 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 considered 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 tax year;
- is not an appropriation;
- is included in the defined tax base;
- 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 (Appendix A).

The tax expenditure budget is required by statute to include every state tax and every local tax that is applied statewide. Special local taxes are not included, such as local sales taxes.

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):

> "Tax Expenditure" means a tax provision which provides a gross income definition, deduction, exemption, credit, or rate for <u>certain</u> persons, types of income, transactions, or property that results in reduced tax revenue. (emphasis added)

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 1988 through 1991.

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 like an interest-free loan for the taxpayer.

Some provisions of tax law are similar to tax expenditures, but they are funded through either a direct or open appropriation. Many of the property tax relief provisions fit this pattern. These provisions are not considered tax expenditures because they are included in the budget as appropriations.

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 first type are outside the tax base and are not tax expenditures; the second type are part of the tax base and are tax expenditures.

For example, if the tax base were apples, an exemption for oranges would not be a tax expenditure because oranges would be outside the tax base. The exemption for oranges would help to define the tax base. However, an exemption for green apples would be a tax expenditure because green apples would be included in the tax 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. 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:

- Taconite and iron ore mining companies are subject to an occupation tax in lieu of the individual income tax or corporate franchise tax.
- The purchase of a motor vehicle is subject to the motor vehicle excise tax in lieu of the general sales and use tax.
- A motor vehicle using propane or compressed natural gas purchases an annual permit in lieu of the per-gallon excise tax on highway fuels.
- Taconite mining companies pay the production tax in lieu of property taxes.
- Telephone companies pay a gross earnings tax in lieu of the property tax. (The gross earnings tax is being phased out, and the property tax will be imposed beginning in 1990.)
- Noncommercial aircraft are taxed under the aircraft registration tax, whereas commercial airflight property is taxed under the airflight property tax.

The biennial budget contains only items which can become law upon passage of both houses of the Minnesota Legislature and approval by 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. Provisions that are contained in the Minnesota Constitution, federal law, or the United States Constitution are not within the sole jurisdiction of the governor and the Minnesota Legislature and, therefore, 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 the amount of revenue that would be gained by repeal. This distinction is important.

Each provision is estimated in isolation, and other provisions in that tax and in other taxes are held constant. The secondary impact of one provision on another provision 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 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 ore more provisions could be more or less than the total of the provisions estimated separately.

In some cases, two or more tax expenditures in a tax overlap, and it is important to understand how this situation is treated in the tax expenditure estimates. When one provision is estimated, all other provisions are held constant, meaning that they are assumed to remain unchanged.

For example, when an exemption of a particular product from the sales tax is estimated, sales to exempt purchasers are assumed to remain exempt and are excluded from the estimates. Likewise, when the exemption from the sales tax for a particular purchaser is estimated, the estimates exclude goods and services covered by other exemptions.

The precision of the estimates varies with the source of the data and with the applicability of the data to the tax expenditure provision. Data from Minnesota tax returns were used whenever possible. Other sources included federal tax expenditure estimates, data from federal tax returns, and other data for Minnesota and the nation. The sources of data used for the tax expenditure estimates are not listed but are available upon request.

TAX EXPENDITURE SUMMARY LIST

	Fiscal Year Impact			
	1988	1989	1990	1991
INDIVIDUAL INCOME TAX				
Federal Exclusions				
1.01 Employer-Provided Meals and Lodging	$4,200,000	$4,600,000	$5,300,000	$5,600,000
1.02 Employer Educational Assistance (Repealed)	600,000	0	0	0
1.03 Employer-Provided Dependent Care	300,000	700,000	1,400,000	2,300,000
1.04 Employee Awards	500,000	500,000	500,000	500,000
1.05 Employer Contributions to Prepaid Legal Services Plans (Repealed)	200,000	0	0	0
1.06 Employer Pension Plans	215,000,000	222,000,000	239,000,000	254,000,000
1.07 Contributions by Employers and the Self-Employed for Medical Insurance Premiums and Medical Care	123,300,000	135,200,000	156,900,000	183,200,000
1.08 Employer-Paid Accident and Disability Premiums	600,000	600,000	600,000	600,000
1.09 Employer-Paid Death Benefits	200,000	200,000	200,000	200,000
1.10 Employer-Paid Group Term Life Insurance Premiums	9,800,000	10,200,000	10,400,000	10,400,000
1.11 Cafeteria Plans	4,200,000	5,300,000	8,200,000	12,500,000
1.12 Employee Fringe Benefits (Other than Provisions Covered in Items 1.01 through 1.11)	16,800,000	18,300,000	20,200,000	21,800,000
1.13 Income Earned by Voluntary Employee Benefit Associations	2,000,000	2,000,000	2,400,000	2,500,000

	Fiscal Year Impact			
	1988	1989	1990	1991
1.14 Income Earned by Supplemental Unemployment Benefit Trusts	$200,000	$200,000	$200,000	$200,000
1.15 Income Earned Abroad by U.S. Citizens and Foreign Housing Costs	3,400,000	3,700,000	4,000,000	4,300,000
1.16 Benefits and Allowances to Armed Forces Personnel	5,100,000	4,900,000	4,800,000	4,800,000
1.17 Veterans' Benefits	8,600,000	7,900,000	7,500,000	7,200,000
1.18 Military Disability Pensions	300,000	300,000	300,000	300,000
1.19 Workers' Compensation Benefits	30,100,000	32,600,000	35,200,000	38,100,000
1.20 Special Benefits for Disabled Coal Miners	*	*	*	*
1.21 Social Security Benefits	87,000,000	85,300,000	88,500,000	94,100,000
1.22 Medicare Benefits	28,900,000	32,000,000	35,400,000	39,300,000
1.23 Foster Care Payments	*	*	*	*
1.24 Public Assistance	3,400,000	2,800,000	2,500,000	2,400,000
1.25 Scholarship and Fellowship Income	2,900,000	2,900,000	2,900,000	3,600,000
1.26 Certain Agricultural Cost-Sharing Payments	600,000	600,000	700,000	700,000
1.27 Discharge of Indebtedness Income for Certain Farmers	400,000	300,000	300,000	200,000
1.28 Interest on Life Insurance and Annuity Savings	24,900,000	26,000,000	28,500,000	31,100,000
1.29 Interest on General Purpose State and Local Government Debt	12,000,000	11,900,000	12,200,000	13,400,000
1.30 Interest on State and Local Private Activity Tax-Exempt Bonds	27,300,000	26,700,000	27,200,000	29,800,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
1.31 Special Treatment of Capital Gains on Home Sales	$62,000,000	$67,400,000	$72,500,000	$79,800,000
1.32 Capital Gains at Death	28,300,000	29,000,000	30,900,000	32,800,000
1.33 Permanent Exemptions from Imputed Interest Rules	500,000	500,000	500,000	1,000,000
1.34 Like-Kind Exchanges	1,000,000	1,000,000	1,000,000	1,000,000
1.35 Special Rules for Magazine, Paperback, and Record Returns	*	*	*	*
Federal Deductions				
1.36 Depreciation	51,700,000	46,900,000	51,700,000	54,900,000
1.37 Expensing Depreciable Business Property	2,000,000	1,500,000	1,000,000	500,000
1.38 Excess of Percentage Over Cost Depletion	700,000	600,000	500,000	500,000
1.39 Five-Year Amortization of Business Organizational and Start-Up Costs	800,000	800,000	500,000	500,000
1.40 Seven-Year Amortization for Reforestation Expenditures	500,000	500,000	500,000	500,000
1.41 Expensing of Research and Development Costs	200,000	200,000	200,000	200,000
1.42 Expensing of Magazine Circulation Expenditures	200,000	200,000	200,000	200,000
1.43 Expensing for Removal of Barriers to the Handicapped and Elderly	100,000	100,000	100,000	100,000
1.44 Expensing of Exploration and Development Costs	700,000	800,000	800,000	900,000
1.45 Expensing of Certain Capital Outlays and Special Cash Accounting Rules for Farmers	500,000	500,000	500,000	500,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
1.46 Expensing of Multiperiod Agricultural Production Costs	$100,000	$100,000	$100,000	$100,000
1.47 Expensing of Multiperiod Timber Growing Costs	200,000	200,000	200,000	200,000
1.48 Special Rules for Mining Reclamation Reserves	*	*	*	*
1.49 Cash Accounting Other than Agriculture	100,000	100,000	100,000	100,000
1.50 Installment Sales	100,000	100,000	100,000	100,000
1.51 Individual Retirement Accounts	42,000,000	44,800,000	47,600,000	50,400,000
1.52 Keogh Plans	11,600,000	12,200,000	12,700,000	13,700,000
1.53 Per Diem Amounts Paid to State Legislators	*	*	*	*
Minnesota Subtractions				
1.54 Income of the Elderly or Disabled	5,900,000	12,000,000	12,800,000	13,100,000
1.55 Disposition of Farm Property	0	200,000	100,000	100,000
Personal Deductions				
1.56 Additional Standard Deduction for the Elderly and Blind	7,400,000	6,000,000	6,000,000	6,400,000
1.57 Medical and Dental Expenses	11,600,000	12,600,000	13,600,000	14,600,000
1.58 Real Estate Taxes	44,800,000	38,200,000	41,100,000	45,600,000
1.59 Motor Vehicle Registration Tax	2,600,000	2,400,000	2,500,000	2,700,000
1.60 Interest on Home Mortgages	178,400,000	149,100,000	161,500,000	176,200,000
1.61 Personal Interest (Repealed)	55,400,000	28,700,000	16,100,000	4,500,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
1.62 Charitable Contributions	$59,100,000	$61,200,000	$63,300,000	$65,300,000
1.63 Casualty and Theft Losses	1,300,000	1,200,000	1,000,000	1,000,000
1.64 Tax Return Preparation Fees	1,500,000	1,400,000	1,500,000	1,600,000
1.65 Education Expenses for Dependent Children	5,000,000	4,600,000	4,900,000	5,300,000
Preferential Computation				
1.66 Five-Year Averaging of Lump Sum Distributions	1,500,000	1,500,000	1,500,000	1,500,000
Credits				
1.67 Credit for Income Tax Paid to Other States	11,000,000	12,300,000	13,800,000	15,400,000
1.68 Child and Dependent Care Credit	10,400,000	10,400,000	10,400,000	10,400,000
1.69 Construction Financing (Enterprise Zones)	700,000	400,000	300,000	300,000
1.70 Employer Tax Credits (Enterprise Zones)	900,000	700,000	700,000	600,000
CORPORATE FRANCHISE TAX				
Exempt Organizations				
2.01 Tax-Exempt Organizations	900,000	1,000,000	1,000,000	1,000,000
2.02 Credit Unions	2,000,000	2,000,000	2,000,000	2,500,000
Federal Exclusions				
2.03 Permanent Exemptions from Imputed Interest Rules	*	*	*	*
2.04 Discharge of Indebtedness Income For Certain Farmers	*	*	*	*
2.05 Like-Kind Exchanges	1,200,000	1,200,000	1,200,000	1,200,000
2.06 Special Rules for Magazine, Paperback, and Record Returns	100,000	100,000	100,000	100,000

*Less than $50,000.

	Fiscal Year Impact			
	1988	1989	1990	1991
Insurance Company Exclusions				
2.07 Unrelated Income (Life Insurance Companies)	*	*	*	*
2.08 Underwriting Income (Life Insurance Companies)	*	*	*	*
2.09 Fee Income (Life Insurance Companies)	*	*	*	*
2.10 Royalties (Life Insurance Companies)	*	*	*	*
Federal Deductions				
2.11 Depreciation	$35,400,000	$47,500,000	$50,400,000	$56,100,000
2.12 Expensing Depreciable Business Property	3,500,000	2,800,000	2,400,000	800,000
2.13 Amortization of Organizational and Start-Up Costs	100,000	100,000	100,000	100,000
2.14 Seven-Year Amortization of Reforestation Expenditures	100,000	100,000	100,000	100,000
2.15 Expensing of Research and Development Costs	3,000,000	4,100,000	4,600,000	5,300,000
2.16 Expensing of Magazine Circulation Expenditures	200,000	200,000	200,000	200,000
2.17 Expensing for Removal of Barriers to the Handicapped and Elderly	100,000	100,000	100,000	100,000
2.18 Expensing of Exploration and Development Costs	100,000	100,000	100,000	100,000
2.19 Expensing of Certain Capital Outlays and Special Cash Accounting Rules for Farmers	1,500,000	1,500,000	1,500,000	1,500,000
2.20 Expensing of Multiperiod Agricultural Production Costs	*	*	*	*
2.21 Expensing of Multiperiod Timber Growing Costs	1,600,000	1,600,000	1,600,000	1,600,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
2.22 Special Rules for Mining Reclamation Reserves	$100,000	$100,000	$100,000	$100,000
2.23 Cash Accounting Other than Agriculture	200,000	200,000	200,000	200,000
2.24 Installment Sales	500,000	400,000	400,000	400,000
2.25 Patronage Dividends (Cooperatives)	4,700,000	4,700,000	4,700,000	4,700,000
2.26 Excess Bad Debt Reserves of Financial Institutions	800,000	800,000	800,000	800,000
2.27 Merger Rules for Thrifts (Repealed)	1,700,000	1,100,000	1,100,000	600,000
2.28 Employee Stock Ownership Plans	1,200,000	1,200,000	1,200,000	1,200,000
2.29 Inventory Property Sales Source Rule Exception	3,800,000	4,400,000	4,900,000	5,500,000
2.30 Capital Construction Funds of Shipping Companies	*	*	*	*
<u>Insurance Company Deductions</u>				
2.31 Exempt Interest (Insurance Companies)	3,200,000	3,400,000	3,700,000	4,000,000
2.32 Sums Paid Out Other than Dividends (Mutual Insurance Companies)	*	*	*	*
2.33 Mean Reserves (Life Insurance Companies)	17,700,000	19,100,000	20,600,000	22,300,000
2.34 Reserves for Deferred Dividends (Life Insurance Companies)	*	*	*	*
<u>Apportionment</u>				
2.35 Weighted Apportionment	71,100,000	75,300,000	76,800,000	78,300,000
2.36 Throwback Sales	21,600,000	21,600,000	21,600,000	21,600,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
2.37 Single-Factor Apportionment for Mail Order Companies	$600,000	$600,000	$600,000	$600,000
Minnesota Subtractions				
2.38 Dividend Received Deduction	19,300,000	19,900,000	20,700,000	23,600,000
2.39 Charitable Contributions	5,700,000	6,200,000	6,800,000	7,500,000
2.40 Foreign Source Income	1,600,000	4,500,000	10,500,000	13,800,000
2.41 Disposition of Farm Property	0	*	*	*
Credits				
2.42 Research and Development Credit	5,700,000	5,900,000	6,100,000	6,400,000
2.43 Construction Financing (Enterprise Zones)	2,200,000	1,200,000	1,000,000	1,000,000
2.44 Employer Tax Credits (Enterprise Zones)	1,700,000	1,400,000	1,200,000	900,000
2.45 Credit for Gross Premiums Tax (Insurance Companies)	26,000,000	26,000,000	26,000,000	26,000,000
ESTATE TAX				
Preferential Valuations				
3.01 Alternate Valuation of Property	100,000	100,000	100,000	100,000
3.02 Special Use Valuation	100,000	100,000	100,000	100,000
Exclusions				
3.03 Life Insurance Proceeds	2,700,000	2,900,000	3,100,000	3,300,000
3.04 Annuities	*	*	*	*
3.05 Social Security Benefits	*	*	*	*
Deductions				
3.06 Marital Deduction	8,200,000	8,200,000	8,200,000	8,200,000
3.07 Charitable Gifts	2,700,000	2,700,000	2,700,000	2,700,000

*Less than $50,000.

SALES AND USE TAX

Exemptions - Particular Goods and Services

	Fiscal Year Impact 1988	1989	1990	1991
4.01 Food	$268,900,000	$281,800,000	$298,400,000	$316,300,000
4.02 Clothing and Wearing Apparel	159,100,000	168,700,000	179,700,000	191,600,000
4.03 Drugs and Medicines	24,700,000	28,800,000	31,300,000	33,900,000
4.04 Prescription Eyeglasses	5,200,000	5,400,000	5,600,000	5,900,000
4.05 Therapeutic and Prosthetic Devices	4,200,000	4,600,000	5,000,000	5,500,000
4.06 Feminine Hygiene Items	1,600,000	1,700,000	1,800,000	1,900,000
4.07 Publications	12,200,000	13,100,000	13,900,000	14,800,000
4.08 Textbooks	1,600,000	1,700,000	1,800,000	1,900,000
4.09 Motor Fuels	140,700,000	145,800,000	150,700,000	155,700,000
4.10 Petroleum Products Used in the Improvement of Agricultural Land	*	*	*	*
4.11 Used Motor Oil	0	100,000	100,000	100,000
4.12 Caskets and Burial Vaults	4,700,000	4,800,000	5,000,000	5,200,000
4.13 Accessory Tools	15,100,000	15,600,000	16,200,000	17,000,000
4.14 Capital Equipment Purchases (Distressed Counties)	4,600,000	3,500,000	2,900,000	6,500,000
4.15 Construction Materials and Supplies (Distressed Counties)	2,300,000	1,700,000	1,500,000	3,200,000
4.16 Construction Materials or Equipment (Enterprise Zones)	1,000,000	700,000	600,000	500,000
4.17 Repair and Replacement Parts for Farm Machinery	11,000,000	11,100,000	10,900,000	10,800,000
4.18 Personal Property Brought into Minnesota	5,000,000	5,200,000	5,400,000	5,700,000

*Less than $50,000

	Fiscal Year Impact 1988	1989	1990	1991
4.19 Packing Materials	$300,000	$300,000	$300,000	$300,000
4.20 Out-of-State Leases of Vehicles	*	*	*	*
4.21 Property for Business Use Outside Minnesota	*	*	*	*
4.22 Resource Recovery Equipment	900,000	1,000,000	1,000,000	1,000,000
4.23 YMCA and YWCA Membership Dues	600,000	600,000	600,000	600,000
4.24 Services	656,100,000	713,700,000	777,700,000	846,600,000
4.25 Sewer Services	9,900,000	10,300,000	10,700,000	11,200,000
4.26 Residential Water Services	3,800,000	3,900,000	4,100,000	4,400,000
4.27 Residential Heating Fuels	49,400,000	51,200,000	52,700,000	54,700,000
4.28 Incoming WATS Calls	1,300,000	1,400,000	1,500,000	1,600,000
<u>Exemptions - Sales to Particular Groups</u>				
4.29 Sales to Local Governments	76,000,000	78,500,000	81,800,000	86,000,000
4.30 Sales to Nonprofit Organizations	33,400,000	35,500,000	37,800,000	40,200,000
4.31 Sales to Veterans' Organizations	700,000	700,000	700,000	800,000
4.32 Sales of Building Materials to Disabled Veterans	*	*	*	*
4.33 New Satellite Broad-casting Facility	0	0	0	*
4.34 Certain Taconite Production Materials	200,000	200,000	200,000	200,000
4.35 Airflight Equipment	2,400,000	2,700,000	2,600,000	1,900,000
<u>Exemptions - Sales by Particular Groups</u>				
4.36 Isolated or Occasional Sales	29,000,000	29,600,000	30,200,000	31,000,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
4.37 Sales by Auctioneers and Brokers	$1,800,000	$1,900,000	$2,000,000	$2,000,000
4.38 Institutional Meals	18,100,000	18,800,000	19,700,000	20,500,000
4.39 Fundraising Sales by Nonprofit Organizations	2,000,000	2,100,000	2,200,000	2,300,000
4.40 Candy Sales by Certain Organizations	*	*	*	*
4.41 Admission to School-Sponsored Events	300,000	300,000	300,000	300,000
4.42 Admission to Artistic Events	900,000	900,000	900,000	900,000
4.43 Cross Country Ski Passes	0	*	*	*
<u>Special Rates</u>				
4.44 Two Percent Rate for Farm Machinery	11,800,000	11,900,000	11,900,000	12,000,000
4.45 Two Percent Rate for Logging Equipment	200,000	300,000	300,000	300,000
4.46 Four Percent Rate for Capital Equipment Sold to New or Expanding Industries	2,000,000	2,100,000	2,400,000	2,400,000
4.47 Four Percent Rate for Special Tooling	100,000	100,000	100,000	100,000
4.48 Tax Paid to Other States	600,000	600,000	600,000	600,000
<u>Reduced Sales Price</u>				
4.49 Price Reduced by Value of Trade In	3,700,000	3,700,000	3,800,000	3,800,000
MOTOR VEHICLE EXCISE TAX				
<u>Exemptions</u>				
5.01 Vehicles Acquired by Inheritance	600,000	600,000	600,000	700,000
5.02 Out-of-State Acquisitions	1,100,000	1,200,000	1,200,000	1,300,000

*Less than $50,000.

	Fiscal Year Impact			
	1988	1989	1990	1991
5.03 Transfers Between Joint Owners	$500,000	$600,000	$600,000	$600,000
5.04 Transfers Between Spouses, Parents and Children, and Guardians and Wards	5,800,000	6,000,000	6,300,000	6,500,000
5.05 Transfers in Divorce Proceedings	300,000	300,000	300,000	300,000
5.06 Corporate and Partnership Transfers	*	*	*	*
5.07 Sales to Disabled Veterans	*	*	*	*
5.08 Vehicles Used in Automotive Training Programs	0	*	*	*
Reduced Purchase Price				
5.09 Federal Excise Taxes	200,000	200,000	200,000	200,000
5.10 Price Reduced by Value of Trade In	36,100,000	37,300,000	38,800,000	40,900,000
Preferential Computation				
5.11 Flat Tax on Older Cars and Collector Vehicles	4,300,000	4,700,000	4,900,000	5,100,000
Credit				
5.12 Credit for Taxes Paid to Other States	200,000	200,000	200,000	200,000
HIGHWAY FUELS EXCISE TAXES				
Exemptions				
6.01 Transit Systems Owned by Local Units of Government	1,300,000	1,500,000	1,500,000	1,500,000
6.02 Reciprocal Agreements for Out-of-State Purchases	500,000	500,000	500,000	500,000
6.03 Motor Vehicles Not Requiring Registration (Special Fuels)	100,000	100,000	100,000	100,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
Special Rates				
6.04 Border Rates	*	$0	$0	$0
Credits				
6.05 Gasohol (Other than for Governmental Units and Schools)	$3,500,000	3,500,000	3,200,000	3,200,000
6.06 Gasohol for Governmental Units and Schools	100,000	100,000	100,000	100,000
ALCOHOLIC BEVERAGE TAXES				
Exemptions				
7.01 Consumer Purchases Made Out of State	*	*	*	*
7.02 Home Fermentation (Wine and Beer)	*	*	*	*
7.03 Sales to Food Processors and Pharmaceutical Firms	*	*	*	*
7.04 Consumption on Brewery Premises (Beer)	*	*	*	*
7.05 Wine for Tasting and Testing	*	*	*	*
7.06 Wine for Sacramental Purposes	*	*	*	*
Credit				
7.07 Small Brewers' Credit (Beer)	200,000	200,000	200,000	200,000
CIGARETTE AND TOBACCO TAXES				
Exemption				
8.01 Limited Quantities Exempt	5,400,000	5,400,000	5,400,000	5,400,000
MORTGAGE REGISTRY TAX				
Exemption				
9.01 Certain Persons and Organizations	200,000	200,000	200,000	200,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
DEED TRANSFER TAX				
Exemptions				
10.01 Transfers Between Co-Owners	$100,000	$100,000	$100,000	$100,000
10.02 Deeds of Distribution by Personal Representatives	*	*	*	*
10.03 Deeds for Cemetery Lots	100,000	100,000	100,000	100,000
CHARITABLE GAMBLING TAX				
Exemptions				
11.01 Bingo at Certain Organizations	*	*	*	*
11.02 Bingo at Fairs and Civic Celebrations	*	*	*	*
11.03 Infrequent Bingo Occasions	*	*	*	*
11.04 Smaller Raffles	*	*	*	*
11.05 Lawful Gambling Under Certain Conditions	600,000	600,000	600,000	600,000
TELEPHONE COMPANIES GROSS EARNING TAX				
Exemptions				
12.01 Interstate Telephone Service	16,900,000	17,600,000	10,700,000	9,400,000
12.02 Cellular Radio	1,700,000	2,600,000	2,000,000	1,900,000
Reduced Rates				
12.03 Reduced Rate for Certain Business	14,200,000	14,200,000	11,200,000	11,900,000
INSURANCE PREMIUMS TAXES				
Exemptions				
13.01 Fraternal Benefit Societies	3,600,000	3,900,000	4,200,000	4,500,000

*Less than $50,000.

	Fiscal Year Impact 1988	1989	1990	1991
13.02 Nonprofit Health Service Plan Corporations	$7,800,000	$8,400,000	$9,100,000	$9,800,000
13.03 Health Maintenance Organizations	14,500,000	15,700,000	17,000,000	18,300,000
13.04 Farmers' Mutual and Township Mutual Fire Insurance Companies (Fire Marshal Tax)	200,000	200,000	200,000	200,000
13.05 Minnesota Comprehensive Health Insurance Plan Premiums	200,000	300,000	300,000	300,000
Preferential Computation				
13.06 Ocean Marine Profits Tax	300,000	300,000	300,000	300,000
Reduced Rates				
13.07 Domestic Mutual Insurance Companies Other Than Life	1,200,000	3,500,000	4,900,000	5,300,000
MINING OCCUPATION TAX				
Credits				
14.01 Labor Credit (Repealed)	6,700,000	6,000,000	6,000,000	0
14.02 Pollution Control Credit (Repealed)	*	*	*	0
14.03 Research, Experimentation, and Exploration Credit (Repealed)	*	0	0	0
14.04 Discount Credit (Iron Ore) (Repealed)	200,000	0	0	0
MINERAL ROYALTY TAXES				
Credit				
15.01 Labor Credit (Repealed)	3,300,000	3,400,000	3,500,000	0
Note on Taconite Amendment				
15.02 Constitutional Limit on the Taxation of Taconite Mining Companies	N/A	N/A	N/A	N/A

*Less than $50,000.

	Fiscal Year Impact			
	1988	1989	1990	1991
PROPERTY TAX				
Exemptions				
16.01 Exempt Property	$701,400,000	$748,000,000	$748,000,000	$763,300,000
Preferential Valuations				
16.02 Classification System	N/A	N/A	N/A	N/A
16.03 Green Acres Treatment of Agricultural Land	5,800,000	5,900,000	6,000,000	6,000,000
16.04 Open Space Properties	3,300,000	3,800,000	4,000,000	4,400,000
Preferential Computations				
16.05 Auxiliary Forest Tax and Tree Growth Tax	1,000,000	1,100,000	1,300,000	1,500,000
Credits				
16.06 Taconite Homestead Credit	10,900,000	10,800,000	7,300,000	7,300,000
16.07 Power Line Credit	200,000	200,000	200,000	200,000
AIRFLIGHT PROPERTY TAX				
Preferential Computation				
17.01 Commuter Airlines	*	*	*	*
Preferential Valuations				
17.02 Quiet Aircraft	0	1,000,000	1,100,000	1,100,000
17.03 Certain Airlines	0	600,000	300,000	300,000
MOTOR VEHICLE REGISTRATION TAX				
Exemptions				
18.01 Local Government Vehicles	5,100,000	5,300,000	5,500,000	5,800,000
18.02 School Buses	400,000	400,000	400,000	400,000
18.03 Nonresident Military Personnel	*	*	*	*
18.04 Medal of Honor Recipients	*	*	*	*

*Less than $50,000.

	Fiscal Year Impact			
	1988	1989	1990	1991
18.05 Disabled Veterans	*	*	*	*
18.06 Nonprofit Charities	*	*	*	*
Credit				
18.07 Physically Handicapped Persons	$300,000	$300,000	$300,000	$400,000

AIRCRAFT REGISTRATION TAX

	1988	1989	1990	1991
Exemptions				
19.01 Local Government Aircraft	*	*	*	*
19.02 Civil Air Patrol Aircraft	*	*	*	*

*Less than $50,000.

CHAPTER 1: INDIVIDUAL INCOME TAX

Collections and History

The individual income tax is the largest single source of revenue for the State of Minnesota. For fiscal year 1988 net collections from this tax were $2.6 billion, which was 43% 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 had been adopted in 1913. The same 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.

Many changes have been made to the individual income tax since 1933, but the most significant changes to the structure of the tax occurred in 1985 and 1987.

The 1985 law changes affected primarily the treatment of the joint income of married couples. Previously, one rate schedule applied to all filers, so that two-income married couples would usually file separately. In 1985 a different rate schedule for married-joint filers was enacted, based on the couple's combined income, and the election to file jointly or separately was required to be the same as on the federal return. It was then advantageous for most married couples to file joint returns.

In 1987 a separate rate schedule was enacted for heads of households and in 1988 a different rate schedule was enacted for married-separate filers who had previously used the same schedule as single persons. Therefore, the one rate schedule system in effect for the years 1933 through 1984 has been replaced by four rate schedules.

In recent years the trend has been to bring the Minnesota individual income tax into closer conformity with the federal income tax. In 1985, in addition to the election of filing status and the treatment of joint income, itemized deductions were made more similar to the federal, and several Minnesota credits and modifications to federal adjusted gross income were repealed.

A giant step toward federal conformity was taken in 1987 with the adoption of federal taxable income (rather than federal adjusted gross income) as the starting point for the tax, thereby adopting the federal personal exemptions and standard deduction. The Minnesota standard deduction and personal credits were repealed, as well as some adjustments to income. Using federal taxable income also continues the conformity to federal itemized deductions, with the exceptions now being Minnesota adjustments to federal taxable income.

In 1987 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. The changes included the repeal of the 60% capital gains exclusion, the dividend exclusion, and the sales tax deduction, and also the restriction of deductions for individual retirement account contributions, home mortgage interest, medical expenses, passive losses, and consumer interest.

A deduction for federal income taxes was part of the original Minnesota income tax enacted in 1933 and continued until 1985 when the deduction was made an option, with a higher set of tax rates applicable if the deduction was used. In 1987 the deduction for federal income taxes was eliminated.

Many of the changes enacted in 1985 and 1987 broadened the base of the individual income tax, and the tax rates were generally lowered. Prior to 1985 there were twelve tax rates ranging from 1.6% to 16%. Beginning with tax year 1988, the tax rates are 6% and 8%, plus a .5% surtax for brackets of higher income, as shown in the rate schedules.

Tax Base

One criterion for determining if a provision is a tax expenditure is that it is included in the defined tax base. 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 determined to be reasonable and necessary to generate income, it is not considered to be a tax expenditure.

Computation of the Tax

The tax expenditures for the individual income tax, as for all other taxes, are generally shown in the order in which they occur in the computation of the tax. Beginning with tax year 1988, the Minnesota individual income tax is computed as follows:

	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 (non-Minnesota state and municipal bond interest; itemized deduction for state income taxes)
minus:	Minnesota subtractions (U.S. bond interest; subtraction for elderly and disabled; state income tax refunds; dependent education expenses for itemizers)
equals:	Minnesota taxable income
times:	graduated rates of 6% and 8%, plus surtax, if applicable
equals:	Minnesota gross tax
minus:	nonrefundable credit (income tax paid to other states)
equals:	Minnesota income tax
minus:	refundable credits (dependent care credit; enterprise zone credits)
equals:	net individual income tax payable

Beginning with tax year 1987 the computation of the Minnesota individual income tax starts with federal taxable income. Legislation is required to adopt any federal provisions, or changes made to those provisions, which affect federal taxable income. Exclusions and deductions which Minnesota has adopted without adjustment are shown in the report as federal exclusions and federal deductions.

If Minnesota law requires that part of a federal exclusion or deduction be added back, the provision is shown as a federal exclusion or deduction, with the fiscal impact reflecting the net Minnesota exclusion. The two provisions for which this occurs are Items 1.29 and 1.30, the federal exclusions for state and municipal bond interest.

The personal exemptions and the standard deduction are the same as the federal personal exemptions and standard deduction. The itemized deductions are also the same as the federal, with two exceptions. State income taxes are not deductible on the Minnesota return, and specified dependent educational expenses are deductible. For the itemized deductions, the estimates measure the incremental cost 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 following brackets and rates apply to tax years 1988 through 1990. Beginning with tax year 1991, the brackets are increased annually by the increase in the United States Consumer Price Index.

The rate schedules for tax years 1988 through 1990 are as follows:

Married-Joint Returns and Surviving Spouses

Taxable Income	Rate (or Amount)
$1 - $19,000	6.0%
$19,001 and over	8.0%
Plus Surtax:	
$75,501 - $165,000	0.5%
$165,001 and over	$447.50

Married-Separate Returns, Estates, and Trusts

Taxable Income	Rate (or Amount)
$1 - $9,500	6.0%
$9,501 and over	8.0%
Plus Surtax:	
$37,751 - $82,500	0.5%
$82,501 and over	$223.75

Single Persons

Taxable Income	Rate (or Amount)
$1 - $13,000	6.0%
$13,001 and over	8.0%
Plus Surtax:	
$42,701 - $93,000	0.5%
$93,001 and over	$251.50

Heads of Households

Taxable Income	Rate (or Amount)
$1 - $16,000	6.0%
$16,001 and over	8.0%
Plus Surtax:	
$64,301 - $135,000	0.5%
$135,001 and over	$353.50

FEDERAL EXCLUSIONS

1.01 EMPLOYER-PROVIDED MEALS AND LODGING

Internal Revenue Code, Sections 119 and 107
Minnesota Statutes, Section 290.01, Subd. 19

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

Section 107 of the Internal Revenue Code allows a member of the clergy to exclude from gross income any housing allowance that is part of compensation, whether it is the rental value of a home furnished or a rental allowance paid, to the extent that it is used to rent or provide a home.

These exclusions were first allowed in 1918 by federal regulation. Section 119 was enacted in 1954 and last changed in 1981. Section 107 was enacted in 1954 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,200,000	$4,600,000	$5,300,000	$5,600,000

1.02 EMPLOYER EDUCATIONAL ASSISTANCE (REPEALED)

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

Employer-provided educational assistance is excluded if the assistance is available to all employees, not just to management, highly-compensated employees, or to certain shareholders. This exclusion applies to all costs of an employee's tuition, fees, books, supplies and equipment paid for by an employer, up to a maximum of $5,250.

Because costs incurred which are necessary in earning an income are not considered to be tax expenditures, only the exclusion for educational expenses that are not job related is considered a tax expenditure.

Prior to 1978, only employer-provided educational assistance which was job related was excluded from federal gross income. In 1978, Section 127 of the Internal Revenue Code was enacted which removed the distinction between job-related and other educational expenditures. In 1987 the maximum exclusion was increased from $5,000 to $5,250, and the expiration date was extended for two years to December 31, 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$0	$0	$0

1.03 EMPLOYER-PROVIDED DEPENDENT CARE

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

The value of employer-provided child or dependent care, not exceeding an employee's earned income, is excluded from federal gross income. Amounts exceeding earned income are taxed. The contributions or benefits provided may not discriminate in favor of employees who are highly compensated, shareholders, owners, or their dependents.

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 1.68).

This provision was enacted in 1981. The maximum exclusion was restricted to $5,000 in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$300,000	$700,000	$1,400,000	$2,300,000

1.04 EMPLOYEE AWARDS

Internal Revenue Code, Sections 74(c), 102, and 274(j)
Minnesota Statutes, Section 290.01, Subd. 19

Certain employee awards are classified as gifts and are excluded from gross income. The award must be tangible personal property and given to an employee 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 value of the award must not exceed $400.

The employee awards provision was first enacted in 1962. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$500,000	$500,000	$500,000	$500,000

1.05 EMPLOYER CONTRIBUTIONS TO PREPAID LEGAL SERVICES PLANS (REPEALED)

Internal Revenue Code, Sections 120 and 501(c)(20)
Minnesota Statutes, Section 290.01, Subd. 19

An employee may exclude from federal gross income the value of legal services or benefits received, if such services or benefits are from a qualified group prepaid legal services plan established by the employer. The exclusion applies only to plans that are prepaid by the employer; plans which reimburse employees for legal fees do not qualify. Also, the plan must provide legal services to all employees equally and not just to certain management personnel, highly-compensated employees, or certain shareholders.

This provision was enacted in 1976. In 1987 the expiration date was extended for two years to December 31, 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$0	$0	$0

1.06 EMPLOYER PENSION PLANS

Internal Revenue Code, Sections 401-407, 410, 415, and 457
Minnesota Statutes, Section 290.01, Subd. 19

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

Strictly speaking, this provision represents a deferral of income and not an exclusion, since all pension income which was not previously subject to taxation must be included in federal gross 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 which is disbursed in that year.

The federal exclusion was enacted in 1921. Minnesota has allowed this exclusion since 1933, adopting the federal language in 1961. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$215,000,000	$222,000,000	$239,000,000	$254,000,000

1.07 CONTRIBUTIONS BY EMPLOYERS AND THE SELF-EMPLOYED FOR MEDICAL INSURANCE PREMIUMS AND MEDICAL CARE

Internal Revenue Code, Sections 105, 106, and 162(m)
Minnesota Statutes, Section 290.01, Subd. 19

An employee may exclude from federal gross income all employer contributions to health insurance plans which provide compensation for sickness and injury. 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.

Although a self-employed person is not considered an employee for the above exclusion, for tax years 1987 through 1989 a deduction is allowed for 25% of the amount paid during the year for health insurance for a self-employed individual, spouse, and dependents if certain conditions are met.

Employer contributions for medical insurance premiums and medical care have never been taxed in the United States. In 1943, an Internal Revenue Service ruling made this previously unwritten rule explicit for employer contributions to group health insurance policies. The 1943 ruling did not cover contributions to individual health insurance policies, and a 1953 Internal Revenue Service ruling declared these to be taxable. Section 106 was enacted in 1954 to reverse the 1953 ruling and, therefore, employer contributions to all employee health and accident plans are excludable from an employee's gross income.

Section 162(m) which allows the temporary deduction for self-employed individuals was enacted in 1986 and was adopted by Minnesota in 1987. It expires for tax years beginning after December 31, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$123,300,000	$135,200,000	$156,900,000	$183,200,000

1.08 EMPLOYER-PAID ACCIDENT AND DISABILITY PREMIUMS

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

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

Section 106 was enacted in 1954 and was last changed in 1986. In 1987 Minnesota adopted the federal changes.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$600,000	$600,000	$600,000

1.09 EMPLOYER-PAID DEATH BENEFITS

Internal Revenue Code, Section 101(b)
Minnesota Statutes, Section 290.01, Subd. 19

Benefits paid by an employer to a beneficiary upon the death of an employee may be excluded from federal gross income. The exclusion is limited to $5,000 and applies to a lump sum distribution from a profit-sharing plan, employee stock ownership plan, an annuity, or tax-sheltered annuity. It does not apply to a joint or survivor annuity.

This provision has been in effect since the 1930's and was last changed in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

1.10 EMPLOYER-PAID GROUP TERM LIFE INSURANCE PREMIUMS

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

An employee may exclude from federal gross income all group term life insurance premiums paid on his behalf by an employer. 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 the satisfying of 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. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$9,800,000	$10,200,000	$10,400,000	$10,400,000

1.11 CAFETERIA PLANS

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

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

This exclusion was first allowed in 1978. In 1987 Minnesota adopted the 1986 federal changes.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,200,000	$5,300,000	$8,200,000	$12,500,000

1.12 EMPLOYEE FRINGE BENEFITS (OTHER THAN PROVISIONS COVERED IN ITEMS 1.01 THROUGH 1.11)

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

In addition to the employee benefits covered in Items 1.01 through 1.11, certain other employee benefits may be excluded from gross income. The exempt benefits include: employee discounts, up to specified limits; no-additional-cost service, such as an airline pass for an airline employee for an otherwise empty seat; 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 impracticable. Working condition fringe benefits are also excluded from gross income but are not considered tax expenditures because they are paid for expenses necessary in earning an income.

Prior to 1984, the status of employee benefits not specifically exempted by statute was uncertain. The Internal Revenue Code's definition of income appeared to include these benefits as taxable income; however, Congress prohibited the Internal Revenue Service from issuing any regulations defining these benefits as taxable income. The status of fringe benefits was made certain through the enactment of Section 132 of the Internal Revenue Code, effective January 1, 1985. Any benefit not specified as exempt by Section 132 or another section of the Internal Revenue Code is now considered taxable compensation.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$16,800,000	$18,300,000	$20,200,000	$21,800,000

1.13 INCOME EARNED BY VOLUNTARY EMPLOYEE BENEFIT ASSOCIATIONS

Internal Revenue Code, Section 501(c)(9)
Minnesota Statutes, Section 290.01, Subd. 19

Section 501 of the Internal Revenue Code provides an exemption for the earnings from money set aside in an entity called a voluntary employee benefit association. The money set aside and the earnings on the money are used to pay the cost of a variety of fringe benefits such as medical benefits.

The exemption was first allowed by the federal government in 1928, and Minnesota statutes first allowed the exemption in 1941. In 1987 Minnesota adopted the 1986 federal changes.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,000,000	$2,000,000	$2,400,000	$2,500,000

1.14 INCOME EARNED BY SUPPLEMENTAL UNEMPLOYMENT BENEFIT TRUSTS

Internal Revenue Code, Section 501(c)(17)
Minnesota Statutes, Section 290.01, Subd. 19

Section 501 of the Internal Revenue Code provides an exemption for the earnings from money set aside in an entity called a supplemental unemployment benefit trust. The money set aside and the earnings on the money are used to provide payments to separated employees. When benefits are distributed from the trust, the entire amount is taxable to the recipient.

The exemption of supplemental unemployment trust earnings was first allowed by Minnesota Statutes in 1941. The provision was last changed in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

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

Internal Revenue Code, Sections 911 and 912
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 from federal gross income the income which is earned in a foreign country up to a maximum of $70,000 per year. This exclusion does not apply to federal employees, including members of the Armed Forces.

The taxpayer may also exclude from federal gross income 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 first excluded from federal gross income in 1926. The deduction for foreign housing costs was enacted in 1979. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,400,000	$3,700,000	$4,000,000	$4,300,000

1.16 BENEFITS AND ALLOWANCES TO ARMED FORCES PERSONNEL

Internal Revenue Code, Sections 112, 113, and 134
Internal Revenue Service Regulation 1.61-2
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000
Court Decisions

Section 112 of the Internal Revenue Code excludes all combat pay for military personnel who serve in a combat zone designated as such by an executive order. If military personnel are hospitalized as a result of wounds or disease while serving in a designated combat zone, their combat pay will be excluded for up to two years after the termination of combat activities in the zone. There is no dollar limit on this exclusion for enlisted personnel, but there is a $500 per month limitation for commissioned officers. (At the time of publication, combat pay is being issued for duty in the Persian Gulf.)

Section 113 excludes amounts specifically designated as mustering-out pay. However, it appears that no such payments are being made at this time.

Under Section 134 of the Internal Revenue Code, the value of in-kind meals and quarters given to military personnel is excluded from gross income. Also excluded are certain cash allowances provided in lieu of in-kind benefits.

The exclusion of benefits and allowances to Armed Forces personnel was first enacted in 1942. The exclusion of meals, quarters, and cash allowances was codified in Section 134 as part of the federal Tax Reform Act of 1986 which was adopted by Minnesota in 1987. Previously this exclusion was authorized by regulation and court decisions.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,100,000	$4,900,000	$4,800,000	$4,800,000

1.17. VETERANS' BENEFITS

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

All benefits administered by the Veterans Administration (VA) are excluded from a taxpayer's federal gross income. VA benefits may be divided into three categories: 1) compensation for service-connected disability or death; 2) pensions for non-service-connected disability or death; and 3) vocational rehabilitation, education, and training assistance (including what is commonly referred to as GI Bill benefits).

Compensation for service-related disability or death is based solely on the degree of impairment or injury, without regard to income or wealth. Pensions for non-service-related disabilities are determined according to how much income a veteran has; as income becomes larger, fewer benefits are awarded. Education and training benefits, including readjustment, rehabilitation, and educational assistance programs, are awarded according to the type of training received, time enrolled in the training program, marital status, and number of dependents.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
Disability Compensation	$7,800,000	$7,200,000	$6,900,000	$6,600,000
Pensions	400,000	400,000	300,000	300,000
Education and Training	400,000	300,000	300,000	300,000
Total-State General Fund	$8,600,000	$7,900,000	$7,500,000	$7,200,000

1.18 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 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 had 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 had entered service after September 24, 1975, only pensions awarded for combat-related injuries qualify.

Military disability pensions were first excluded from federal gross income in 1942. The last major change to this provision occurred in 1976.

Approximately 1,300 Minnesotans received military disability pensions in fiscal year 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$300,000	$300,000	$300,000	$300,000

1.19 WORKERS' COMPENSATION BENEFITS

Internal Revenue Code, Section 104
Minnesota Statutes, Section 290.01, Subd. 19

All workers' compensation benefits are excluded from federal gross income. The three basic types of workers' compensation benefits are: 1) payments for medical or rehabilitation expenses; 2) compensation for permanent disabilities; and 3) replacement of lost wages.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$30,100,000	$32,600,000	$35,200,000	$38,100,000

1.20 SPECIAL BENEFITS FOR DISABLED COAL MINERS

Internal Revenue Code, Section 104(a)(1)
30 United States Code 801
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), to widows of coal miners who died as a result of pneumoconiosis, and to their dependents are excluded from federal gross income.

Disability payments for black lung disease were first specifically excluded from federal gross income by the Black Lung Benefits Act of 1972. Payments received after December 31, 1972, were excluded from income by Revenue Ruling 72-400 because the benefits are classified as workers' compensation.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

1.21 SOCIAL SECURITY BENEFITS

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

Some or all of a taxpayer's social security benefits are excluded from gross income. The portion that is included in income is equal to the lesser of a) one-half of the benefits received or b) one-half of the excess over the base amount of the sum of the taxpayer's federal adjusted gross income plus interest on tax exempt obligations plus one-half of the social security benefits. The base amount is $32,000 for a married-joint return and $25,000 for a single filer.

The tax expenditure measures the exclusion of nontaxable social security benefits, net of the recovery of previously-taxed employee contributions.

Prior to 1984, social security benefits had never been taxed by the federal or Minnesota income tax. The federal taxation of a portion of social security benefits was enacted in 1983, effective beginning in 1984. In 1984 Minnesota enacted a subtraction for benefits included in federal adjusted gross income so that no benefits were taxed. In 1985, Minnesota adopted the federal treatment, beginning with tax year 1985.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$87,000,000	$85,300,000	$88,500,000	$94,100,000

*Less than $50,000.

1.22 MEDICARE BENEFITS

Revenue Rulings 70-217 and 70-341
Minnesota Statutes, Section 290.01, Subd. 19
Minnesota Rules, Part 8001.9000

Medicare benefits are excluded from the gross income of the recipient. The exclusion applies to benefits paid under both the basic hospital insurance program and the supplemental 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 supplemental program is a voluntary program financed through individual premiums and matching federal contributions. The tax expenditure measures the impact of excluding 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. Revenue rulings in 1970 upheld the exclusion of these benefits.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$28,900,000	$32,000,000	$35,400,000	$39,300,000

1.23 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 payment for no more than ten qualifying foster children or five qualifying foster adults. The tax expenditure measures the exclusion of income that exceeds expenses.

This provision was first adopted in 1978. Prior to the federal Tax Reform Act of 1986, any foster care payments that exceeded documented expenses were included as income. Beginning with tax year 1986, detailed record keeping is no longer required, and the exclusion is extended to foster care payments made for qualifying adults.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

1.24 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 such benefits are paid include Aid to Families with Dependent Children, General Assistance, Emergency Assistance, Minnesota Supplemental Aid, and Supplemental Security Income.

The estimates include benefits received both in cash and in kind. The estimates take into account that only a portion of the benefits would be subject to the income tax because the annual income of some recipients would be below the income tax filing requirements.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,400,000	$2,800,000	$2,500,000	$2,400,000

1.25 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 federal gross income scholarships and fellowships given to degree candidates to cover tuition, fees, and related expenses, including books and supplies.

This exclusion was first allowed in 1954. Prior to the federal Tax Reform Act of 1986 which was adopted by Minnesota in 1987, scholarship money to cover room and board and money paid to nondegree students (up to $300 per month) were also excluded.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,900,000	$2,900,000	$2,900,000	$3,600,000

1.26 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 from federal gross income if these 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 cost-sharing payment is for a capital expense.

Payments from four federal programs and one state program currently qualify for the exclusion. The federal programs are the Agricultural Conservation Program, the Rural Clean Water Program, the Forestry Incentive Program, and the Water Bank Program. The state program is the Minnesota Soil and Water Conservation Program.

No deductions, depreciation, amortization, or depletion may be claimed with respect to any such amount excluded from federal gross income.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$600,000	$700,000	$700,000

1.27 DISCHARGE OF INDEBTEDNESS INCOME FOR CERTAIN FARMERS

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

As a general rule, the amount of any debt forgiveness must be included in the debtor's gross income. If the debtor is insolvent, however, the income is excluded to the extent of insolvency, and the taxpayer's tax attributes, including basis in property and loss and credit carryovers, must be reduced.

A solvent farmer may be treated as insolvent for purposes of this exclusion if at least 50% of his average annual gross receipts for the previous three years comes from farming. Therefore, a solvent farmer who participates in a loan write-down program does not have a potentially large amount of discharge of indebtedness income added to his taxable income in that year. The treatment of solvent farmers as if insolvent is considered to be a tax expenditure.

The income exclusion for solvent farmers was enacted federally in 1986 and by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$400,000	$300,000	$300,000	$200,000

1.28 INTEREST ON LIFE INSURANCE AND ANNUITY SAVINGS

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

Interest earned on life insurance and annuity savings is not included in the recipient's gross income as the interest 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 interest is credited to the policy. This interest is excluded from the policyholder's income as it accumulates. If the policy is surrendered before the death of the policyholder, only the excess of the cash surrender value over the premiums paid is included in income. Policy proceeds paid because of the death of the insured are excluded from the gross income of a beneficiary, although they may be subject to the estate tax (Chapter 3).

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 interest is not included in the gross income of the owner as it accumulates but is deferred until payments are made from the contract to the annuitant.

These exclusions have been in effect since the income tax laws were enacted in 1933. The last change occurred in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$24,900,000	$26,000,000	$28,500,000	$31,100,000

1.29 INTEREST ON GENERAL PURPOSE STATE AND LOCAL GOVERNMENT DEBT

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

Generally, all interest income is included in the taxpayer's federal gross income. However, Section 103 of the Internal Revenue Code allows a taxpayer to exclude from federal gross income interest received or accrued from all state and municipal general obligation bonds. 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 1.30.

In determining the Minnesota individual income tax, this exclusion is disallowed if the interest is derived from bonds of non-Minnesota governmental units. Interest from other states which was excluded from federal income is added back to arrive at Minnesota taxable income. The result is that the exclusion is restricted to interest from bonds issued by the State of Minnesota or by local units of government in Minnesota.

The federal government first excluded the interest from state and local bonds from gross income in 1913. Minnesota first exempted interest from Minnesota state and local bonds 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. In 1987, the adoption by Minnesota of federal taxable income (rather than adjusted gross income) necessitated the recodification of these provisions.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$12,000,000	$11,900,000	$12,200,000	$13,400,000

1.30 INTEREST ON STATE AND LOCAL PRIVATE ACTIVITY TAX-EXEMPT BONDS

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

Interest received from private activity tax-exempt bonds is excluded from federal gross income. For Minnesota income tax purposes, any interest from non-Minnesota state or local governments is added back to determine Minnesota taxable income. Therefore, the net effect is that the exclusion is restricted to interest from private activity bonds issued by the State of Minnesota or by Minnesota local government units. In contrast to Item 1.29 which shows the impact of the interest exclusion from bonds which are backed by the full faith and credit of the government which issues them, 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. Beginning in 1988, the limitation for each state is the greater of $50 per resident or $150 million. In 1987 the limitation was the greater of $75 per resident or $250 million. 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.

The federal government first excluded interest from all forms of state and local bonds in 1913. Minnesota first exempted interest from Minnesota state and local bonds in 1933. When the state began adopting the federal definition of gross income in 1961, the add-back provision was included in the statutes to maintain the intent and effect of the 1933 law. A 1968 federal law restricted the tax-free status given interest of industrial revenue bonds to those issued for specific purposes. In 1984 a federal law was enacted which limits by state the total amount of certain types of state and local bonds which may be issued, and the federal Tax Reform Act of 1986 further limited the amount of tax-exempt bonds by reducing the per capita limitations for the states. In 1987, the adoption by Minnesota of federal taxable income (rather than adjusted gross income) necessitated the recodification of these provisions.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$27,300,000	$26,700,000	$27,200,000	$29,800,000

1.31 SPECIAL TREATMENT OF CAPITAL GAINS ON HOME SALES

Internal Revenue Code, Sections 121 and 1034
Minnesota Statutes, Section 290.01, Subd. 19

The capital gain from the sale of a taxpayer's principal residence may be deferred or excluded from income if certain conditions are met.

A deferral of the gain from the sale of an owner-occupied home is allowed when the seller buys another home of equal or greater value within two years. The deferred gain reduces the basis of the second home, and the lowered basis will increase the gain realized when the second home is sold unless the seller again qualifies for deferral. There is no limit to the number of home sales from which a taxpayer may defer the gain as long as the specified conditions are met each time.

A once-in-a-lifetime exclusion of up to $125,000 is allowed to a taxpayer age 55 or over on the gain from the sale of a principal residence. This exclusion allows the older taxpayer to move into a less expensive home or into an apartment without being taxed on up to $125,000 of gain from the home's sale. The exclusion could apply to the gain on one home or to the deferred gain from any number of previous homes. In the latter case, a deferral is therefore converted to an exclusion.

Capital gains on home sales excluded at death are included in Item 1.32.

Congress enacted the deferral provision (Section 1034) in 1951. The exclusion provision (Section 121) was enacted by Congress in 1964. Both provisions were last revised in 1981. In 1985 the minimum holding period for property to qualify for long-term capital gains treatment was changed from twelve months to six months.

	Fiscal Year Impact			
	1988	1989	1990	1991
Deferral	$46,400,000	$50,400,000	$54,500,000	$59,700,000
Exclusion-Age 55+	15,600,000	17,000,000	18,000,000	20,100,000
Total - State General Fund	$62,000,000	$67,400,000	$72,500,000	$79,800,000

1.32 CAPITAL GAINS AT DEATH

Internal Revenue Code, Sections 1001, 1002, 1014, 1015, 1023, 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.

When property is transferred as a gift during the lifetime of the owner, the donee's basis is the same as the donor's basis. However, the gain is not reported as income until the property is sold by the donee, resulting in a deferral of tax.

The fiscal impact of these provisions measures the exclusion and deferral against the taxation of the gain at the time of transfer at death or by gift.

The exclusion of capital gains at death was enacted federally in 1921. A similar provision was also incorporated into the original Minnesota income tax law in 1933. In 1985 the minimum holding period for property to qualify for long-term capital gains treatment was changed from twelve months to six months.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$28,300,000	$29,000,000	$30,900,000	$32,800,000

1.33 PERMANENT EXEMPTIONS FROM IMPUTED INTEREST RULES

Internal Revenue Code, Section 7872
Minnesota Statutes, Section 290.01, Subd. 19

Section 7872 of the Internal Revenue Code contains imputed interest rules designed to prevent the assignment of income through the use of below-market or interest-free loans. When the rules apply, a lender is deemed to have received interest payments, and a borrower is deemed to have paid interest payments. Exempt from the imputed interest rules are loans of less than $10,000 if they are gift loans or if they are compensation related or are corporate-shareholder loans. Also exempt are loans to qualified continuing extended care facilities and certain employee home relocation loans. There is a special method for computing income from a gift loan of less than $100,000.

Imputed interest rules and exemption from the rules were first effective in 1984, and they were last changed in 1985.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$500,000	$500,000	$500,000	$1,000,000

1.34 LIKE-KIND EXCHANGES

Internal Revenue Code, Section 1031(a)
Treasury Regulation 1.1031(a)-1
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain from a sale or exchange of property is recognized for tax purposes. However, the gain from a like-kind exchange is not recognized if both the relinquished and the received property are held for productive use in a trade or business or for investment. 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.

Section 1031 was enacted in 1954 and was last amended in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,000,000	$1,000,000	$1,000,000	$1,000,000

1.35 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

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

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

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

FEDERAL DEDUCTIONS

1.36 DEPRECIATION

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

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

Under MACRS, machinery or equipment is classified as either three-, five-, seven-, or ten-year property, 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 31.5 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.

*Less than $50,000.

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 as it was enacted as part of the federal Tax Reform Act of 1986.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$51,700,000	$46,900,000	$51,700,000	$54,900,000

1.37 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 $10,000 for property placed in service after 1986. If the taxpayer places more than $200,000 of qualifying personal property in service during the taxable year, the $10,000 limitation is reduced by one dollar for each dollar that the cost exceeds $200,000. Therefore, no expensing deduction is allowed if the cost exceeds $210,000.

The estimates measure the difference between expensing the property and a depreciation deduction which would reflect the actual useful life of the property.

This provision was adopted in 1982. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,000,000	$1,500,000	$1,000,000	$500,000

1.38 EXCESS OF PERCENTAGE OVER COST DEPLETION

Internal Revenue Code, Sections 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. Depletion deductions are allowed on such diverse properties as oil and gas wells, mineral mines, peat bogs, clay mines, gravel quarries, and commercial stands of timber. In fact, depletion allowances 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 almost identical to depreciation in its application. Percentage depletion, on the other hand, is based on a percentage of the gross income received from the extractive operation and has little relationship to a taxpayer's basis. Because cost depletion is a normal and necessary cost of doing business, only the amount of percentage depletion in excess of cost depletion is considered a tax expenditure.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$700,000	$600,000	$500,000	$500,000

1.39 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. In addition, 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 business is sold.

Section 709 was enacted in 1976, and Section 195 was enacted in 1980. The last change to these provisions took effect in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$800,000	$800,000	$500,000	$500,000

1.40 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, beginning with tax year 1980, timber growers have been provided with a special incentive for forestation or reforestation. Up to $10,000 expended in a year for reforestation can be amortized over seven years. Since 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 1982.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$500,000	$500,000	$500,000	$500,000

1.41 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

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

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

No substantive changes have been made to this provision since it was adopted in 1955.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

1.42 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 adopted by Minnesota in 1951. It was last changed in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

1.43 EXPENSING FOR REMOVAL OF BARRIERS TO THE HANDICAPPED AND ELDERLY

Internal Revenue Code, Section 190
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to expense qualifying barrier removal expenses in the year incurred instead of capitalizing them. To qualify, the removal of barriers must make a facility or public transportation vehicle owned or leased by the taxpayer for use in his trade or business more accessible to and usable by handicapped and elderly persons and must meet standards of the Architectural and Transportation Barriers Compliance Board. The maximum deduction per year is $35,000.

This provision was first effective for tax year 1977. In 1987 Minnesota adopted the federal repeal of the sunset date so the provision is now permanent.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

1.44 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 263(c), 465, 616, 617, 704(d), and 1254
Minnesota Statutes, Section 290.01, Subd. 19

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$700,000	$800,000	$800,000	$900,000

1.45 EXPENSING OF CERTAIN CAPITAL OUTLAYS AND SPECIAL CASH ACCOUNTING RULES FOR FARMERS

Internal Revenue Code, Sections 162, 175, 180, 447, 464, 465, and 704(d)
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer engaged in the business of farming may treat certain expenditures made during the tax year as expenses rather than as capital expenditures. Therefore, the expenditures are entirely deductible in the current year rather than throughout an asset's useful life. To qualify for this special treatment the expenditures must be for soil and water conservation under a government-approved plan, fertilizer, or certain preproduction costs.

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. The accrual system is normally required for businesses with inventories.

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, and Minnesota adopted these federal changes in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$500,000	$500,000	$500,000	$500,000

1.46 EXPENSING OF MULTIPERIOD AGRICULTURAL PRODUCTION COSTS

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

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

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

This provision was enacted as part of the federal Tax Reform Act of 1986 and was adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

1.47 EXPENSING OF MULTIPERIOD TIMBER GROWING COSTS

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

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

The new capitalization rules were enacted as part of the Tax Reform Act of 1986. Although the expensing of timber growing costs was allowed previously, it is now considered a tax expenditure because the general rules that apply to other business activities are more restrictive. Minnesota adopted the 1986 federal changes in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

1.48 SPECIAL RULES FOR MINING RECLAMATION RESERVES

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

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

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

1.49 CASH ACCOUNTING OTHER THAN AGRICULTURE

Internal Revenue Code, Section 446
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. Presently, accrual accounting is required in a limited form only for businesses that sell inventory directly.

Cash accounting has been permitted since 1933. The provision has remained unchanged since then.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

1.50 INSTALLMENT SALES

Internal Revenue Code, Sections 453, 453A, 453B, and 453C
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. The installment method of reporting may be used to report gains if at least one payment is received in a tax year other than the year of sale. Under the installment method, 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. The 1986 and 1987 federal changes were adopted by Minnesota in 1987 and 1988 respectively.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

1.51 INDIVIDUAL RETIREMENT ACCOUNTS

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

An individual may take a deduction for contributions made during the year to an individual retirement account (IRA) up to a maximum of $2,000 or an amount equal to earned income, whichever is less. These maximum amounts apply if neither the taxpayer nor the spouse is a participant in an employer-provided retirement plan.

If the taxpayer or spouse is a participant in an employer plan, the full deduction is allowed if adjusted gross income is $40,000 or less for a married-joint return or $25,000 or less for a single person. The maximum deduction is phased out so that no deduction is allowed for a married-joint return with income of $50,000 or more or for a single person with income of $35,000 or more.

Earnings on IRA funds are not included in income until the funds are distributed. A taxpayer may make nondeductible contributions to an IRA, but the earnings would still be deferred. The sum of deductible and nondeductible contributions for a year cannot exceed the lesser of $2,000 or the amount of earned income.

Disbursements from an IRA are included in the recipient's income except for the recovery of any previously-taxed contributions. Therefore, the IRA 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.

The federal IRA provisions were enacted in 1974. In 1981 the contribution deduction was extended to persons covered by employer pension plans. In 1986 restrictions were placed on the deductions allowed for participants in employer plans, and nondeductible contributions were allowed. Minnesota has followed the federal provisions but did not conform to the 1981 federal changes until 1985. Minnesota adopted the 1986 federal changes in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$42,000,000	$44,800,000	$47,600,000	$50,400,000

1.52 KEOGH PLANS

Internal Revenue Code, Sections 219, 220, 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 or $30,000. Income earned is not included in the recipient's income until it is withdrawn from the fund.

A Keogh plan must cover any eligible employees in addition to the owner. The deduction for contributions made on behalf of employees is considered a normal business expense and, therefore, 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. In 1985 Minnesota adopted the federally-allowed deduction. The 1986 federal technical changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$11,600,000	$12,200,000	$12,700,000	$13,700,000

1.53 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. For the years that both the federal and Minnesota provisions were in effect, any federally-allowed deduction passed through to Minnesota as part of federal adjusted gross income, and any allowance not deductible on the federal return was subtracted on the Minnesota return. Beginning with tax year 1987, Minnesota conforms to the federal treatment and, therefore, disallows the deduction for legislators who reside within fifty miles of the capitol building and for nonqualifying interim per diem.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

MINNESOTA SUBTRACTIONS

1.54 INCOME OF THE ELDERLY OR DISABLED

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

Beginning with tax year 1988, a subtraction is allowed from federal taxable income for persons who are elderly (age 65 or over) or totally disabled. Taxpayers eligible for the subtraction are generally those with low income from pension and interest who receive relatively small amounts of nontaxable income, 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 as elderly or disabled and file a joint return: $10,000 minus nontaxable retirement and social security benefits (except railroad retirement) minus one-half of federal adjusted gross income over $15,000.

The $10,000 and $15,000 amounts used in the above computation are replaced as follows: $10,000 and $12,000 for a married-joint return if only one spouse qualifies; $8,000 and $12,000 for a single person; and $5,000 and $7,500 for a married-separate return. A married couple must file a joint return to claim the subtraction unless the spouses live apart the entire year.

*Less than $50,000.

This subtraction was enacted in 1988, but, from the beginning of the state income tax, Minnesota has provided some form of tax relief for retired, elderly, or disabled persons. Public pensions were exempt from the Minnesota income tax from 1933 through 1977. From 1978 through 1986 a subtraction was allowed, in various forms, for public or private pension income, limited to a maximum amount with qualifying offsets or reductions. For tax year 1987 only, a credit against the tax was allowed which was equal to 40% of the federal credit for the elderly and disabled.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,900,000	$12,000,000	$12,500,000	$13,100,000

1.55 DISPOSITION OF FARM PROPERTY

Minnesota Statutes, Section 290.491(b)

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.

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			
	1988	1989	1990	1991
State General Fund	$0	$200,000	$100,000	$100,000

PERSONAL DEDUCTIONS

1.56 ADDITIONAL STANDARD DEDUCTION FOR THE ELDERLY AND BLIND

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

Beginning with tax year 1987, the elderly (age 65 and over) and the blind are allowed a standard deduction amount in addition to the standard deduction available to other taxpayers.

The additional standard deduction for married couples filing jointly or separately is $600 for each person (taxpayer or spouse) who is elderly or blind and $1,200 for a person who is both elderly and blind. The additional standard deduction for single filers and head of household filers is $750 for a taxpayer who is elderly or blind and $1,500 for a taxpayer who is both elderly and blind.

Also for tax year 1987 elderly and blind filers are not subject to the smaller transitional basic standard deduction amounts but are allowed the full 1988 amounts immediately. Therefore, in addition to the above amounts, an extra $1,240 is allowed on married-joint returns, $620 on married-separate returns, $460 on single returns, and $1,860 on head of household returns.

The basic and additional standard deduction amounts will be indexed annually, beginning in tax year 1989.

The tax expenditure measures only the impact of the additional standard deduction allowed to elderly and blind filers. 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, with an additional credit for the deaf enacted in 1975 and for the quadriplegic in 1979. Prior to tax year 1987, an additional personal exemption was allowed to the elderly and the blind on the federal return. The additional Minnesota personal credits and the additional federal personal exemptions were replaced by the additional standard deduction which was enacted as part of the federal Tax Reform Act of 1986 and was adopted by Minnesota in 1987 when Minnesota first adopted the federal standard deduction.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$7,400,000	$6,000,000	$6,000,000	$6,400,000

1.57 MEDICAL AND DENTAL EXPENSES

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

A deduction is allowed for expenses paid for medical treatment, health care, health insurance, and transportation essential for medical care. The deduction is equal to the amount by which the sum of all qualified medical expenses exceeds 7.5% of federal adjusted gross income.

A deduction for medical expenses has been allowed by Minnesota since 1933. The state adopted the federal provisions for this deduction beginning with tax year 1982. In 1987 Minnesota adopted the 1986 federal change which increased the floor for the deduction from 5% to 7.5% of federal adjusted gross income.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$11,600,000	$12,600,000	$13,600,000	$14,600,000

1.58 REAL ESTATE TAXES

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

An itemized deduction is allowed for real estate taxes paid during the taxable year. The deduction is reduced by any Minnesota property tax refund received. Special assessments are not considered real estate taxes and cannot be deducted.

Business or trade-related real estate taxes are not included in the estimates because they are not itemized personal deductions. Furthermore, they are not considered tax expenditures because they are costs necessary for earning income.

Minnesota has allowed this itemized deduction since 1933. Upon enactment of the property tax refund, this deduction was reduced by the amount of that refund to determine the net property tax paid, beginning in 1976. The provision was recodified in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$44,800,000	$38,200,000	$41,100,000	$45,600,000

1.59 MOTOR VEHICLE REGISTRATION TAX

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

An itemized deduction is allowed for the ad valorem portion of motor vehicle registration taxes paid during the tax year. The motor vehicle registration tax is explained in Chapter 18.

This deduction was enacted in 1933. It was last changed in 1983 and was recodified in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,600,000	$2,400,000	$2,500,000	$2,700,000

1.60 INTEREST ON HOME MORTGAGES

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

A taxpayer may take an itemized deduction for interest on debt secured by a principal or second residence. Although certain restrictions apply, most taxpayers can deduct the full amount of their mortgage or contract-for-deed interest.

For tax year 1987 only, the deduction for interest on a debt incurred after August 16, 1986, was limited to interest on debt up to the amount of the taxpayer's cost basis in the residence. Interest on additional borrowed amounts was deductible only if the loan was used for educational or medical purposes.

Beginning with tax year 1988, new restrictions apply which replace those applicable in 1987. For a debt incurred after October 13, 1987, mortgage interest is deductible on up to $1 million of debt used to buy, build, or improve a principal or second residence. If the debt is used for any other purpose, the limitation is $100,000 of debt. Home equity loans fall into this second category and are subject to the $100,000 debt limitation. If more than one home is involved, the limitations apply to the total amount of the mortgages.

Home mortgage interest was deductible without limitation for tax years 1933 through 1986. The tax year 1987 rules were part of the federal Tax Reform Act of 1986 adopted by Minnesota in 1987. The current restrictions were enacted federally in 1987 and by Minnesota in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$178,400,000	$149,100,000	$161,500,000	$176,200,000

1.61 PERSONAL INTEREST (REPEALED)

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

Prior to tax year 1987, the full amount of personal interest paid was allowed as an itemized deduction. The deductibility of personal interest is phased out over a five-year period, and the percentage of the deduction disallowed is 35% for tax year 1987, 60% for 1988, 80% for 1989, 90% for 1990, and 100% for 1991 and thereafter.

Personal interest includes interest paid on credit card purchases, automobile loans, and other personal loans. Not deductible are: interest on a debt incurred in the purchase of certain life insurance policies; interest on a debt incurred in the earning of tax-exempt income, such as loans taken to buy government bonds; and interest on a debt for which the taxpayer is not legally liable.

Although interest paid in connection with an investment activity is also an itemized deduction, it is not considered a tax expenditure because it is a cost of earning income. The deduction of investment interest is not phased out.

This deduction was enacted in 1933 as part of the original Minnesota income tax law. The phase out and repeal were enacted as part of the federal Tax Reform Act of 1986 and were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$55,400,000	$28,700,000	$16,100,000	$4,500,000

1.62 CHARITABLE CONTRIBUTIONS

Internal Revenue Code, Sections 63(d) and 170
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.

A deduction for charitable contributions has been allowed since the Minnesota income tax was enacted in 1933. Until 1985, the deduction differed from the federally-allowed deduction, mainly in regard to the maximum deduction and carryforward provision. In 1985 Minnesota adopted the federal deduction. A 1986 federal change adopted by Minnesota in 1987 placed some restrictions on travel expenses that are allowed as deductible charitable contributions.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$59,100,000	$61,200,000	$63,300,000	$65,300,000

1.63 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 nonbusiness losses caused by theft, vandalism, fire, storm, and car, boat, and other accidents or similar causes. The deduction is allowed only to the extent that each separate casualty or theft loss exceeds $100 and that the total of all 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 1986 federal change to this provision was adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,300,000	$1,200,000	$1,000,000	$1,000,000

1.64 TAX RETURN PREPARATION FEES

Internal Revenue Code, Sections 63(d) and 212
Minnesota Statutes, Section 290.01, Subd. 19

An itemized deduction is allowed for all the ordinary and necessary expenses paid for the determination, collection, or refund of any tax. Beginning with tax year 1987, the fees are deductible only to the extent that they, together with other miscellaneous deductions, exceed 2% of federal adjusted gross income. The other miscellaneous deductions include certain employee and investment expenses.

Tax return preparation fees were fully deductible from 1933 through 1986. In 1987 Minnesota adopted the federal limitation enacted in 1986.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,500,000	$1,400,000	$1,500,000	$1,600,000

1.65 EDUCATION EXPENSES FOR DEPENDENT CHILDREN

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

A Minnesota resident may deduct certain education expenses for dependent children in public or private school. Qualifying expenses include those for tuition, transportation, and non-religious textbooks or supplies required for a subject commonly taught in the public schools. The maximum deduction is $650 per child in kindergarten through sixth grade and $1,000 per child in seventh through twelfth grades.

This deduction has been allowed since 1955. From 1971 through 1973 Minnesota also provided a credit for tuition paid to private schools, but the credit was declared unconstitutional and repealed. In 1983 the United States Supreme Court ruled the deduction constitutional. The current maximum amounts were enacted in 1984. The provision was recodified in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,000,000	$4,600,000	$4,900,000	$5,300,000

PREFERENTIAL COMPUTATION

1.66 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. The tax is computed using five-year averaging and is done in isolation of other income of the taxpayer. The estimates measure the difference between the lump sum distribution tax and the additional regular income tax that would be paid if the entire lump sum was added to the income of the taxpayer in the year received.

Beginning with tax year 1987, the recipient must be age $59\frac{1}{2}$ or older in order to elect the averaging treatment, and the averaging treatment can be used only once in a lifetime. The capital gains treatment of pre-1974 contributions is phased out over six years. Ten-year averaging was in effect prior to 1987 but is replaced by five-year averaging.

A ten-year averaging provision was adopted by Minnesota in 1975. In 1987 Minnesota adopted the federal changes listed above that were effective with tax year 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,500,000	$1,500,000	$1,500,000	$1,500,000

CREDITS

1.67 CREDIT FOR INCOME TAX PAID TO OTHER STATES

Minnesota Statutes, Section 290.06, Sub. 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, province, or territory is included in Minnesota income. The credit is the lesser of the tax owed to the other state or province, or the amount computed by multiplying the Minnesota gross tax computed on all income times the percentage that the income earned outside Minnesota is to Minnesota income.

The credit does not apply to wage and personal service income earned in a state with which Minnesota has a reciprocity agreement. Minnesota entered into such reciprocity agreements with Wisconsin in 1968, with North Dakota in 1969, and with Michigan in 1984. Under these agreements a taxpayer with wage and personal service income is required to file an income tax return only in the state of residency.

Since 1973 the Minnesota-Wisconsin reciprocity agreement has included a unique reimbursement provision. The state which experiences a net revenue loss due to reciprocity is reimbursed by the other state for the amount of that loss, and, therefore, this provision is not considered a tax expenditure. The reciprocity agreements with North Dakota and Michigan have no provisions for reimbursement. However, they are not considered tax expenditures because there is no estimated revenue loss for Minnesota.

This credit was enacted in 1959 and was last changed in 1988.

This credit was claimed on 20,600 returns in tax year 1986.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$11,000,000	$12,300,000	$13,800,000	$15,400,000

1.68 CHILD AND DEPENDENT CARE CREDIT

Internal Revenue Code, Section 21
Minnesota Statutes, Section 290.067

A Minnesota taxpayer may claim a refundable credit of from 23% to 30% of dependent care expenses, depending on income, provided that those expenses were necessary in order to hold or look for a job. The maximum credit is $720 for one dependent and $1,440 for two or more dependents. These maximum amounts and allowable percentages are reduced for taxpayers with total household income over $12,200, so that a taxpayer with total household income over $24,000 receives no credit. A dependent is defined as a child under age 15 or a person of any age who is disabled.

The dependent care credit was enacted in 1977. It was last revised in 1988.

This credit was claimed on approximately 40,000 returns filed for tax year 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$10,400,000	$10,400,000	$10,400,000	$10,400,000

1.69 CONSTRUCTION FINANCING (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(3)

A taxpayer may apply for a credit equal to a percentage of the cost of debt financing for construction of new or expanded facilities in a designated enterprise zone. Each municipality determines the percentage of financing used in computing credit amounts within its zone. Credit amounts in excess of annual tax liability are refundable to the taxpayer.

The credit was enacted in 1983 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$700,000	$400,000	$300,000	$300,000

1.70 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

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

Two separate refundable credits against the income tax are available to employers in designated enterprise zones.

1. An employer may claim a credit of up to $3,000 annually for each additional worker employed in a designated enterprise zone.

2. An employer in a designated border city enterprise zone may claim a credit of up to $1,500 annually for each worker employed in the zone who does not qualify for the $3,000 credit.

The employer job credit was enacted in 1983 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$900,000	$700,000	$700,000	$600,000

CHAPTER 2: CORPORATE FRANCHISE TAX

Collections and History

For fiscal year 1988 net revenues from the corporate franchise tax were $411 million, equaling 6.7% of total state revenue. The revenue goes 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. In 1937 the rates for both the individual and corporate income taxes were changed, and the corporate rate was no longer the same as the individual. The corporate rate was changed from a graduated rate schedule to a flat rate of 7% and remained basically a flat rate until tax year 1982 when it was changed to a two-step rate, although various rate changes, additional taxes, and surtaxes were enacted during the intervening years. For tax years 1983 through 1986, the rate was 6% on the first $25,000 of taxable income apportioned to Minnesota and 12% on the remainder. Beginning with tax year 1987 the rate is again a flat rate, now 9.5%.

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. Beginning with tax year 1987 the separate bank excise tax is no longer imposed, and banks are subject to the corporate franchise tax.

In 1981 Minnesota adopted 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.

In 1987 the corporate income and bank excise taxes were replaced by the corporate franchise tax, and, for the first time in the history of the Minnesota corporate tax, 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. In 1987 Minnesota also adopted many of the changes contained in the federal Tax Reform Act of 1986.

An alternative minimum tax was enacted for tax years 1987, 1988, and 1989 which is one mill times the total of the Minnesota property, payroll, and sales factors. An exemption applies to the first $5 million of Minnesota factors, with the exemption phased out for corporations with total factors exceeding $10 million. The property and payroll factors are deemed to be zero for the first five years of a new corporation. Beginning with tax year 1990, the factors tax is replaced by an add-on minimum tax equal to 40% of the excess of the federal minimum tax over the regular federal tax.

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 considered a necessary business expense and not a tax expenditure. However, when accelerated depreciation or expensing is allowed, the excess over the actual depreciation is considered to be a tax expenditure.

A tax expenditure is also created when a business or organization operates with all the rights and privileges of a corporation but is not subject to the tax. Items 2.01 and 2.02 are tax expenditures for this reason. The exemption of mining companies from the income tax is not a tax expenditure because they are subject to the occupation tax (Chapter 14).

Computation of the Tax

The computation of the tax is as follows:

	Income from all sources
minus:	federal exclusions
minus:	federal deductions
equals:	federal taxable income
plus:	Minnesota additions
	- state or foreign income taxes deducted federally
	- federally-exempt interest on government bonds
	- exempt-interest dividends paid by regulated investment companies
	- windfall profits tax deducted federally
	- net operating loss deducted federally
	- federal dividend received deduction
	- losses from mining subject to the occupation tax
	- capital losses
	- federal charitable contribution deduction
	- exempt foreign trade income of a foreign sales corporation
	- percentage depletion
	- amortization deduction for specified pollution control facilities
	- deemed dividends from foreign operating corporations
minus:	Minnesota subtractions
	- foreign dividend gross up
	- salary expenses not deducted federally due to federal jobs credit
	- for banks, any dividend paid on its preferred stock to the federal government
	- depreciation and depletion deductions for intangible drilling costs previously disallowed
	- 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
	- depreciation deduction for specified pollution control facilities
	- refundable enterprise zone credits included in taxable income
	- state income tax refunds
	- 50% of specified foreign source income in 1989 and 1990 and 80% in 1991 and after
plus or minus:	modifications to the federal accelerated cost recovery system
equals:	total net income
times:	apportionment factor
equals:	Minnesota net income
minus:	Minnesota deductions (net operating loss; dividend received; Minnesota charitable contributions)
equals:	Minnesota taxable income
times:	tax rate of 9.5%
equals:	gross tax
minus:	nonrefundable credits (research and development credit; gross premiums tax credit for insurance companies)

equals:	tax liability
minus:	refundable enterprise zone credits
equals:	net corporate franchise tax payable

For most multistate corporations, income is apportioned to Minnesota based on a weighted three-factor formula of 15% of the Minnesota property ratio, 15% of the Minnesota payroll ratio, and 70% of the Minnesota sales ratio. With special permission, separate accounting or a single factor of sales may be used.

Unlike other corporations which start with federal taxable income in computing their tax, insurance companies determine net income for Minnesota tax purposes under provisions adopted from the Internal Revenue Code of 1936. Income is apportioned to Minnesota by the ratio that gross premiums collected in Minnesota is to total gross premiums collected for that year.

EXEMPT ORGANIZATIONS

2.01 TAX-EXEMPT ORGANIZATIONS

Subchapter F of the Internal Revenue Code
Minnesota Statutes, Section 290.05

Minnesota law generally conforms to Subchapter F of the Internal Revenue Code in exempting certain types of organizations from taxation. Minnesota law does not conform with federal law in taxing the unrelated business income of tax-exempt organizations. A tax-exempt organization is subject to the federal unrelated business income tax if the activity meets the following three conditions: the activity is a trade or business; the trade or business is regularly carried on; and the trade or business is not substantially related to the organization's exempt purpose.

Conceptually, the Minnesota tax expenditure is the revenue impact of exempting both related and unrelated business income. In practice, no data exists from which to derive what would be the taxable portion of related business income. Also, it is difficult to apply the concept of taxable income to the related business income of nonprofit organizations.

The revenue impact of exempting unrelated business income from tax, however, can be estimated because federal data exists for that portion of this tax expenditure. The estimates below therefore are a measurement of exempting only that portion of income which is considered by the Internal Revenue Service to be unrelated to the goals of the organization.

Most of these organizations have been exempt from Minnesota income tax since 1933. In 1981 Minnesota adopted the list of tax-exempt organizations found in Subchapter F of the Internal Revenue Code. The last change occurred in 1986.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$900,000	$1,000,000	$1,000,000	$1,000,000

The following is a list of the types of organizations which are exempt from the Minnesota corporate franchise tax:

IRC, Sec.	Type of Organization	Number of Organizations Nationally (1987)
501(c)(1)	Federal corporations created by federal law to act as instrumentalities of the United States. Example: Federal Deposit Insurance Corporation	24
501(c)(2)	Title-holding corporations for exempt organizations, necessary because certain states prohibit tax exempt organizations from holding property.	5,977
501(c)(3)	Religious, educational, charitable, scientific, and literary organizations testing for public safety, fostering certain national or international amateur sports competition, or prevention of cruelty to children or animals. This classification also includes private foundations.	422,103
501(c)(4)	Civic leagues, social welfare organizations, and local associations of employees which promote community welfare or contribute earnings to charitable, educational, or recreational purposes.	138,485
501(c)(5)	Labor, agricultural, and horticultural organizations which seek to improve working conditions, products, or efficiency through education or instruction.	75,238
501(c)(6)	Business leagues, chambers of commerce, real estate boards, and other similar organizations which seek to improve the common business of their members.	59,981
501(c)(7)	Clubs organized for the pleasure, recreation, or social activities of their members.	60,146
501(c)(8)	Fraternal beneficiary societies and associations. These organizations operate under the lodge system and provide life, sickness, and/or accident benefits to their members.	98,979
501(c)(9)	Voluntary employee benefit associations (including federal employee voluntary benefit associations formerly covered by Section 501(c)(10)). These organizations provide for payment of life, sickness, accident, or other benefits to members.	10,927
501(c)(10)	Domestic fraternal societies and associations. These organizations are similar to 501(c)(8) organizations but do not provide life, sickness, or accident payments to their members.	17,813
501(c)(11)	Teachers' retirement fund associations. These are organizations of a purely local character which provide for payment of retirement benefits.	11

IRC, Sec.	Type of Organization	Number of Organizations Nationally (1987)
501(c)(12)	Benevolent life insurance associations, mutual ditch or irrigation companies, and mutual or cooperative telephone companies among others.	5,572
501(c)(13)	Cemetery companies owned by and operated exclusively for the benefit of their members.	7,942
501(c)(14)	State chartered credit unions and mutual reserve funds. These organizations provide banking services to their members.	6,652
501(c)(15)	Mutual insurance companies or associations which provide insurance to members at cost. (Tax exempt status is limited to organizations with annual net written premiums of $350,000 or less).	950
501(c)(16)	Cooperative organizations which finance crop operations in conjunction with activities of a marketing or purchasing association.	18
501(c)(17)	Supplemental unemployment benefit trusts.	728
501(c)(18)	Employee funded pension trusts (founded prior to June 25, 1959).	5
501(c)(19)	Recognized posts or organizations of war veterans.	24,749
501(c)(20)	Trusts to provide for prepaid legal services for employees.	210
501(c)(21)	Black lung disease trusts.	21
501(c)(22)	Withdrawal liability payment funds. These organizations provide funds to meet the liability of employers withdrawing from a multi-employer pension fund.	N/A
501(c)(23)	Associations of past or present members of the Armed Forces, founded before 1880.	N/A
501(c)(24)	A trust described in section 4049 of the Employee Retirement Income Security Act of 1974 (ERISA).	N/A
501(c)(25)	A corporation or trust that has no more than 35 shareholders, has only one class of stock or beneficial interest, and is operated for the exclusive purpose of holding title to property and distributing income to eligible shareholders. An eligible shareholder includes a qualified pension plan, a state or political subdivision, or a 501(c)(3) organization.	N/A

IRC, Sec.	Type of Organization	Number of Organizations Nationally (1987)
501(d)	Religious and apostolic associations. These organizations provide a common treasury of the regular business activities of a communal religious group.	88
501(e)	Cooperative hospital associations providing the following services for two or more exempt hospitals: data processing, purchasing, laboratory testing, printing, communications, records center, and personnel services.	80
501(f)	Cooperative educational service organizations. These perform collective investment services for educational organizations.	1
521(a)	Farmers' cooperative associations. These organizations perform cooperative purchasing and marketing of agricultural products.	2,405

2.02 CREDIT UNIONS

Subchapter F of the Internal Revenue Code
Minnesota Statutes, Section 290.05, Subd. 2

Credit unions, which are cooperative associations similar to savings banks, 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 building and loan associations if they were subject to the franchise tax.

Credit unions 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 excludes numerous organizations, including credit unions, from income tax. The general topic of tax-exempt organizations is discussed in Item 2.01.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,000,000	$2,000,000	$2,000,000	$2,500,000

FEDERAL EXCLUSIONS

2.03 PERMANENT EXEMPTIONS FROM IMPUTED INTEREST RULES

Internal Revenue Code, Section 7872
Minnesota Statutes, Section 290.01, Subd. 19

Section 7872 of the Internal Revenue Code contains imputed interest rules designed to prevent the assignment of income through the use of below-market or interest-free loans. When the rules apply, a lender is deemed to have received interest payments, and a borrower is deemed to have paid interest payments. Exempt from the imputed interest rules are loans of less than $10,000 if they are gift loans or if they are compensation related or are corporate-shareholder loans. Also exempt are loans to qualified continuing extended care facilities and certain employee home relocation loans. There is a special method for computing income from a gift loan of less than $100,000.

Imputed interest rules and exceptions to the rules were first effective in 1984, and they were last changed in 1985.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

2.04 DISCHARGE OF INDEBTEDNESS INCOME FOR CERTAIN FARMERS

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

As a general rule, the amount of any debt forgiveness must be included in the debtor's gross income. If the debtor is insolvent, however, the income is excluded to the extent of insolvency, and the taxpayer's tax attributes, including basis in property and loss and credit carrovers, must be reduced.

A solvent farmer may be treated as insolvent for purposes of this exclusion if at least 50% of his average annual gross receipts for the previous three years comes from farming. Therefore, a solvent farmer who participates in a loan write-down program does not have a potentially large amount of discharge of indebtedness income added to his taxable income in that year. The treatment of solvent farmers as if insolvent is considered to be a tax expenditure.

The income exclusion for solvent farmers was enacted federally in 1986 and by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

2.05 LIKE-KIND EXCHANGES

Internal Revenue Code, Section 1031(a)
Treasury Regulation 1.1031(a)-1
Minnesota Statutes, Section 290.01, Subd. 19

In general, the gain from a sale or exchange of property is recognized for tax purposes. However, the gain from a like-kind exchange is not recognized if both the relinquished and the received property are held for productive use in a trade or business or for investment. 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.

Section 1031 was enacted in 1954 and was last amended in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,200,000	$1,200,000	$1,200,000	$1,200,000

2.06 SPECIAL RULES FOR MAGAZINE, PAPERBACK, AND RECORD RETURNS

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

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

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

INSURANCE COMPANY EXCLUSIONS

2.07 UNRELATED INCOME (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Minnesota taxes life insurance companies on three types of income: interest, dividends, and rent. All other income, including income from non-insurance business activities, is excluded. The estimates below are for unrelated income only; other types of excluded income are estimated separately in Items 2.08, 2.09, and 2.10.

Unrelated income has been excluded from the corporate income tax since the state first taxed insurance companies in 1937.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

2.08 UNDERWRITING INCOME (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Life insurance companies may exclude from Minnesota taxable income all underwriting income earned in a taxable year. Underwriting income is defined as a life insurance company's total gain from operations minus the company's taxable investment income. Underwriting income is chiefly made up of the following two types of income: (1) mortality savings, which are realized when deaths occur at a rate less than was assumed when life insurance premiums and reserves were established; and (2) loading savings, which are realized when expenses incurred in placing insurance policies on the books and subsequently servicing them are lower than was anticipated.

Insurance companies were originally exempt from the Minnesota income tax when it was enacted in 1933. In 1937, the state adopted a portion of the Federal Revenue Act of 1936 dealing with the taxation of insurance companies. This act, which is still used by the state, imposed an income tax on insurance companies but excluded underwriting income.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

2.09 FEE INCOME (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Life insurance companies may exclude from taxable income any fees received during the taxable year. Examples of fees collected by life insurance companies are partial release fees, loan assumption fees, rent collection fees, mortgage loan commitment fees, and income cancellation mortgage loan commitment fees.

Fee income has been excluded since life insurance companies were first subject to the Minnesota corporate income tax in 1937.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

2.10 ROYALTIES (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Minnesota life insurance companies may exclude from taxable income all royalties received during the year.

The royalties of life insurance companies have been excluded from taxation since 1937.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

FEDERAL DEDUCTIONS

2.11 DEPRECIATION

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

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

Under MACRS, machinery or equipment is classified as either three-, five-, seven-, or ten-year property, 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 31.5 years is used for nonresidential real property.

*Less than $50,000.

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

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$35,400,000	$47,500,000	$50,400,000	$56,100,000

2.12 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 cost in the year the property is placed in service. The deduction is taken instead of the depreciation deduction.

The maximum annual deduction is $10,000 for property placed in service after 1986. If the corporation places more than $200,000 of qualifying personal property in service during the taxable year, then the $10,000 limitation is reduced by one dollar for each dollar that the cost exceeds $200,000. Therefore, no expensing deduction is allowed if the cost exceeds $210,000.

The estimates measure the difference between expensing the property and a depreciation deduction which would reflect the actual useful life of the property.

This provision was adopted in 1982. The 1986 federal changes were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,500,000	$2,800,000	$2,400,000	$800,000

2.13 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 organization 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.

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			
	1988	1989	1990	1991
State General Fund	\$100,000	\$100,000	\$100,000	\$100,000

2.14 SEVEN-YEAR AMORTIZATION OF REFORESTATION EXPENDITURES

Internal Revenue Code, Sections 48 and 94
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, timber growers have been provided with a special incentive for forestation or reforestation. Up to \$10,000 expended in a year for reforestation can be amortized over seven years. Since 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.

The federal provision was enacted in 1980 and was last changed in 1982. In 1987 Minnesota adopted this provision for the corporate franchise tax, beginning with tax year 1987, by adopting federal taxable income as the starting point for the tax.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	\$100,000	\$100,000	\$100,000	\$100,000

2.15 EXPENSING OF RESEARCH AND DEVELOPMENT COSTS

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

Generally, expenses incurred in creating or developing an asset must be capitalized, with recovery occurring over the life of the asset. However, a 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.

No substantive changes have been made to this provision since it was adopted in 1955.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,000,000	$4,100,000	$4,600,000	$5,300,000

2.16 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 enacted by Minnesota in 1951 and was last amended in 1982.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

2.17 EXPENSING FOR REMOVAL OF BARRIERS TO THE HANDICAPPED AND ELDERLY

Internal Revenue Code, Section 190
Minnesota Statutes, Section 290.01, Subd. 19

A taxpayer may elect to expense qualifying barrier removal expenses in the year incurred instead of capitalizing them. To qualify, the removal of barriers must make a facility or public transportation vehicle owned or leased by the taxpayer for use in his trade or business more accessible to and usable by handicapped and elderly persons and must meet standards of the Architectural and Transportation Barriers Compliance Board. The maximum deduction per year is $35,000.

The federal provision was first effective for tax year 1977. In 1986 the provision was made permanent by the federal repeal of the sunset date. Minnesota first adopted this provision for corporate franchise tax purposes in 1987, beginning with tax year 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

2.18 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

Internal Revenue Code, Sections 263(c), 465, 616, 617, 704(d), and 1254
Minnesota Statutes, Section 290.01, Subd. 19

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

2.19 EXPENSING OF CERTAIN CAPITAL OUTLAYS AND SPECIAL CASH ACCOUNTING RULES FOR FARMERS

Internal Revenue Code, Sections 162, 175, 180, 447, 464, 465, and 704(d)
Minnesota Statutes, Section 290.01, Subd. 19

A corporate taxpayer engaged in the business of farming may treat expenditures made during the tax year as expenses rather than as capital expenditures. Therefore, these expenditures are entirely deductible in the current year rather than throughout an asset's useful life. To qualify for this special treatment the expenditures must be for soil and water conservation under a government-approved plan, fertilizer, or certain preproduction costs.

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. The accrual system is normally required for businesses with inventories.

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. Prior to 1987 the Minnesota corporate provision for expensing capital outlays pertained only to soil and water conservation but was broadened with the adoption of federal taxable income. In 1986 the expensing of soil and conservation expenditures was restricted, and in 1987 cash accounting was repealed for farms with annual gross receipts over $25 million. Minnesota adopted these federal changes in 1987 and 1988 respectively.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,500,000	$1,500,000	$1,500,000	$1,500,000

2.20 EXPENSING OF MULTIPERIOD AGRICULTURAL PRODUCTION COSTS

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

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

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

This provision was enacted as part of the federal Tax Reform Act of 1986 and was adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000

2.21 EXPENSING OF MULTIPERIOD TIMBER GROWING COSTS

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

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

The new capitalization rules were enacted as part of the Tax Reform Act of 1986. Although the expensing of timber growing costs was allowed previously, it is now considered a tax expenditure because the general rules that apply to other business activities are more restrictive. Minnesota adopted the 1986 federal changes in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,600,000	$1,600,000	$1,600,000	$1,600,000

2.22 SPECIAL RULES FOR MINING RECLAMATION RESERVES

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

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

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

2.23 CASH ACCOUNTING OTHER THAN AGRICULTURE

Internal Revenue Code, Section 446
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.

Cash accounting has been permitted since 1933. Prior to the 1986 federal changes which were adopted by Minnesota in 1987, accrual accounting was required only for corporations which sold inventory directly.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

2.24 INSTALLMENT SALES

Internal Revenue Code, Sections 453, 453A, 453B, and 453C
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. The installment method of reporting may be used to report gains if at least one payment is received in a tax year other than the year of sale. Under the installment method, 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. The 1986 and 1987 federal changes were adopted by Minnesota in 1987 and 1988 respectively.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$500,000	$400,000	$400,000	$400,000

2.25 PATRONAGE DIVIDENDS (COOPERATIVES)

Internal Revenue Code, Sections 1381-1388
Minnesota Statutes, Section 290.01, Subd. 19

Cooperative buying, selling, or producing associations may exclude from gross income amounts which are distributed to customers (patrons) in the form of patronage dividends. This exclusion applies to both cash and noncash dividends. Cooperatives may retain earnings beyond the end of the tax year in this manner. This provision results in cooperatives paying very little or no corporate franchise tax. However, both cash and noncash dividends are treated as taxable income to the patron.

Minnesota has excluded patronage dividends from the income of cooperatives since 1933.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,700,000	$4,700,000	$4,700,000	$4,700,000

2.26 EXCESS BAD DEBT RESERVES OF FINANCIAL INSTITUTIONS

Internal Revenue Code, Sections 585, 593, and 596
Minnesota Statutes, Section 290.01, Subd. 19

Generally, bad debt deductions are a necessary cost of doing business which arise when a taxpayer uses the accrual method of accounting. Under the accrual method, a corporation includes as income all amounts that it has earned the right to receive. A bad debt deduction reduces accrued income by the amount that the taxpayer did not receive.

Beginning with tax year 1987, large commercial banks (those with assets exceeding $500 million) must use the charge-off method to determine a bad debt deduction. Under the charge-off method, the bad debt deduction can be taken only when the debt actually becomes worthless. The use of the charge-off method is not considered a tax expenditure.

Smaller banks and thrift institutions continue to have the option of using the charge-off method or one of the reserve methods. Under the reserve methods, a deduction which is in excess of actual experience may be taken at the end of the taxable year. Limitations are placed on the amount a financial institution adds to its bad debt reserves, and separate limitations apply to smaller banks and to thrifts. The tax expenditure is measured as the reduction in tax under the reserve method as compared to the charge-off method.

The reserve method was first allowed for use by banks in 1947 and by thrifts in 1952. The repeal of the reserve method for large commercial banks and the changes in the limitations for other institutions were enacted federally in 1986 and were adopted by Minnesota in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$800,000	$800,000	$800,000	$800,000

2.27 MERGER RULES FOR THRIFTS (REPEALED)

Internal Revenue Code, Sections 368, 382, and 597
Minnesota Statutes, Section 290.01, Subd. 19

A thrift is a savings and loan association, a cooperative bank, or a mutual savings bank. Two tax provisions pertain to a merger involving a financially-troubled thrift - special tax-free reorganization rules and special contribution-to-basis rules.

The special tax-free reorganization rules are an exception to the general rule that says if two corporations combine in a reorganization, the shareholders of the target corporation must maintain meaningful ownership interest in the acquiring corporation in order for the reorganization to be tax free under the continuity of interest rules. To qualify, the appropriate federal agency must certify that the thrift is insolvent. To meet the continuity of interest rules, the depositors of the financially-troubled thrift must be the depositors in the surviving thrift. Tax attributes, mainly net operating losses, can be carried over from the financially-troubled thrift to the new thrift.

Financially-troubled thrifts may exclude from gross income payments by the Federal Savings and Loan Insurance Corporation (FSLIC) which are made in connection with a merger. Such payments are also exempt from the general requirement that the basis of the corporation's assets be reduced by nonshareholder contributions to capital.

Both provisions were enacted federally in 1981. Minnesota adopted the tax-free reorganization rules in 1981 and the contribution-to-basis rules in 1987. These provisions are repealed for mergers occurring after December 31, 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,700,000	$1,100,000	$1,100,000	$600,000

2.28 EMPLOYEE STOCK OWNERSHIP PLANS

Internal Revenue Code, Sections 133, 404(k), 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. There are three components to the ESOP tax expenditure: exclusion of interest on ESOP loans; dividend deduction; and nonrecognition of gain on stock sales.

Banks or other qualified lenders may exclude from gross income 50% of the interest earned on loans which are used by a corporation or an ESOP to acquire employer securities for an ESOP.

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

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

The federal provisions were enacted in 1984 and were amended by the 1986 Tax Reform Act. Minnesota adopted the dividend deduction and the nonrecognition of gain on stock sales in 1984. In 1987 Minnesota adopted the interest exclusion along with the 1986 federal changes.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,200,000	$1,200,000	$1,200,000	$1,200,000

2.29 INVENTORY PROPERTY SALES SOURCE RULE EXCEPTION

Internal Revenue Code, Section 865(b) and (h)
Minnesota Statutes, Section 290.01, Subd. 19

According to the general rule contained in the federal Tax Reform Act of 1986, income from the sale of personal property by a United States resident is considered United States-source income, and income from the sale of personal property by a nonresident is foreign-source income. An exception to that rule applies to the sale of inventory property which is sourced not by residency but at the location where the sale occurs.

Prior to the Tax Reform Act of 1986, the sale of all personal property was sourced at the location of the sale. When the general residency rule was adopted, the exception for inventory property is considered a tax expenditure to the extent that United States residents sell inventory property outside the United States. Minnesota adopted these provisions in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,800,000	$4,400,000	$4,900,000	$5,500,000

2.30 CAPITAL CONSTRUCTION FUNDS OF SHIPPING COMPANIES

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

Section 7518 of the Internal Revenue Code provides tax incentives to the capital construction funds of 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 currently taxable if they are used to acquire, construct, or reconstruct vessels covered by the above-mentioned agreements. Such a withdrawal is treated first as made out of the capital account, second as made out of the capital gain account, and third as made out of the ordinary income account. Provisions are made for the adjustment of basis.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

INSURANCE COMPANY DEDUCTIONS

2.31 EXEMPT INTEREST (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Insurance companies may take a deduction for interest income which they receive by virtue of holding interest-bearing debt obligations of a state, territory, possession of the United States, or of any political subdivision thereof.

This provision was enacted in 1937 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,200,000	$3,400,000	$3,700,000	$4,000,000

2.32 SUMS PAID OUT OTHER THAN DIVIDENDS (MUTUAL INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Mutual insurance companies may take a deduction from net income for all sums paid out other than dividends. Certain sums paid out, such as payments on claims, are deemed to be ordinary and necessary business expenses, and their deduction is not viewed as a tax expenditure. Other sums paid out represent special treatment, and their deduction is considered a tax expenditure. Examples of the latter include liabilities for unearned premiums and company surplus. Current-year liability is affected when these sums are held for more than one tax year before being refunded to the policyholders. Therefore, they constitute a form of retained earnings which are not taxed, and their deduction is considered a tax expenditure.

*Less than $50,000.

This provision was enacted in 1937 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

2.33 MEAN RESERVES (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Depending on certain conditions, life insurance companies are allowed a deduction from gross income of either 3.75% or 4% of the mean of reserve funds held at the beginning and end of the taxable year. Reserve funds are required by state law for most types of life insurance policies in order to protect policyholders. The conditions affecting the deduction involve interest rates, the types of policies issued, and determinations made by the commissioner of revenue.

The provision was enacted in 1937 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$17,700,000	$19,100,000	$20,600,000	$22,300,000

2.34 RESERVES FOR DEFERRED DIVIDENDS (LIFE INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35

Life insurance companies may take a deduction, in addition to the deduction allowed for all business expenses, equal to 2% of all qualified funds held at the end of a taxable year as a reserve for payment of deferred dividends. Qualifying funds must be for dividend payments which are deferred for not less than five years from the date of the policy contract.

This provision was enacted in 1937 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

APPORTIONMENT

2.35 WEIGHTED APPORTIONMENT

Minnesota Statutes, Section 290.191

Minnesota allows a corporation to apportion its income to Minnesota by using a three-factor formula of the Minnesota ratios of property, payroll, and sales. The corporation uses a weighted ratio of 15% property, 15% payroll, and 70% sales. Prior to tax year 1987, a corporation could use the lesser of the weighted ratio or the average of the three ratios.

For purposes of this study, the extent to which the weighted apportionment formula reduces the tax as compared to the tax that would be paid under the average ratio formula is considered a tax expenditure.

Minnesota first allowed manufacturing firms the option to choose between the two formulas in 1939. Nonmanufacturing firms were given the same option in 1953. In 1987 the option to use the average ratio formula was repealed, effective with tax year 1987.

Approximately 4,000 corporations benefit by using the weighted ratio as compared to the average ratio.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$71,100,000	$75,300,000	$76,800,000	$78,300,000

2.36 THROWBACK SALES

Minnesota Statutes, Section 290.191, Subd. 5

Multistate corporate taxpayers are not required to include throwback sales in their Minnesota sales when apportioning income to Minnesota for tax purposes. The throwback rule would say that a sale of tangible property is in Minnesota if the property is shipped from an office, store, warehouse, factory, or other place of storage in Minnesota, and the purchaser is the United States government, or the selling corporation is not taxable in the state of the purchaser.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$21,600,000	$21,600,000	$21,600,000	$21,600,000

2.37 SINGLE-FACTOR APPORTIONMENT FOR MAIL ORDER COMPANIES

Minnesota Statutes, Section 290.191, Subd. 4

A business which consists exclusively of selling tangible personal property and services by mail order or telephone 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 2.35).

This provision was enacted in 1985. In 1988 the provision was made permanent by the repeal of the December 31, 1988, sunset date, and the qualifying Minnesota portion of property and payroll was reduced from 100% to 99%.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$600,000	$600,000	$600,000

MINNESOTA SUBTRACTIONS

2.38 DIVIDEND RECEIVED DEDUCTION

Minnesota Statutes, Section 290.21, Subd. 4

Beginning with tax year 1988, a corporation or bank may deduct from its taxable net income either 70% or 80% of dividend income it receives from other corporations if specified conditions are met Generally the conditions relate to the nature or type of corporation receiving the dividends, the purpose for which the stocks are held, and the relationship between the dividend recipient and the dividend paying company.

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.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$19,300,000	$19,900,000	$20,700,000	$23,600,000

2.39 CHARITABLE CONTRIBUTIONS

Minnesota Statutes, Section 290.21, Subd. 3

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

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

This deduction was enacted in 1933. In 1987 the deduction was eliminated for contributions to organizations in other states, and the deduction for contributions to the United States government was restricted to real property located in Minnesota. In 1988 a partial deduction was reinstated for contributions to non-Minnesota foundations.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,700,000	$6,200,000	$6,800,000	$7,500,000

2.40 FOREIGN SOURCE INCOME

Minnesota Statutes, Section 290.01, Subd. 19d(11) and Section 290.21, Subd. 8

For tax years 1987 and 1988, a corporation is allowed to deduct 35% of the rentals, fees, and royalties it receives from a foreign corporation. In order to claim the deduction, the corporation must receive at least 80% of its gross income from these sources.

Beginning with tax year 1989, the deduction for foreign source royalties is replaced by a subtraction for royalties, fees, and other like income received from a foreign operating corporation or a foreign corporation which is part of the same unitary group. The subtraction is 50% of such income for tax years 1989 and 1990 and 80% beginning with tax year 1991.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,600,000	$4,500,000	$10,500,000	$13,800,000

2.41 DISPOSITION OF FARM PROPERTY

Minnesota Statutes, Section 290.491(b)

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.

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			
	1988	1989	1990	1991
State General Fund	$0	*	*	*

*Less than $50,000.

CREDITS

2.42 RESEARCH AND DEVELOPMENT CREDIT

Minnesota Statutes, Section 290.068

A corporate taxpayer may claim a nonrefundable credit against the franchise tax based on qualified expenditures for research and development performed solely within Minnesota. Expenditures include such things as wages paid to researchers, costs of supplies used in conducting research, rental costs of personal property used in research, 65% of contract costs paid to others for doing research, and certain contributions to nonprofit organizations engaged in research and development within Minnesota. Current year expenditures must exceed the average yearly research and development expenditures for the three preceding years to qualify. This average of the preceding three years is referred to as the base-year expenditure.

The credit is equal to 5% of the first $2 million of current-year expenditures over the base-year expenditure. A credit equal to 2.5% is allowed for amounts in excess of $2 million over the base year. Credit in excess of current tax liability may be carried forward fifteen years.

The research and development credit was enacted in 1981 and was last changed in 1987 when the percentages were reduced from 12.5% and 6.25% to 5% and 2.5%, respectively.

This credit was claimed on 320 returns filed in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,700,000	$5,900,000	$6,100,000	$6,400,000

2.43 CONSTRUCTION FINANCING (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(3)

A corporation may apply for a credit equal to a percentage of the cost of debt financing for construction of a new or expanded facility in a designated enterprise zone. Each municipality determines the percentage of financing used in computing credit amounts within its zone. Credit amounts in excess of annual tax liability are refundable to the taxpayer.

The credit was enacted in 1983 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,200,000	$1,200,000	$1,000,000	$1,000,000

2.44 EMPLOYER TAX CREDITS (ENTERPRISE ZONES)

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

Two separate refundable credits against the income tax are available to employers in designated enterprise zones.

1. An employer may claim a credit of up to $3,000 annually for each additional worker employed in a designated enterprise zone.

2. An employer in a designated border city enterprise zone may claim a credit of up to $1,500 annually for each worker employed in the zone who does not qualify for the $3,000 credit.

The employer job credit was enacted in 1983 as part of the state enterprise zone program. It was recodified in 1987. It is scheduled to expire on December 31, 1996, when the enterprise zone program expires.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,700,000	$1,400,000	$1,200,000	$900,000

2.45 CREDIT FOR GROSS PREMIUMS TAX (INSURANCE COMPANIES)

Minnesota Statutes, Section 290.35, Subd. 3

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

This credit was enacted in 1937. In 1987, the credit was recodified but was not changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$26,000,000	$26,000,000	$26,000,000	$26,000,000

CHAPTER 3: ESTATE TAX

Collections and History

Revenues from the Minnesota estate tax were $13 million in fiscal year 1988. 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.

Major changes in the federal estate tax were enacted in 1981, and Minnesota adopted conforming legislation to remove the limit on the marital deduction and to increase, over a six-year period, the minimum filing requirement and the general estate deduction.

In 1985 a major change was made in the Minnesota estate tax. Prior to the effective date of the 1985 legislation, the Minnesota estate tax was equal to the greater of: a) the tax computed from the Minnesota rate schedule on Minnesota taxable estate; or b) the Minnesota portion of the federal estate tax credit for state death taxes. The 1985 law eliminated the first computation and adopted the Minnesota portion of the federal tax credit for state death taxes, known as the "pick-up tax," as the Minnesota estate tax, effective for estates of decedents dying after December 31, 1985.

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 excluded from taxable estate because of the identity of the recipient. Preferential valuations are also considered to be tax expenditures.

Computation of the Tax

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

An estate tax return must be filed if the decedent's federal gross estate exceeds $600,000 for persons dying in 1987 and thereafter. For the estate of a resident decedent, an alternate computation is used if it results in a tax larger than the pick-up tax. The alternate tax is equal to the maximum federal credit for state death taxes minus the death tax paid to the other state. Therefore, the alternate computation would be used only when the other state's tax was less than its share of the pick-up tax.

PREFERENTIAL VALUATIONS

3.01 ALTERNATE VALUATION OF PROPERTY

Internal Revenue Code, Section 2032
Minnesota Statutes, Section 291.03

As a general rule, property included in a decedent's gross estate is valued at its fair market value as of the date of death. However, the estate's executor may choose to use an alternate valuation, which is the value of the property six months after death. Property which is sold, distributed, or otherwise disposed of during the six month period is valued at its fair market value at the time of disposition. When the alternate valuation is used, it must be used for all property in the estate. The tax expenditure in this provision is the difference between the tax liability using the valuation on the date of death and the tax liability using the alternate valuation.

Minnesota first adopted Section 2032 of the Internal Revenue Code in 1980. In 1985 Minnesota adopted this provision through the federal pick-up tax.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

3.02 SPECIAL USE VALUATION

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

Property is generally included in the 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 $750,000. The estimates below measure the difference between tax liability using the highest use 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.

The special use valuation was claimed on eight returns in fiscal year 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

EXCLUSIONS

3.03 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(ies) 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 below do not include death benefits paid to a spouse because such benefits would also be exempt under the marital deduction (Item 3.06).

This provision was originally enacted in 1951 under the inheritance tax. With some modification, it was carried over to the estate tax in 1979. Minnesota adopted the federal provision through the pick-up tax in 1985.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,700,000	$2,900,000	$3,100,000	$3,300,000

3.04 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.

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 those changes in 1985 through the federal pick-up tax.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

3.05 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			
	1988	1989	1990	1991
State General Fund	*	*	*	*

DEDUCTIONS

3.06 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 through the pick-up tax.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$8,200,000	$8,200,000	$8,200,000	$8,200,000

*Less than $50,000.

3.07 CHARITABLE GIFTS

Internal Revenue Code, Section 2055
Minnesota Statutes, Section 291.03

Gifts from an estate to certain persons or organizations are excluded from gross estate for tax purposes. 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 through the pick-up tax.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,700,000	$2,700,000	$2,700,000	$2,700,000

CHAPTER 4: SALES AND USE TAX

Collections and History

Revenues from the general sales and use tax totaled $1.68 billion in fiscal year 1988, making it the second largest source of state revenue with 27.5% of the total. All revenues from the sales and use tax are deposited in the state general fund (except for the revenues from the tax on club dues which go to the sports and health club sales tax revenue 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 has been increased three times since enactment of the tax: to 4% on November 1, 1971; to 5% on July 1, 1981; and to 6% on January 1, 1983.

One sales and use tax rate applied to all taxable sales from 1967 until 1981 with the exception of vending machines. When the rate was increased from 4% to 5%, the rate on farm machinery was kept at 4%. In 1984, when the general rate was 6%, the rate for certain capital equipment and special tooling was reduced to 4%, and the farm machinery rate remained at 4%. In 1985, the rate for farm machinery was reduced from 4% to 2%. Since 1983 alcoholic beverages, both on-sale and off-sale, are subject to a higher rate of 8.5%.

A separate motor vehicle excise tax (Chapter 5) was enacted, effective January 1, 1972. Prior to that time, motor vehicles were subject to the general sales and use tax, but, with the enactment of the motor vehicle excise tax, they were exempted from the general sales and use tax.

Some exemptions have been added since 1967, and some have been repealed, but the most significant changes to the sales tax base enacted in one year occurred in 1987 with the repeal of several exemptions and the extension of the sales tax to selected services.

The exemptions that were repealed in 1987 included: nonprescribed drugs and medicine except insulin (nonprescribed analgesics re-exempted in 1988); purchases by state government; interstate telephone service (except incoming WATS); railroad rolling stock; club dues; and admission to public recreational areas. The sales tax was extended to selected services, including: parking; laundry and dry cleaning; building and residential cleaning, maintenance, and exterminating; detective and security services; pet grooming; and lawn and garden services.

Tax Base

For purposes of this study, the tax base for the general sales and use tax is defined as the sale of tangible personal property or services to the final consumer. However, this fairly simple definition requires some explanation.

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 properly be considered outside the tax base, they are included in the tax base for this study because currently some services are taxed.

Sales for resale in the regular course of business are not included in the tax base because they are not a sale to the final consumer. In agricultural and industrial production, the sales of raw materials, component parts, and products consumed directly in the process are considered to be for resale, and therefore the exemption of these items is not a tax expenditure. However, the sale of machinery, equipment, and tools used in agricultural or industrial production is not considered a sale for resale. Therefore, a tax expenditure is created when a certain type of machinery, equipment, or tools is exempt from the sales tax or is taxed at a reduced rate.

Although the tax base would include motor vehicles, 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 excise tax.

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, 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%, with different rates applicable to certain items.

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

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

Generally, food purchased for home consumption is exempt from the sales tax, and food that is prepared and served, such as in a restaurant, is taxable, as is all food sold in vending machines. Taxable items also include candy, chewing gum, soft drinks and other carbonated beverages, ice, heated food and drinks, hand-prepared ice cream or ice milk products, and sandwiches and party trays prepared by the retailer.

Food items that would otherwise be taxable but are exempt because of the identity of the seller are estimated separately. See Items 4.38, 4.39, and 4.40.

The exemption granted sales of food was included when the sales and use tax was enacted in 1967. It was last changed in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$268,900,000	$281,800,000	$298,400,000	$316,300,000

4.02 CLOTHING AND WEARING APPAREL

Minnesota Statutes, Section 297A.25, Subd. 8 and 41

Generally, all clothing, whether new or used, is exempt from the sales and use tax. The exemption includes inner and outer wear, footwear, headwear, gloves and mittens, neckwear, hosiery, and similar items customarily worn for general use. Also exempted are fabrics, thread, buttons, zippers, and similar items which are to be directly incorporated into wearing apparel. This exemption does not apply to jewelry, articles made of fur or pelt, handbags, billfolds, sports clothing sold for exclusive use in a sporting activity, or work-related safety articles.

The exemption granted for clothing was included in the sales and use tax statutes enacted in 1967. An exemption was enacted in 1988 for bullet-proof vests sold to licensed peace officers.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$159,100,000	$168,700,000	$179,700,000	$191,600,000

4.03 DRUGS AND MEDICINES

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

An exemption from the sales and use tax applies to: prescribed drugs and medicine; insulin; and analgesics.

Drugs and medicine are exempt if they are sold only by prescription or if they are prescribed by a physician. Over-the-counter analgesics are exempt if they consist principally of aspirin, acetaminophen, or ibuprofen.

An exemption of 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, qualifying over-the-counter analgesics were again exempted, effective July 1, 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$24,700,000	$28,800,000	$31,300,000	$33,900,000

4.04 PRESCRIPTION EYEGLASSES

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

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

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,200,000	$5,400,000	$5,600,000	$5,900,000

4.05 THERAPEUTIC AND PROSTHETIC DEVICES

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

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

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

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

This provision was enacted in 1967 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,200,000	$4,600,000	$5,000,000	$5,500,000

4.06 FEMININE HYGIENE ITEMS

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

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

This exemption was enacted in 1981 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,600,000	$1,700,000	$1,800,000	$1,900,000

4.07 PUBLICATIONS

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

Publications regularly issued at least once every three months, such as newspapers, journals, and magazines, are exempt from the sales and use tax. As of July 1, 1983, this exemption does not apply to magazines and periodicals sold over the counter (non-subscription).

This provision was included in the original sales and use tax enacted in 1967. It was last changed in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$12,200,000	$13,100,000	$13,900,000	$14,800,000

4.08 TEXTBOOKS

Minnesota Statutes, Section 297A.25, Subd. 21

Sales of textbooks to students are exempt from the sales and use tax, provided that the books are required for a course of study at a public or private school, college, university, business, or trade school.

This provision was enacted in 1973 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,600,000	$1,700,000	$1,800,000	$1,900,000

4.09 MOTOR FUELS

Minnesota Statutes, Section 297A.25, Subd. 7(1)

The gross receipts from the sale of and storage, use, or consumption of petroleum products taxed under the motor fuels tax (Minnesota Statutes, Chapter 296) 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			
	1988	1989	1990	1991
State General Fund	$140,700,000	$145,800,000	$150,700,000	$155,700,000

4.10 PETROLEUM PRODUCTS USED IN THE IMPROVEMENT OF AGRICULTURAL LAND

Minnesota Statutes, Section 297A.25, Subd. 7(2)

Gross receipts from the sale of petroleum products used in the improvement of agricultural land are exempt from the sales and use tax. Products qualifying for exemption are those used in constructing, maintaining, and repairing drainage ditches, tile drainage systems, grass waterways, water impoundment, and other erosion control structures.

This provision was enacted in 1985 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

4.11 USED MOTOR OIL

Minnesota Statutes, Section 297A.25, Subd. 38

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

This exemption was enacted in 1988, effective July 1, 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$0	$100,000	$100,000	$100,000

4.12 CASKETS AND BURIAL VAULTS

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

The gross receipts from the sale of caskets, burial vaults, and urns used for human burial or cremation purposes are exempt from the Minnesota sales and use tax.

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

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,700,000	$4,800,000	$5,000,000	$5,200,000

4.13 ACCESSORY TOOLS

Minnesota Statutes, Section 297A.25, Subd. 9

As a general rule, machinery, equipment, tools, and implements used in industrial production are subject to the Minnesota sales and use tax. This provision exempts 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			
	1988	1989	1990	1991
State General Fund	$15,100,000	$15,600,000	$16,200,000	$17,000,000

4.14 CAPITAL EQUIPMENT PURCHASES (DISTRESSED COUNTIES)

Minnesota Statutes, Section 297A.257, Subd. 2

The purchase of capital equipment placed in service in connection with the construction of a new or expanded manufacturing facility in a distressed county or in the taconite tax relief area is exempt from the sales tax if certain conditions are met. Only purchases in excess of $100,000 in a calendar year are exempt. To qualify as an expansion, either the production must be increased by at least 20% or the capital investment made within a twelve-month period must exceed $25 million.

Capital equipment in a new or expanding manufacturing facility is normally subject to a special 4% rate, as explained in Item 4.46. Therefore, the estimates measure the difference between the exemption and the 4% rate.

This exemption was enacted in 1985. In 1987 it was extended to the defined taconite tax relief area. The authority of the commissioner of trade and economic development to annually designate distressed counties expires June 30, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,600,000	$3,500,000	$2,900,000	$6,500,000

4.15 CONSTRUCTION MATERIALS AND SUPPLIES (DISTRESSED COUNTIES)

Minnesota Statutes, Section 297A.257, Subd. 2a

The purchase of construction materials and supplies used in constructing a new or expanding an existing manufacturing facility in a distressed county or in the taconite tax relief area is exempt from the sales tax. If the project is in a distressed county, total capital investment made within a three-year period must exceed $75 million. If the project is in the taconite tax relief area, total capital investment made within a three-year period must exceed $50 million.

This exemption was enacted in 1986. In 1987 it was extended to the defined taconite tax relief area. The authority of the commissioner of trade and economic development to annually designate distressed counties expires June 30, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,300,000	$1,700,000	$1,500,000	$3,200,000

4.16 CONSTRUCTION MATERIALS OR EQUIPMENT (ENTERPRISE ZONES)

Minnesota Statutes, Section 469.171, Subd. 1(1)

An exemption from the sales and use tax may be authorized by the commissioner of revenue for sales of construction materials or equipment used in a designated enterprise zone. Only those sales made after an approved application for the enterprise zone was made may qualify for the exemption.

This provision was enacted in 1983 and was last changed in 1987. This exemption, along with the enterprise zone program, is scheduled to expire on December 31, 1996.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,000,000	$700,000	$600,000	$500,000

4.17 REPAIR AND REPLACEMENT PARTS FOR FARM MACHINERY

Minnesota Statutes, Section 297A.25, Subd. 29

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

This exemption was enacted in 1985. In 1987 the definition of farm machinery was expanded to include sod-harvesting machinery and dealer-installed equipment.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$11,000,000	$11,100,000	$10,900,000	$10,800,000

4.18 PERSONAL PROPERTY BROUGHT INTO MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 32

When individuals, businesses, or corporations 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 normally be subject to the use tax when brought into the state. The estimates are reduced by the amount of sales tax paid to other states as explained in Item 4.48.

This provision was enacted in 1967 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,000,000	$5,200,000	$5,400,000	$5,700,000

4.19 PACKING MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 6

Sales of packing materials, primarily cartons and containers, used to pack and ship household goods are exempt from the sales and use tax. The packing materials must be used to ship goods to an out-of-state destination and must not be returned to Minnesota except to pass through the state in the course of interstate commerce.

This exemption was enacted in 1973 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$300,000	$300,000	$300,000	$300,000

4.20 OUT-OF-STATE LEASES OF VEHICLES

Minnesota Rules, Part 8130.0400, Subp. 2

In general, payments made pursuant to leases of tangible personal property are subject to the sales and use tax if the property is used in Minnesota. However, the tax is not imposed upon lease payments made in Minnesota pursuant to a lease executed in another state for a drive-it-yourself automobile, trailer, or other vehicle.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

4.21 PROPERTY FOR BUSINESS USE OUTSIDE MINNESOTA

Minnesota Statutes, Section 297A.25, Subd. 5

Goods which are sold in Minnesota, delivered to a purchaser in Minnesota, transported outside Minnesota by the purchaser without intermediate use, and used in a trade or business outside Minnesota are exempt from the sales and use tax if one of the following conditions is met:

1. the property is not subject to the sales tax in the state or country to which it is transported; or
2. the property consists of repair or replacement parts to be used in the other state or country as part of a maintenance contract.

Although property used in interstate commerce is also exempt from the sales and use tax, it is not included in the estimates because the state is prohibited from taxing interstate commerce.

*Less than $50,000.

This provision was enacted in 1967 and was last changed in 1988. Prior to July 1, 1988, an exemption applied if the other state allowed a reciprocal exemption for taxable personal property purchased there and transported to Minnesota for use. Also repealed effective July 1, 1988, was a provision by which the other state's use tax rate applied if that state imposed a use tax on the property.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

4.22 RESOURCE RECOVERY EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 28

The gross receipts from the sale of equipment used to process solid or hazardous waste at a qualifying resource recovery facility are exempt from the sales and use tax.

This provision was enacted in 1984 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$900,000	$1,000,000	$1,000,000	$1,000,000

4.23 YMCA AND YWCA MEMBERSHIP DUES

Minnesota Statutes, Section 297A.25, Subd. 37

Generally, the sales tax applies to the granting of membership in a club or association that provides sports and athletic facilities to its members, including one-time initiation fees and periodic membership dues. However, such initiation fees and periodic membership dues to the YMCA and YWCA are exempt from the sales and use tax. The exemption does not apply to separate charges made for using the association's sports and athletic facilities.

Prior to 1987, membership dues paid to country clubs, tennis clubs, or other similar clubs were also exempt. In 1987, when the tax was imposed in general on memberships to clubs providing sports and athletic facilities, the exemption for the YMCA and YWCA was enacted.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$600,000	$600,000	$600,000

*Less than $50,000.

4.24 SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3 and 4

Services could be considered outside the tax base of the sales and use tax, and therefore the exemption of services would not be a tax expenditure. For purposes of this study, however, services are included in the tax base because some services are taxed.

The total fiscal impact for this item includes those services listed below. Sewer services and residential water services are estimated separately in Items 4.25 and 4.26.

Most services were not taxed under the sales and use tax as it was enacted in 1967. In 1987 the tax was extended to a number of services including: parking; laundry and dry cleaning; building and residential cleaning, maintenance, and exterminating; detective and security services; pet grooming; and lawn and garden services.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$656,100,000	$713,700,000	$777,700,000	$846,600,000

The following is a breakdown of services into eleven categories based on the Standard Industrial Classification. The estimates have been adjusted to exclude services provided to exempt organizations.

	Fiscal Year Impact			
	1988 (000's)	1989 (000's)	1990 (000's)	1991 (000's)
Personal Services (total)	**$24,800**	**$26,800**	**$28,600**	**$30,800**
Beauty Shops	11,000	12,000	12,800	13,500
Barber Shops	2,400	2,600	2,800	3,000
Shoe Repair	400	400	400	500
Funeral Services	6,100	6,500	7,000	7,600
Miscellaneous Personal Services	4,900	5,300	5,600	6,200
Legal Services (total)	**$55,300**	**$60,500**	**$66,100**	**$72,100**
Engineering, Architectural, and Surveying Services (total)	**$36,300**	**$39,700**	**$43,300**	**$47,300**
Business Services (total)	**$87,900**	**$99,000**	**$110,900**	**$123,800**
Advertising	23,100	26,000	29,100	32,500
Management, Consulting, and Public Relations Services	27,200	30,800	34,500	38,600
Tax Exempt Research Services	1,100	1,200	1,400	1,500
Computer and Data Processing	22,900	25,800	28,900	32,200
Other Business Services	13,600	15,200	17,000	19,000
Accounting (total)	**$36,100**	**$40,600**	**$45,500**	**$50,800**

	Fiscal Year Impact			
	1988 (000's)	1989 (000's)	1990 (000's)	1991 (000's)
Auto Services (total)	**$61,300**	**$65,800**	**$70,700**	**$76,000**
Automotive Repair Services	60,000	64,400	69,200	74,400
Automotive Services Other Than Repair	1,300	1,400	1,500	1,600
Miscellaneous Repair Services (total)	**$18,900**	**$20,500**	**$22,100**	**$23,800**
Health Services (total) - Except Hospitals	**$223,400**	**$240,400**	**$260,800**	**$282,000**
Physicians	73,400	78,100	85,600	92,600
Optometrists	3,300	3,600	3,800	4,200
Dentists	29,800	32,300	34,800	37,700
Chiropractors	4,900	5,300	5,800	6,200
Nursing and Personal Care Facilities	18,400	19,900	21,500	23,200
Other Health Services	10,100	10,900	11,800	12,700
Tax Exempt Health Services	81,400	88,000	95,000	102,700
Veterinarians	2,100	2,300	2,500	2,700
Selected Educational Services (total)	**$29,600**	**$31,700**	**$34,000**	**$38,100**
Private Elementary and Secondary Schools	6,000	6,400	6,900	7,700
Colleges, Universities, Professional Schools, and Junior Colleges	19,900	21,300	22,800	25,600
Libraries, Vocational, Others	2,800	3,000	3,200	3,600
Tax Exempt Educational Services	900	1,000	1,100	1,200
Social Services (total)	**$72,400**	**$77,900**	**$84,100**	**$89,800**
Child Day Care Services	4,200	4,500	4,900	5,200
Individual and Family Social Services, Job Training and Rehabilitation Services, Residential Care, and Social Services Not Classified Elsewhere	18,700	20,100	21,700	22,600
Tax Exempt Social Services	47,800	51,500	55,500	59,900
Other Services	1,700	1,800	2,000	2,100
Transportation (total)	**$10,100**	**$10,800**	**$11,600**	**$12,100**
Taxi Services	4,100	4,400	4,700	4,900
Intercity Bus Services	1,800	1,900	2,100	2,200
Other Local Transit Services	4,200	4,500	4,800	5,000

4.25 SEWER SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3

The furnishing of sewer services is exempt from the Minnesota sales and use tax.

This exemption was enacted in 1967.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$9,900,000	$10,300,000	$10,700,000	$11,200,000

4.26 RESIDENTIAL WATER SERVICES

Minnesota Statutes, Section 297A.01, Subd. 3(f)

The furnishing of water services to residential customers is specifically exempt from the Minnesota sales and use tax.

This provision was enacted in 1979 and has remained unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,800,000	$3,900,000	$4,100,000	$4,400,000

4.27 RESIDENTIAL HEATING FUELS

Minnesota Statutes, Section 297A.25, Subd. 23

Generally, sales of electricity, gas, water, steam, or other energies for use or consumption within Minnesota are taxable. This provision, however, exempts from the sales and use tax any fuel oil, coal, wood, steam, hot water, propane gas, or L.P. gas sold to residential customers for residential use. Additionally, purchases of natural gas or electricity by residential customers who use natural gas or electricity for their primary source of residential heat are exempt from November 1 through April 30.

This provision was enacted in 1978 and was expanded in 1984 to include hot water heat sold for residential use.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$49,400,000	$51,200,000	$52,700,000	$54,700,000

4.28 INCOMING WATS CALLS

Minnesota Statutes, Section 297A.25, Subd. 36

An exemption from the sales tax is allowed for WATS (wide area telecommunications service) calls made from outside Minnesota to an individual or business in Minnesota at no toll charge to the person making the call.

This provision was enacted in 1987, effective June 1, 1987. Prior to June 1, 1987, all interstate long distance telephone service had been exempt from the sales tax.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,300,000	$1,400,000	$1,500,000	$1,600,000

EXEMPTIONS - SALES TO PARTICULAR GROUPS

4.29 SALES TO LOCAL GOVERNMENTS

Minnesota Statutes, Sections 297A.25, Subd. 11 and 297A.258

The sale of tangible personal property and utilities to local governments is exempt from the Minnesota sales and use tax. Units of local government included in the exemption are counties, cities, towns, school districts, and special districts. This exemption also applies to a private vendor treated as a municipality under a service contract.

It should be noted that these estimates do not include items such as food and motor fuels which would remain exempt due to other provisions even if local government purchases were generally subject to taxation.

This exemption was enacted in 1967 and was last revised in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$76,000,000	$78,500,000	$81,800,000	$86,000,000

4.30 SALES TO NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 16

The sale of tangible personal property and utilities 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 citizen's groups are also included in the exemption.

It should be noted that the estimates below do not include: sales to local governments, Item 4.29; sales to veterans' organizations, Item 4.31; or sales of items such as food and motor fuels which are exempt due to other provisions of this tax.

This provision was included in the sales and use tax when it was enacted in 1967, and it was last changed in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$33,400,000	$35,500,000	$37,800,000	$40,200,000

4.31 SALES TO VETERANS' ORGANIZATIONS

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

Purchases of tangible personal property and the storage, use, or consumption of such property by an organization of military service veterans or an auxiliary unit are exempt from taxation provided: the group is organized in Minnesota and is exempt from income taxes under federal law; and the property is used for charitable, civic, educational, or nonprofit uses and not for social, recreational, pleasure, or profit uses.

This provision was enacted in 1980.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$700,000	$700,000	$700,000	$800,000

4.32 SALES OF BUILDING MATERIALS TO DISABLED VETERANS

Minnesota Statutes, Section 297A.25, Subd. 20

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 Title 38, United States Code, Sections 801 to 805. This exemption is provided in the form of a refund to the veteran for sales tax paid.

This exemption was enacted in 1971.

Fewer than ten claims for refund are filed annually under this provision.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

4.33 NEW SATELLITE BROADCASTING FACILITY

Minnesota Statutes, Section 297A.253

All materials, supplies, and equipment used or consumed in the construction and equipping of a new, FCC licensed, direct satellite broadcasting facility within Minnesota are exempt from the sales and use tax.

This exemption was enacted in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$0	$0	$0	*

* Less than $50,000.

4.34 CERTAIN TACONITE PRODUCTION MATERIALS

Minnesota Statutes, Section 297A.25, Subd. 15

The gross receipts from the sale of and the storage, use, or consumption by taconite mining companies of mill liners, grinding rods, and grinding balls are exempt from the sales and use tax. To qualify, the items must be substantially consumed in the production of taconite, the material of which primarily is added to and becomes a part of the material being processed.

The estimates do not include items that would qualify under the exemption for accessory tools (Item 4.13).

This exemption was enacted in 1971.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

4.35 AIRFLIGHT EQUIPMENT

Minnesota Statutes, Section 297A.25, Subd. 14

The gross receipts from the sales of airflight equipment to airline companies taxed under the airflight property tax 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.

This exemption was enacted in 1967 and was last changed in 1971.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,400,000	$2,700,000	$2,600,000	$1,900,000

EXEMPTIONS - SALES BY PARTICULAR GROUPS

4.36 ISOLATED OR OCCASIONAL SALES

Minnesota Statutes, Section 297A.25, Subd. 12

Although sales of tangible personal property in Minnesota are generally subject to the sales and use tax, isolated or occasional sales made by persons not engaged in selling such property in the normal course of business are exempt.

This provision was enacted in 1967 and was last revised in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$29,000,000	$29,600,000	$30,200,000	$31,000,000

4.37 SALES BY AUCTIONEERS AND BROKERS

Minnesota Statutes, Section 297A.25, Subd. 12
Minnesota Rules, Part 8130.5800, Subp. 2B

When an auctioneer or broker sells items for someone who is not in the business of selling that type of merchandise, the gross receipts from the sale are exempt from the sales tax as an isolated or occasional sale. However, the sale is taxable if the items would have been taxable if they had been sold by the owner or if the auctioneer or broker acquires title to the property.

Isolated or occasional sales have been exempt since the sales tax was enacted in 1967.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,800,000	$1,900,000	$2,000,000	$2,000,000

4.38 INSTITUTIONAL MEALS

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

Although the gross receipts from the sale of 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, sanatoriums, senior citizens' homes, and correctional, detention, and detoxification facilities.
2. Meals and drinks 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 and the handicapped.

This provision was enacted as part of the sales and use tax law in 1967. It was last changed in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$18,100,000	$18,800,000	$19,700,000	$20,500,000

4.39 FUNDRAISING SALES BY NONPROFIT ORGANIZATIONS

Minnesota Statutes, Section 297A.256

Certain fundraising sales by nonprofit organizations are exempt from the Minnesota sales tax.

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 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,000,000	$2,100,000	$2,200,000	$2,300,000

4.40 CANDY SALES BY CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 297A.25, Subd. 2 (1)

Candy and candy products are exempt from the sales tax when sold for fundraising purposes by a nonprofit organization which provides educational and social activities for young people age eighteen and under.

This exemption was enacted in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

4.41 ADMISSION TO SCHOOL-SPONSORED EVENTS

Minnesota Statutes, Sction 297A.25, Subd. 30

The gross receipts from the sale of tickets or admissions to regular season school games, events, and activities of elementary and secondary schools are exempt from the sales and use tax.

This exemption was enacted in 1985.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$300,000	$300,000	$300,000	$300,000

4.42 ADMISSION TO ARTISTIC EVENTS

Minnesota Statutes, Section 297A.25, Subd. 24

In general, an admission charge is a taxable sale. Taxable admission charges include those for concerts, stage plays, and dances. This provision exempts from taxation the sale of tickets or admissions to events which provide opportunities for participation in the creation, performance, or appreciation of the arts. Only those artistic events sponsored by organizations which are exempt from income taxes, for example churches and charities, qualify under this provision.

*Less than $50,000.

This exemption was enacted in 1980 and remains substantially unchanged since then.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$900,000	$900,000	$900,000	$900,000

4.43 CROSS COUNTY SKI PASSES

Minnesota Statutes, Section 297A.25, Subd. 39

Exempt from the Minnesota sales and use tax are cross country ski passes issued by the Minnesota Department of Natural Resources for use of public trails.

This exemption was enacted in 1988, effective July 1, 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$0	*	*	*

SPECIAL RATES

4.44 TWO PERCENT RATE FOR FARM MACHINERY

Minnesota Statutes, Sections 297A.01, Subd. 15 and 297A.02, Subd. 2

New or used farm machinery is taxed at a 2% sales and use tax rate rather than the general 6% rate. Farm machinery is defined by statute as ". . . machinery, equipment, implements, accessories and contrivances used directly and principally in the production for sale, but not including the processing, of livestock, dairy animals, dairy products, poultry and poultry products, fruits, vegetables, forage, grains and bees and apiary products."

The exemption of farm machinery repair and replacement parts is estimated separately in Item 4.17.

A 4% rate for farm machinery was enacted in 1981 when the general sales and use tax rate was raised from 4% to 5%. In 1985 the rate on farm machinery was reduced from 4% to 2%. In 1987, the lower rate was extended to sod-harvesting machinery and to dealer-installed equipment, whether or not it becomes part of the real property.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$11,800,000	$11,900,000	$11,900,000	$12,000,000

*Less than $50,000.

4.45 TWO PERCENT RATE FOR LOGGING EQUIPMENT

Minnesota Statutes, Sections 297A.01, Subd. 15 and 297A.02, Subd.2

New and used logging equipment is subject to a 2% sales and use tax rate, rather than the general 6% rate. Included in the exemption are chain saws used only for logging if the engine displacement equals or exceeds five cubic inches.

The reduced rate for logging equipment was enacted in 1984 at 4%. In 1985, the rate was reduced to 2%, and the exemption was extended to qualifying chain saws.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$300,000	$300,000	$300,000

4.46 FOUR PERCENT RATE FOR CAPITAL EQUIPMENT SOLD TO NEW OR EXPANDING INDUSTRIES

Minnesota Statutes, Sections 297A.01, Subd. 16 and 297A.02, Subd. 2

Certain capital equipment and machinery purchases are subject to a 4% sales and use tax rate rather than the general 6% rate. In order to qualify, the capital equipment, or the materials necessary to construct and install it, must be used by the purchaser or lessee to establish or expand a manufacturing, fabricating, or refining facility in the state. This reduced rate does not extend to: 1) equipment purchased as replacements; 2) replacement or repair parts; or 3) machinery or equipment used to extract, receive, or store raw materials.

Capital equipment which is exempt from the sales and use tax because it is used in a distressed county is estimated separately in Item 4.14.

This provision was enacted in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$2,000,000	$2,100,000	$2,400,000	$2,400,000

4.47 FOUR PERCENT RATE FOR SPECIAL TOOLING

Minnesota Statutes, Sections 297A.01, Subd. 17 and 297A.02, Subd. 2

Special tooling, 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", is subject to a 4% sales and use tax rate rather than the general 6% rate. To qualify for the reduced rate, items must be special ordered and produced in accordance with buyer specifications.

Special tools that qualify for the accessory tool exemption in Item 4.13 are included in that estimate and are not included herein.

The reduced rate for special tooling was enacted in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$100,000	$100,000	$100,000	$100,000

4.48 TAX PAID TO OTHER STATES

Minnesota Statutes, Section 297A.24

If a sales or use tax has previously been paid on an article of tangible personal property to another state at a rate lower than the Minnesota rate, then the Minnesota rate applicable to that article is the difference between the Minnesota rate and the other state's rate. In practice, the reduced rate is the equivalent of providing a credit to taxpayers for taxes paid to other states. If the other state's rate is equal to or higher than Minnesota's rate, no Minnesota sales and use tax is imposed.

This provision was enacted in 1967 and was last changed in 1981.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$600,000	$600,000	$600,000

REDUCED SALES PRICE

4.49 PRICE REDUCED BY VALUE OF TRADE IN

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

The sales price is reduced by any amount allowed as credit for tangible personal property taken in trade for resale. To qualify for the reduction in sales price, the property must be taxable under the sales and use tax law or the motor vehicle excise tax law and of the type of property normally sold in the regular course of the retailer's business.

This provision was enacted in 1967.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,700,000	$3,700,000	$3,800,000	$3,800,000

CHAPTER 5: MOTOR VEHICLE EXCISE TAX

Collections and History

Total revenues from the motor vehicle excise tax were $236 million in fiscal year 1988. Prior to fiscal year 1985, all revenues from this tax went into the state general fund. The distribution of the receipts has been modified as follows:

Fiscal Years	General Fund	Highway User Tax Distribution Fund*	Transit Assistance Fund
1985	75%	18.75%	6.25%
1986 - 1987	100	0	0
1988	95	3.75	1.25
1989 and after	70	22.50	7.50

*Beginning with fiscal year 1992, the 22.5% will go to the trunk highway fund instead of the highway user tax distribution fund.

The motor vehicle excise tax was enacted during the 1971 legislative session in lieu of the general sales tax on motor vehicles. Motor vehicles were exempted from the sales tax at the same time.

When the tax became effective on January 1, 1972, the rate was 4%. The rate was increased to 5% on July 1, 1981, and to the current 6% rate on July 1, 1983. For most of its history, the motor vehicle excise tax rate has been the same as the rate for the general sales and use tax.

Tax Base

The tax base for the motor vehicle excise 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. The transfer of a motor vehicle to a dealer for resale in the regular course of business is not within the base. Regardless of the number of times a vehicle is sold, each transfer of ownership is in the tax 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 excise tax is imposed when a motor vehicle required to be registered in Minnesota is purchased or acquired, either in or outside Minnesota. The 6% 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. In the case of a gift or a transfer for a nominal or no monetary consideration, the average value of similar motor vehicles is used as the purchase price.

The tax is paid to the motor vehicle registrar, and it must be paid before registration plates or a certificate of title can be issued.

EXEMPTIONS

5.01 VEHICLES ACQUIRED BY INHERITANCE

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

When any vehicle is transferred by inheritance or by bequest of a decedent, the transfer is exempt from the motor vehicle excise tax.

This provision was enacted in 1971 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$570,000	$420,000	$420,000	$490,000
Highway User Tax Distribution Fund	22,500	135,000	135,000	157,500
Transit Assistance Fund	7,500	45,000	45,000	52,500
Total - All Funds	$600,000	$600,000	$600,000	$700,000

5.02 OUT-OF-STATE ACQUISITIONS

Minnesota Statutes, Section 297B.03 (2)

When a person moves to Minnesota and establishes residency, 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 Minnesota motor vehicle excise tax.

This provision was enacted in 1971 and remains substantially unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,045,000	$840,000	$840,000	$910,000
Highway User Tax Distribution Fund	41,250	270,000	270,000	292,500
Transit Assistance Fund	13,750	90,000	90,000	97,500
Total - All Funds	$1,100,000	$1,200,000	$1,200,000	$1,300,000

5.03 TRANSFERS BETWEEN JOINT OWNERS

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

When the joint owner of a motor vehicle gratuitously transfers his or her interest to the other joint owner(s) of the vehicle, the transaction is exempt from the motor vehicle excise 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 has not been changed since its enactment in 1971.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$475,000	$420,000	$420,000	$420,000
Highway User Tax Distribution Fund	18,750	135,000	135,000	135,000
Transit Assistance Fund	6,250	45,000	45,000	45,000
Total - All Funds	$500,000	$600,000	$600,000	$600,000

5.04 TRANSFERS BETWEEN SPOUSES, PARENTS AND CHILDREN, AND GUARDIANS AND WARDS

Minnesota Statutes, Section 297B.01, Subd. 7(c) and 8

Any transfer of a vehicle in the form of a gift between spouses, a parent and a child, or a guardian and a ward is exempt from the motor vehicle excise tax. Since other transfers of vehicles by gift are taxed on the basis of the average value of similar vehicles, this provision is a tax expenditure.

This exemption was enacted in 1971 and was last changed in 1974.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$5,510,000	$4,200,000	$4,410,000	$4,550,000
Highway User Tax Distribution Fund	217,500	1,350,000	1,417,500	1,462,500
Transit Assistance Fund	72,500	450,000	472,500	487,500
Total - All Funds	$5,800,000	$6,000,000	$6,300,000	$6,500,000

5.05 TRANSFERS IN DIVORCE PROCEEDINGS

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

The transfer of a motor vehicle between husband and wife in a divorce proceeding, whether the transfer is voluntary or involuntary, is exempt from taxation. Because transfers between joint owners are exempt under another provision (Item 5.03), the estimates below include only those transfers involving vehicles previously registered to one person.

This provision was enacted in 1974 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$285,000	$210,000	$210,000	$210,000
Highway User Tax Distribution Fund	11,250	67,500	67,500	67,500
Transit Assistance Fund	3,750	22,500	22,500	22,500
Total - All Funds	$300,000	$300,000	$300,000	$300,000

5.06 CORPORATE AND PARTNERSHIP TRANSFERS

Minnesota Statutes, Section 297B.03 (4)

When an individual transfers a vehicle to a corporation in exchange for stock or securities, or to a partnership in exchange for an interest in the partnership, the transfer is exempt from the motor vehicle excise tax.

This provision was enacted in 1975 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
Total - All Funds	*	*	*	*

5.07 SALES TO DISABLED VETERANS

Minnesota Statutes, Section 297B.03 (1)

Disabled veterans who purchase motor vehicles with funds provided either in whole or in part by the Veterans Administration under the provisions of 38 United States Code, Section 1901, are not required to pay any motor vehicle excise tax.

This provision was enacted in 1971 and has not been revised since that time.

	Fiscal Year Impact			
	1988	1989	1990	1991
Total - All Funds	*	*	*	*

5.08 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 excise tax if the vehicle is used as an instructional aid in an automotive training program operated by the institution. Vehicles used for driver education programs do not qualify for this exemption. Nearly all the vehicles that qualify for this exemption are donated to the institution. Although a transfer is made without monetary consideration, the tax would otherwise be imposed on the average value of similar vehicles.

This exemption was enacted in 1988, effective July 1, 1988. The purchase or use of these vehicles had previously been included under the general exemption for local government units and nonprofit organizations which was repealed effective June 1, 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
Total - All Funds	$0	*	*	*

*Less than $50,000.

REDUCED PURCHASE PRICE

5.09 FEDERAL EXCISE TAXES

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

When computing the Minnesota motor vehicle excise tax, any federal taxes imposed on the retail sale of a vehicle may be eliminated from the purchase price. At the present time two federal excise taxes are levied upon new motor vehicles, both at a rate of 12% of retail price. The first is levied upon trucks in excess of 33,000 pounds gross vehicle weight, and the second is levied upon trailers or semitrailers in excess of 26,000 pounds gross vehicle weight.

This provision was enacted in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$190,000	$140,000	$140,000	$140,000
Highway User Tax Distribution Fund	7,500	45,000	45,000	45,000
Transit Assistance Fund	2,500	15,000	15,000	15,000
Total - All Funds	$200,000	$200,000	$200,000	$200,000

5.10 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% motor vehicle excise tax is applied to the reduced price. This provision applies to dealer sales and to sales between individuals. The tax expenditure is the difference between the tax collected on the reduced purchase price and tax that would be collected if imposed on the full purchase price.

The provision was enacted along with the motor vehicle excise tax in 1971.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$34,295,000	$26,110,000	$27,160,000	$28,630,000
Highway User Tax Distribution Fund	1,353,750	8,392,500	8,730,000	9,202,500
Transit Assistance Fund	451,250	2,797,500	2,910,000	3,067,500
Total - All Funds	$36,100,000	$37,300,000	$38,800,000	$40,900,000

PREFERENTIAL COMPUTATION

5.11 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% motor vehicle excise 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.

If an older car is classified as a collector vehicle (pioneer, classic, collector, or street rod), it is not eligible for the $10 flat tax but is subject to a flat tax of $90. The $90 flat tax is a tax expenditure to the extent that it is lower than the tax would be at 6% of the purchase price (vehicles with purchase price exceeding $1,500).

The $10 flat tax on older cars was enacted in 1985. The $90 flat tax on collector vehicles was enacted in 1988, effective July 31, 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$4,085,000	$3,290,000	$3,430,000	$3,570,000
Highway User Tax Distribution Fund	161,250	1,057,500	1,102,500	1,147,500
Transit Assistance Fund	53,750	352,500	367,500	382,500
Total - All Funds	$4,300,000	$4,700,000	$4,900,000	$5,100,000

CREDIT

5.12 CREDIT FOR TAXES PAID TO OTHER STATES

Minnesota Statutes, Section 297B.08

Minnesota allows a credit against the motor vehicle excise tax due at the time of vehicle registration for any sales, use, or excise tax paid on a vehicle to another state. The credit is allowed only if the other state has a similar provision allowing a credit for excise taxes paid in Minnesota.

Because vehicles purchased by nonresidents more than sixty days prior to moving into Minnesota are exempt (Item 5.02), this provision affects only purchases by nonresidents that occurred within the sixty days prior to the move and purchases by residents for any tax paid to another state.

This exemption was enacted in 1971 and was last changed in 1981.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$190,000	$140,000	$140,000	$140,000
Highway User Tax Distribution Fund	7,500	45,000	45,000	45,000
Transit Assistance Fund	2,500	15,000	15,000	15,000
Total - All Funds	$200,000	$200,000	$200,000	$200,000

CHAPTER 6: HIGHWAY FUELS EXCISE TAXES

Collections and History

The net revenues from the taxes on highway gasoline and special fuels were $389 million in fiscal year 1988. 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 May 1, 1988.

In 1985 an annual user permit fee was enacted for vehicles using compressed natural gas, to be imposed in lieu of the gasoline and special fuels taxes. In 1988, the annual user permit fee was extended to propane.

Tax Base

The tax base for the highway fuels excise taxes is motor fuel used in vehicles on Minnesota highways. Therefore, it is not considered a tax expenditure when the tax does not apply to off-road usage, such as for farming, or to out-of-state usage.

Computation of the Tax

The highway fuel tax rate is 20¢ per gallon and is imposed on gasoline and special fuels used on Minnesota highways. Motor carriers based in states other than Minnesota pay the road tax which is 20¢ per gallon for gasoline or special fuel used on Minnesota highways.

Lower rates may apply in areas bordering other states (Item 6.04) and credits apply to gasohol (Items 6.05 and 6.06). A person who purchases gasoline or special fuel in Minnesota and regularly drives in another state(s) may claim a refund for the tax paid on the fuel used in another state.

For gasoline, the distributor collects and remits the tax; for special fuel, the seller collects and remits the tax. A special fuel is defined as all combustible gases and liquid petroleum products or substitutes therefor, except gasoline.

Vehicles using compressed natural gas or propane pay an annual user permit fee in lieu of gasoline or special fuels taxes. The fee is based on the vehicle's weight and mileage driven within Minnesota in the preceding year and is paid annually to the Department of Public Safety.

EXEMPTIONS

6.01 TRANSIT SYSTEMS OWNED BY LOCAL UNITS OF GOVERNMENT

Minnesota Statutes, Sections 296.02, Subd. 1a and 296.025, Subd. 1a

The highway fuels excise taxes are not imposed on gasoline and special fuel purchased by a transit system owned by one or more cities or towns.

This exemption was enacted in 1977 and has not been changed since that time.

Twenty-eight transit systems qualified for this exemption in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$1,300,000	$1,500,000	$1,500,000	$1,500,000

6.02 RECIPROCAL AGREEMENTS FOR OUT-OF-STATE PURCHASES

Minnesota Statutes, Section 296.17, Subd. 6

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 exempts motor carriers based in another state from paying the Minnesota road tax if the other state exempts Minnesota-based motor carriers from paying the road tax in that state. The only state with which Minnesota has this type of reciprocity agreement is North Dakota.

This exemption was enacted in 1961 and was last changed in 1986.

Approximately 1,100 North Dakota motor carriers have registered under the reciprocal agreement.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$500,000	$500,000	$500,000	$500,000

6.03 MOTOR VEHICLES NOT REQUIRING REGISTRATION (SPECIAL FUELS)

Minnesota Statutes, Sections 168.012, Subd. 1 and 296.18, Subd. 1

The highway special fuels tax is imposed on licensed motor vehicles, which are those requiring registration. Vehicles not requiring registration and therefore exempt from the special fuels tax include municipal fire apparatus, police patrols, and ambulances, the appearance of which is unmistakable. For example, an unmarked police car must be registered and is therefore not exempt.

This provision was enacted in 1951 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

SPECIAL RATES

6.04 BORDER RATES

Minnesota Statutes, Section 296.02, Subd. 1

When the excise tax on highway fuel sold at a Minnesota service station located within 7.5 miles of a service station in a contiguous state is more than 3¢ higher than the tax levied on the same fuel in the bordering state, the Minnesota excise tax is reduced to 3¢ over the bordering state's rate for the affected Minnesota service station. The current excise tax rates for border states are:

	Highway Fuels Taxes - Rate Per Gallon	
State	Gasoline	Diesel
Minnesota	20.0¢	20.0¢
Iowa	18.0¢	18.5¢
North Dakota	17.0¢	17.0¢
South Dakota	18.0¢	18.0¢
Wisconsin	20.0¢	20.0¢

A differential of more than 3¢ per gallon existed between Minnesota and South Dakota until the rates in South Dakota were increased on April 1, 1988.

This provision was enacted in 1981 and last revised in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	*	$0	$0	$0

*Less than $50,000.

CREDITS

6.05 GASOHOL (OTHER THAN FOR GOVERNMENTAL UNITS AND SCHOOLS)

Minnesota Statutes, Section 296.02, Subd. 7

Agricultural alcohol gasoline, commonly referred to as "gasohol," is a gasoline blend of up to 10% agriculturally derived fermentation ethanol. Beginning with fiscal year 1988, a credit is allowed to distributors equal to 20¢ per gallon of fuel-grade alcohol blended with gasoline to produce gasohol. The credit must be passed on by the distributor to the retailer.

Preferential treatment for gasohol was first enacted in 1980 in the form of a reduced rate. The reduced rate was changed to a credit in 1985, and the current credit amount was adopted in 1986.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$3,500,000	$3,500,000	$3,200,000	$3,200,000

6.06 GASOHOL FOR GOVERNMENTAL UNITS AND SCHOOL TRANSPORTATION

Minnesota Statutes, Section 296.02, Subd. 8

A credit of 80¢ per gallon of ethanol blended with gasoline to produce gasohol is allowed on gasohol sold in bulk to governmental units and for school transportation. This credit is in lieu of, not in addition to, the 20¢ per gallon credit explained in Item 6.05.

This provision was enacted in 1983 in the form of an 8¢ per gallon rate reduction for gasohol. The reduced rate was changed to a credit in 1985. The credit of 80¢ per gallon of ethanol is the equivalent of an 8¢ per gallon reduction in the tax on gasohol because the blend is nearly always 10% ethanol.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$100,000	$100,000	$100,000	$100,000

CHAPTER 7: ALCOHOLIC BEVERAGE TAXES

Collections and History

In fiscal year 1988, the revenues from the alcoholic beverage taxes were: $37.5 million from distilled spirits; $13.7 million from beer; and $4.5 million from wine. The total of $55.7 million was 0.9% of total state revenues. 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 June 1, 1987.

Tax Base

The 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 of 8.5% of the purchase price, compared to the general sales tax rate of 6%.

The current 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 Liter	Per Gallon
Distilled Spirits	$1.33	$5.03
Wine: Alcohol by Volume		
Less than 14%	$.08	$.30
14% to 21%	.25	.95
21% to 24%	.48	1.82
More than 24%	.93	3.52
Sparkling Wine	.48	1.82

EXEMPTIONS

7.01 CONSUMER PURCHASES MADE OUT OF STATE

Minnesota Statutes, Section 297C.09

Any person who may legally consume alcohol in Minnesota may bring into this state specified quantities of alcoholic beverages from another state or country without paying the appropriate Minnesota excise tax. A person may bring into Minnesota from another state one liter of distilled spirits or wine or nine quarts of beer without paying the excise tax. A person entering Minnesota from another country may have in possession four liters of distilled spirits or wine or ten quarts of beer without paying the Minnesota excise tax. Amounts in excess of the exempt amounts may be imported only by a licensed manufacturer, wholesaler, or importer.

This provision was enacted in 1947 and was last changed in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

7.02 HOME FERMENTATION (WINE AND BEER)

Minnesota Statutes, Section 297C.07(3)

No excise tax is placed upon beer or wine made in the home for family use.

This exemption was first authorized by statute in 1957 and was last changed in 1985.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

7.03 SALES TO FOOD PROCESSORS AND PHARMACEUTICAL FIRMS

Minnesota Statutes, Section 297C.07(5)

Alcoholic beverages sold to authorized manufacturers of food products or pharmaceutical firms are exempt from the alcoholic beverage taxes if they are used exclusively in the manufacture of food products or medicines.

This exemption was codified in 1988 although it had previously been allowed through administrative procedures.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

7.04 CONSUMPTION ON BREWERY PREMISES (BEER)

Minnesota Statutes, Section 297C.07(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			
	1988	1989	1990	1991
State General Fund	*	*	*	*

7.05 WINE FOR TASTING AND TESTING

Minnesota Statutes, Section 297C.03

The excise tax imposed on the production of wine in Minnesota exempts wine which is used for tasting and testing purposes.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

7.06 WINE FOR SACRAMENTAL PURPOSES

Minnesota Statutes, Sections 297C.07 (2)

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			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

CREDIT

7.07 SMALL BREWERS' CREDIT (BEER)

Minnesota Statutes, Section 297C.02, Subd. 3

A credit is allowed to a brewer who manufactures less than 100,000 barrels of beer in the calendar year preceding the year for which the credit is claimed. The credit is $4.60 per barrel on 25,000 barrels sold in a fiscal year, with a maximum credit of the lesser of the brewer's tax liability or $115,000.

The credit was enacted in 1985 and was changed in 1988. A credit for beer produced and sold in Minnesota had been in effect from its enactment in 1973 to its repeal in 1985.

Seven breweries qualified for this credit in fiscal year 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

CHAPTER 8: CIGARETTE AND TOBACCO TAXES

Collections and History

In fiscal year 1988, cigarette tax net revenues were $150.2 million and tobacco products tax net revenues were $5.7 million. Of the 38¢ per pack cigarette tax, the revenues are distributed as follows: debt service on specified bonds is paid first; 4¢ goes to the state water pollution control fund less debt service to control water pollution; 2¢ goes to the Minnesota resources fund; 2¢ to the public health fund; and the balance to the state general fund. Of the tobacco products tax, 85.7% goes to the state general fund and 14.3% goes to the state water pollution control fund.

The cigarette tax was enacted in 1947 at a rate of 3¢ per pack. Several rate increases have occurred since then, with the most recent being to 23¢ in 1985 and to 38¢ on June 1, 1987. 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 to 35% on June 1, 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 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 38¢ 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 1.25% for the first $1.5 million of stamps purchased and 0.75% for stamps over $1.5 million purchased each year.

A complementary use and storage tax of 38¢ 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 complementary 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.

For both the cigarette and tobacco products taxes, the statutes state the tax "... shall not be construed as a cost of doing business or an overhead expense ...". In all cases, the taxes are passed on to the consumer.

EXEMPTION

8.01 LIMITED QUANTITIES EXEMPT

Minnesota Statutes, Sections 297.22, Subd. 3 and 297.32, Subd.2

A use and storage tax equal to the cigarette tax is imposed on consumers in possession of cigarettes which were not previously subject to the Minnesota cigarette excise tax. Likewise, a use and storage tax equal to the tobacco products tax is imposed on consumers in possession of tobacco products not previously subject to the tobacco products tax.

For both taxes, limited quantities in the possession of a consumer are exempt from the tax. The exemption applies to: not more than 200 cigarettes; not more than fifty cigars; not more than ten ounces of snuff or snuff powder; and not more than one pound of smoking or chewing tobacco or other tobacco products not specifically mentioned in the statutes.

This exemption could be viewed as an incentive for consumers to purchase cigarettes and tobacco products in bordering states because they have lower rates.

State	Cigarette Tax Rate Per Pack of 20
Minnesota	38¢
Iowa	34¢ (3/1/88 - 6/30/89) 31¢ (7/1/89 and after)
North Dakota	27¢
South Dakota	23¢
Wisconsin	30¢

The exemption for cigarettes was enacted in 1949 and was last changed in 1973. The exemption for tobacco products was enacted in 1957 and revised in 1971.

	Fiscal Year Impact			
	1988	1989	1990	1991
Cigarettes				
State General Fund	$4,000,000	$4,000,000	$4,000,000	$4,000,000
State Water Pollution Control Fund	500,000	500,000	500,000	500,000
Minnesota Resources Fund	300,000	300,000	300,000	300,000
Public Health Fund	300,000	300,000	300,000	300,000
Total-Cigarettes	$5,100,000	$5,100,000	$5,100,000	$5,100,000
Tobacco Products				
State General Fund	$257,000	$257,000	$257,000	$257,000
State Water Pollution Control Fund	43,000	43,000	43,000	43,000
Total-Tobacco Products	$300,000	$300,000	$300,000	$300,000
Grand Total	$5,400,000	$5,400,000	$5,400,000	$5,400,000

CHAPTER 9: MORTGAGE REGISTRY TAX

Collections and History

In fiscal year 1988, combined revenues from the mortgage registry and deed transfer (Chapter 10) taxes were $56.7 million. Beginning July 1, 1985, all revenue from the mortgage registry tax goes to the county revenue fund of the county in which the tax is collected. However, 97% of the tax is used as a deduction from welfare expenditures reported to the state and results in a reduction of state welfare reimbursement to the counties equal to that amount.

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, or fraction thereof, of such debt. On July 1, 1987, the tax was increased to 23¢ for each $100, or fraction thereof, of principal debt.

Tax Base

The tax base is the amount of principal debt secured by a mortgage of real property within Minnesota. Only registered mortgages are within the tax base. Although similar to a mortgage in some respects, a contract for deed is not a mortgage because the debt is not secured by real property. Therefore, the exemption of registered contracts for deed is not considered a tax expenditure.

Computation of the Tax

The mortgage registry tax is 23¢ for each $100, or fraction thereof, of principal debt which is or may be secured by any mortgage of real property within Minnesota and which is recorded or registered. If the real estate used to secure the debt includes property outside Minnesota, the tax is applied to a proportion of the entire debt, the proportion being the value of the Minnesota real estate to the value of the entire real estate described in the mortgage.

The statutes do not specify who pays the mortgage registry tax. Generally, the lender records or registers the mortgage and pays the tax. The tax is paid to the county treasurer at or before the time of filing the mortgage for record or registration.

EXEMPTION

9.01 CERTAIN PERSONS AND ORGANIZATIONS

Minnesota Statutes, Section 287.06

Organizations which are exempt from the property tax, such as municipalities, churches, and school districts, are exempt from the mortgage registry tax when they are the mortgage lender. This exemption is based on the identity of the lender because it is the lender who pays the tax in order to officially register its security interest in the affected property.

This provision was enacted in 1907 and was last revised in 1965.

	Fiscal Year Impact			
	1988	1989	1990	1991
County Revenue Fund	$200,000	$200,000	$200,000	$200,000

CHAPTER 10: DEED TRANSFER TAX

Collections and History

Combined revenues from the mortgage registry (Chapter 9) and deed transfer taxes were \$56.7 million in fiscal year 1988. Beginning July 1, 1985, all revenue from the deed transfer tax goes to the county revenue fund of the county in which the tax is collected. However, 97% of the tax is used as a deduction from welfare expenditures reported to the state and results in a reduction of state welfare reimbursement to the counties equal to that amount.

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 increased to \$2.20 for consideration of \$1,000 or less plus \$1.10 for each \$500 in excess of \$1,000. On July 1, 1987, the rate was increased to \$1.65 for consideration of \$500 or less plus \$1.65 for each additional \$500.

Tax Base

The tax base for the deed transfer tax is the granting, assigning, transferring, or otherwise conveying of real estate by deed, instrument, or writing. The most common situation is the transferring of real estate by deed.

Computation of the Tax

A tax of \$1.65 is imposed in these situations:

1. transfers made by instruments pursuant to mergers, consolidations, sales, or transfers of substantially all of the assets of corporations pursuant to plans of reorganization; or
2. transfers made with no consideration; or
3. transfers made with consideration of \$500 or less.

When the consideration is in excess of \$500, the tax is \$1.65 plus \$1.65 for each \$500, or fractional part of \$500, in excess of \$500.

The person who grants, assigns, tranfers, or conveys real estate is liable for the tax. The deed, instrument, or writing 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 TRANSFERS BETWEEN CO-OWNERS

Minnesota Statutes, Section 287.22

Deeds transferred between co-owners in order to partition a commonly-held piece of land are exempt from the deed transfer tax.

This provision became effective August 1, 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
County Revenue Fund	$100,000	$100,000	$100,000	$100,000

10.02 DEEDS OF DISTRIBUTION BY PERSONAL REPRESENTATIVES

Minnesota Statutes, Section 287.22

Deeds of distribution by personal representatives are exempt from the deed transfer tax.

This provision was enacted in 1975 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
County Revenue Fund	*	*	*	*

10.03 DEEDS FOR CEMETERY LOTS

Minnesota Statutes, Section 287.22

Deeds or other instruments transferring cemetery lots are exempt from the deed transfer tax.

This provision was enacted in 1961.

Approximately 30,000 cemetery lots are sold in Minnesota each year.

	Fiscal Year Impact			
	1988	1989	1990	1991
County Revenue Fund	$100,000	$100,000	$100,000	$100,000

*Less than $50,000.

CHAPTER 11: CHARITABLE GAMBLING TAX

Collections and History

In fiscal year 1988, revenues from the charitable gambling tax were $3.3 million and from the pull-tab tax they were $12 million. The proceeds from these taxes are deposited in the state general fund.

The 10% charitable gambling tax was enacted in 1984 and became effective June 1, 1985. The enactment of the tax was part of legislation which created the Charitable Gambling Control Board and gave the board jurisdiction over charitable gambling. Previously, licensing was the responsibility of the local government units. The provisions of the charitable gambling law specify the requirements for all phases of lawful gambling activity.

A separate tax on pull-tabs was established, effective January 1, 1987, and that tax was extended to tipboards effective July 1, 1988. Pull-tabs and tipboards are exempt from the charitable gambling tax.

Tax Base

The tax base is gross receipts from lawful gambling less prizes.

Computation of the Tax

The charitable gambling tax covers lawful gambling consisting of bingo, raffles, and paddlewheels. Lawful gambling is allowed only by qualifying organizations which are licensed by the Charitable Gambling Control Board or which are exempt from licensing by statute. The organization must be a fraternal, religious, veterans, or other nonprofit organization. The profits from the lawful gambling must be used only for the purposes specified by statute.

The tax is 10% of the gross receipts of a licensed organization from lawful gambling less prizes actually paid out. Organizations which are exempt from licensing are also exempt from the tax (Items 11.01 to 11.05).

Pull-tabs and tipboards are exempt from the charitable gambling tax, but a separate tax applies to pull-tabs and tipboards which is 10% of the face resale value of all the pull-tabs or tipboards in each deal less the total predetermined prizes for that deal. A "deal" is defined as each separate package, or series of packages, consisting of one game of pull-tabs or tipboards. The exemptions explained in Items 11.01 through 11.05 do not apply to pull-tabs and tipboards.

EXEMPTIONS

11.01 BINGO AT CERTAIN ORGANIZATIONS

Minnesota Statutes, Section 349.214, Subd. 1a

An exemption from the charitable gambling tax is allowed for bingo conducted within a nursing home or a senior citizen housing project or by a senior citizen organization if the prizes for a single bingo game do not exceed $10, total prizes awarded at a single bingo occasion do not exceed $200, no more than two bingo occasions are held each week, and specified other conditions are met.

This provision was enacted in 1985 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

11.02 BINGO AT FAIRS AND CIVIC CELEBRATIONS

Minnesota Statutes, Section 349.214, Subd. 1 (1)

The 10% charitable gambling tax is not imposed on bingo conducted in connection with a county fair, the state fair, or a civic celebration if conducted twelve or fewer consecutive days in a calendar year.

This exemption was enacted in 1984 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

11.03 INFREQUENT BINGO OCCASIONS

Minnesota Statutes, Section 349.214, Subd. 1 (2)

An exemption from the charitable gambling tax is allowed for bingo conducted by an organization which holds four or fewer bingo occasions in a calendar year.

This exemption was enacted in 1984 and has not been changed.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

*Less than $50,000.

11.04 SMALLER RAFFLES

Minnesota Statutes, Section 349.214, Subd. 2(a)

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 charitable gambling tax.

This provision was enacted in 1984 and was amended in 1986.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	*

11.05 LAWFUL GAMBLING UNDER CERTAIN CONDITIONS

Minnesota Statutes, Section 349.214, Subd. 2(b)

Lawful gambling is exempt from the charitable gambling tax 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. The organization must follow specified procedures in order to qualify for the exemption.

This exemption was enacted in 1986. Because this exemption applies only to lawful gambling taxed under the charitable gambling tax, it no longer applies to pull-tabs after December 31, 1986, or to tipboards after June 30, 1988, when the separate tax on these forms of gambling becomes effective. Therefore, the exemption applies only to bingo, raffles, and paddlewheels.

About 1,450 organizations have been granted this exemption.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$600,000	$600,000	$600,000	$600,000

*Less than $50,000.

CHAPTER 12: TELEPHONE COMPANIES GROSS EARNINGS TAX

Collections and History

The revenue from the telephone companies gross earnings tax was $99 million in fiscal year 1988. All revenue from this tax goes to the state general fund.

Minnesota first enacted a gross earnings tax on telephone companies in 1887 at a rate of 2%. Although replaced by a property tax between 1891 and 1897, the gross earnings tax was re-enacted in 1897 at a rate of 3%. The rate was increased to 4% in 1921, and in 1937 the rates that were in existence through 1988 were adopted.

Legislation enacted in 1985 and modified in 1987 phases out the gross earnings tax and replaces it with the local property tax, which will go into effect beginning with property taxes payable in 1990. Prior to that legislation, the gross earnings tax had been in lieu of all other taxes, except the income tax.

Tax Base

The tax base is the gross earnings of telephone companies from business within Minnesota.

Computation of the Tax

The gross earnings tax is paid by each telephone company that owns or operates a telephone line or telephone exchange for hire wholly or partly within Minnesota. The rate of the gross earnings tax depends upon the source of the business. Beginning in 1992 the tax is repealed, and the rates are reduced from 1988 through 1991, as follows:

	Percent of Gross Earnings				
Type of Telephone Service	Through 1988	1989	1990	1991	After 1991
Service to rural subscribers and to cities of the fourth class	4.0%	3.0%	1.5%	1.0%	Exempt
Service to all others	7.0%	5.5%	3.0%	2.5%	Exempt

EXEMPTIONS

12.01 INTERSTATE TELEPHONE SERVICE

Minnesota Statutes, Section 295.34, Subd. 1

Business originating or terminating outside Minnesota is exempt from the telephone gross earnings tax.

This exemption was enacted in 1985, effective January 1, 1986. In 1987, interstate long distance access charges were added to the tax base for calendar years 1987 through 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$16,900,000	$17,600,000	$10,700,000	$9,400,000

12.02 CELLULAR RADIO

Minnesota Statutes, Section 295.01, Subd. 10

Cellular radio is exempt from the telephone gross earnings tax.

This exemption was enacted in 1985, effective January 1, 1986.

Six companies are currently licensed by the Federal Communications Commission to provide cellular telephone service in Minnesota.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,700,000	$2,600,000	$2,000,000	$1,900,000

REDUCED RATES

12.03 REDUCED RATE FOR CERTAIN BUSINESS

Minnesota Statutes, Section 295.34, Subd. 1

Telephone companies are taxed at a percentage of their gross earnings. Gross earnings received from rural subscribers and from exchange business in cities of the fourth class (those having a population of 10,000 or less) are taxed at a lower rate than all other types of business.

In 1987, the following schedule of rates was adopted, so that the telephone gross earnings tax is repealed, beginning in 1992. The gross earnings tax is replaced by a property tax which will go into effect beginning with property taxes payable in 1990.

	Percent of Gross Earnings				
Type of Telephone Service	Through 1988	1989	1990	1991	After 1991
Service to rural subscribers and to cities of the fourth class	4.0%	3.0%	1.5%	1.0%	Exempt
Service to all others	7.0%	5.5%	3.0%	2.5%	Exempt

The preferential rate for gross earnings received from rural or small city customers was enacted in 1937. In 1985 the phase-out of the gross earnings tax was enacted, and in 1987 the phase-out was delayed by two years.

In calendar year 1987, the lower rate applied to some or all of the gross earnings of 99 telephone companies.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$14,200,000	$14,200,000	$11,200,000	$11,900,000

CHAPTER 13: INSURANCE PREMIUMS TAXES

Collections and History

In fiscal year 1988 the revenues from the insurance premiums taxes totaled $127 million. The proceeds from these taxes are deposited in the state general fund.

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. This tax is in addition to the 2% gross premiums tax and is imposed only on fire premiums.

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.

In 1953 the ocean marine profits tax was enacted at a rate of 5% on taxable underwriting profit from marine insurance written in Minnesota. This tax replaced the 2% gross premiums tax for this type of insurance. The rate remains at 5%.

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. This tax applies to insurance placed with an insurer not licensed in Minnesota when coverage is not available from a Minnesota-licensed insurer.

Tax Base

For purposes of this study, the tax base is defined as gross premiums less return premiums on all direct business received in Minnesota by domestic and foreign insurance companies.

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 or organized in Minnesota, and a foreign company is one which is incorporated in another state or country. A lower rate applies to domestic mutual insurance companies other than life (Item 13.07).

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 (Item 13.04).

The 2% surcharge is imposed on the fire, lightning, and sprinkler leakage gross premiums less return premiums on all direct business received by domestic and foreign fire insurance companies on property in cities of the first class. The cities of the first class are Minneapolis, St. Paul, and Duluth.

The 3% surplus lines insurance tax is imposed on total written premiums less cancellations for insurance placed with an insurer not licensed in Minnesota when coverage is not available from a

Minnesota licensed insurer. The tax is paid by the Minnesota agent or broker who has a surplus lines license.

The ocean marine profits tax is not based on the amount of premiums but is 5% of the average of the taxable underwriting profits or losses of marine insurance written in Minnesota in the three preceding years. The computation of the taxable underwriting profit or loss is specified by statute.

The amount of premiums tax paid, except for the surcharge, is allowed as a credit against the corporate franchise tax (Item 2.45).

EXEMPTIONS

13.01 FRATERNAL BENEFIT SOCIETIES

Minnesota Statutes, Section 64B.24

Fraternal benefit societies or associations are exempt from the Minnesota gross premiums tax. These societies are nonprofit, charitable organizations which provide life, sickness, and/or accident benefits for their members.

This exemption dates back to 1907 and was last changed in 1985.

Fifty-five fraternal benefit societies do business in Minnesota.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,600,000	$3,900,000	$4,200,000	$4,500,000

13.02 NONPROFIT HEALTH SERVICE PLAN CORPORATIONS

Minnesota Statutes, Section 62C.01, Subd. 3

Medical and hospital service associations organized and controlled by state law under the Minnesota Nonprofit Health Service Plan Corporations Act are exempted from the gross premiums tax.

This exemption was enacted in 1971 as part of the Minnesota Nonprofit Health Service Plan Corporations Act and has not been changed. Prior to the 1971 enactment, these entities were exempt under other statutory provisions.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$7,800,000	$8,400,000	$9,100,000	$9,800,000

13.03 HEALTH MAINTENANCE ORGANIZATIONS

Minnesota Statutes, Section 62D.01, Subd. 2

Health maintenance organizations qualifying under the Health Maintenance Act of 1973 are exempt from the Minnesota gross premiums tax.

This provision was enacted in 1973.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$14,500,000	$15,700,000	$17,000,000	$18,300,000

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

Minnesota Statutes, Section 299F.21, Subd. 1

Insurance companies doing business in Minnesota are required to pay an annual fire marshal tax on their fire insurance premiums. The tax is equal to 0.5% of gross fire insurance premiums and assessments received annually on all direct business in Minnesota. Farmers' mutual insurance companies and township mutual insurance companies are exempt from this tax.

This exemption was enacted in 1915 and was last changed in 1987.

Approximately 120 insurance companies receive this exemption.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$200,000	$200,000	$200,000

13.05 MINNESOTA COMPREHENSIVE HEALTH INSURANCE PLAN PREMIUMS

Minnesota Statutes, Section 62E.13, Subd. 10

The Minnesota Comprehensive Health Association (MCHA) was established by state law to provide health insurance coverage to high risk persons. Premiums received by the writing carrier for the MCHA plan are exempt from the 2% gross premiums tax.

This exemption was enacted in 1976 as part of the MCHA legislation. The exemption was repealed in 1987 but was re-enacted in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$300,000	$300,000	$300,000

PREFERENTIAL COMPUTATION

13.06 OCEAN MARINE PROFITS TAX

Minnesota Statutes, Section 60A.15, Subd. 6

The ocean marine profits tax is based not on the amount of premiums but is 5% of the average of the taxable underwriting profits or losses of marine insurance written in Minnesota in the three preceding years. The estimates measure the difference between the 5% ocean marine profits tax and the tax that would be paid if the 2% gross premiums tax were applied to ocean marine premiums.

The ocean marine profits tax was enacted in 1953.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$300,000	$300,000	$300,000	$300,000

REDUCED RATES

13.07 DOMESTIC MUTUAL INSURANCE COMPANIES OTHER THAN LIFE

Minnesota Statutes, Section 60A.15, Subd. 1

Beginning in calendar year 1988, the gross premiums tax rate imposed on domestic mutual insurance companies other than life is lower than the 2% rate imposed on insurance companies generally. The rate is lowered in subsequent years as follows:

Calendar Year	Rate on Domestic Mutuals
1988	1.5%
1989-1991	1.0%
1992 and after	0.5%

The reduced rate applies to domestic mutual insurance companies other than life and to farmers' mutual and township mutual insurance companies. The reduced rate does not apply to companies writing principally workers' compensation insurance or to companies with total assets exceeding $1.6 billion.

From 1905 to 1987, domestic mutual insurance companies other than life paid the 2% gross premiums tax only on their fire, lightning, and sprinkler leakage premiums and were exempt from paying the tax on all other types of premiums. In 1987, the exemption was repealed so that they were subject to the 2% tax on all their premiums. In 1988, the reduced rates were enacted.

The reduced rates apply to about 150 mutual insurance companies.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$1,200,000	$3,500,000	$4,900,000	$5,300,000

CHAPTER 14: MINING OCCUPATION TAX

Collections and History

In fiscal year 1988, revenues from the occupation tax were $2.9 million. The Minnesota Constitution mandates the distribution of the tax: 50% to the state general fund; 40% for the support of elementary and secondary schools; and 10% for the general support of the university. Of the general fund portion, an amount equal to the yield of a 1¢ per ton production tax is appropriated to the Iron Range Resources and Rehabilitation Board to be used for specified purposes.

The occupation tax was enacted in 1921 at a rate of 6%. Several rate changes have been enacted since then, including increases and decreases, surtaxes and additional taxes. Although the rates for taconite and for iron ore have not always been the same, they have been the same since 1985. The rate for both types of ore was 15% for production year 1985, 14.5% for 1986, and 14% for 1987 and after.

In 1964 the Minnesota Constitution was amended to limit for 25 years the taxation of taconite companies. (See Item 15.02.)

The occupation tax in its present form is repealed for iron ore and taconite concentrates mined after December 31, 1989. It is replaced by an occupation tax which is computed in the same manner and at the same rates as the corporate franchise tax (or the individual income tax for unincorporated businesses or S corporations), including applicable minimum taxes.

Tax Base

The tax base for the occupation tax is the taxable value of the ore, defined as the value of the ore less necessary and reasonable expenses incurred in mining, producing, and transporting that ore. For purposes of this study, all the deductions that are currently allowed, either by statute or by administrative practice, are considered to define the tax base rather than to be exceptions to that base. Therefore, none of the deductions are considered to be tax expenditures.

Computation of the Tax

The occupation tax that is imposed on mining companies prior to 1990 is in lieu of the franchise or income tax and is somewhat similar to an income tax.

Minnesota statutes specify that the computation of the occupation tax begins with the value of the ore at the mouth of the mine. Because no published market price exists for ore at the mouth of a Minnesota mine, the determination of this valuation has been established by administrative practice and court decisions. The value at the mouth of the mine is determined by taking the Lake Erie value less certain deductions, including stockpiling and loading costs, transportation costs, and processing costs.

After the value at the mouth of the mine is determined, certain deductions are allowed by statute to determine the taxable value of the ore. These deductions include mining costs, plant and equipment depreciation, and other expenses.

The tax rate applied to the taxable value of the ore for both taconite and iron ore is 14%, but the labor credit can reduce the effective rate of tax to a minimum of 5.75%. The other credits allowed are also included in this report (Items 14.02 through 14.04).

Beginning in 1990, the occupation tax will be essentially the same as the tax imposed under Chapter 290 - the franchise tax for corporations and the income tax for partnerships, proprietorships, and S corporations. The credits contained in Items 14.01 through 14.04 will no longer apply.

The Taconite Amendment to the Minnesota Constitution limits the combined occupation, royalty, and excise taxes of a taconite company to the greater of: a) the amount of these taxes as computed under 1963 laws; or b) the income and sales tax that the company would pay if it were a manufacturing corporation. The amendment was adopted in 1964 and will expire in 1989.

The fiscal impacts shown in this chapter do not take the constitutional limit into account. The effects of the limitation and a further explanation of it can be found on in Item 15.02.

CREDITS

14.01 LABOR CREDIT (REPEALED)

Minnesota Statutes, Section 298.02

A credit may be claimed against the occupation tax for high labor cost ores. The credit is determined by a formula based on the cost of labor per ton of processed iron ore or concentrate. The credit cannot exceed 8.25% of the valuation of the ore used in computing the occupation tax. Therefore, the effective rate of the tax can be reduced to a minimum of 5.75% for 1987 and subsequent years.

The labor credit was enacted in 1939. This provision and the occupation tax are repealed for iron ore and taconite concentrates mined after December 31, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$6,700,000	$6,000,000	$6,000,000	$0

14.02 POLLUTION CONTROL CREDIT (REPEALED)

Minnesota Statutes, Section 298.028

A company engaged in mining taconite or other iron bearing ores in Minnesota may take a credit against the occupation tax equal to 5% of the net cost of equipment used primarily to abate or control pollutants in order to meet or exceed state laws, rules, or standards. The credit amount is limited to $75,000 for any single tax year. Excess credit amounts may be carried forward for up to four successive years.

The pollution control credit was enacted in 1979. This provision and the occupation tax are repealed for iron ore and taconite concentrates mined after December 31, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	*	*	$0

*Less than $50,000.

14.03 RESEARCH, EXPERIMENTATION, AND EXPLORATION CREDIT (REPEALED)

Minnesota Statutes, Section 298.026

An occupation tax credit is allowed each Minnesota mining operation for the cost of all research, experimentation, pilot plant tests, and exploration work performed in Minnesota for the express purpose of furthering the discovery, development, or beneficiation (concentration) of Minnesota ores. Credit amounts exceeding current tax liability may be carried forward up to two years.

This provision was enacted in 1963. This provision and the occupation tax are repealed for iron ore and taconite concentrates mined after December 31, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	*	$0	$0	$0

14.04 DISCOUNT CREDIT (IRON ORE) (REPEALED)

Minnesota Statutes, Section 298.031

A tax credit is allowed to iron ore mining companies for iron ore which is sold at a discount. The credit amount is determined by multiplying the number of tons of ore sold at a discount by the amount of the discount as determined by the commissioner of revenue. The credit is subject to several limitations.

The discount credit was enacted in 1961. This provision and the occupation tax are repealed for iron ore and taconite concentrates mined after December 31, 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$200,000	$0	$0	$0

*Less than $50,000.

CHAPTER 15: MINERAL ROYALTY TAXES

Collections and History

In fiscal year 1988, a total of $2.4 million in royalty taxes was collected. The proceeds from this tax are deposited in the state general fund.

The royalty tax was first enacted in 1923 at a rate of 6%. Since that time the rates have been the same as the occupation tax rates. The rate for taconite and iron ore was 15% for 1985, 14.5% for 1986, and is 14% for 1987 and after. The royalty tax for iron ore and taconite is repealed, beginning with tax year 1990. The royalty taxes on copper-nickel, gold, silver, platinum, and other precious metals was repealed, beginning with tax year 1987.

In 1964 the Minnesota Constitution was amended to limit the taxation, including the royalty tax, of taconite companies. (See Item 15.02.)

Tax Base

The tax base is all royalty received in money or in value of property for permission to explore, mine, take out, and remove ore from land in Minnesota.

Computation of the Tax

Royalty is defined by statute as ". . . the amount in money or value of property received by any person having any right, title, or interest in or to any tract of land in this state for permission to explore, mine, take out and remove ore therefrom."

The 14% tax rate is applied to the amount of the taconite or iron ore royalty. A labor credit is allowed against the tax which reduces the effective rate of tax to a minimum of 5.75%. The statutory rate and the effective rate for the royalty tax on iron ore and taconite are the same as for the occupation tax (Chapter 14).

Although the terms of the lease between the mining company and the owner of the land determine who is liable for the tax, the tax is remitted by the mining company to the Department of Revenue.

The amount of royalty tax paid by taconite companies is limited by the Taconite Amendment to the Minnesota Constitution. The fiscal impact of the tax expenditure in this chapter was computed without taking into account that limitation. The overall impact of the constitutional limitation is shown in Item 15.02.

The royalty tax on taconite and iron ore is repealed effective beginning with tax year 1990.

CREDIT

15.01 LABOR CREDIT (REPEALED)

Minnesota Statutes, Section 299.012, Subd. 1

Taxpayers receiving royalties from a taconite or other ore operation may claim a labor credit in an amount which will cause the net effective tax rate to equal the net effective mining occupation tax rate for the same operation. See Item 14.01 for a discussion of the occupation tax labor credit.

This provision was enacted in 1959. This provision and the royalty tax are repealed, beginning with tax year 1990.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$3,300,000	$3,400,000	$3,500,000	$0

NOTE ON TACONITE AMENDMENT

15.02 CONSTITUTIONAL LIMIT ON THE TAXATION OF TACONITE MINING COMPANIES

Minnesota Constitution, Article X, Section 6
Minnesota Statutes, Section 298.40

The Minnesota Constitution places a ceiling on the total amount of occupation, royalty, and excise taxes to be paid annually by each taconite mining company. The ceiling is the greater of a) the total amount of occupation, royalty, and excise taxes which would be payable by the company under the laws of 1963, or b) the amount of income and excise taxes which would be payable if the company were a manufacturing corporation.

If a company's computed occupation, royalty, and excise taxes are at or above its ceiling, no fiscal impact from the tax expenditures in these taxes can be attributed to that company because the state is constitutionally prohibited from taxing the company above its ceiling.

If a company's occupation, royalty, and excise taxes are below its ceiling, the total of the tax expenditures attributed to that company is limited to the amount by which its ceiling exceeds its current taxes.

The Taconite Amendment to the Minnesota Constitution was passed by the Legislature in 1963 and adopted by the voters in 1964. It will expire at the end of 1989.

	Fiscal Year Impact			
	1988	1989	1990	1991
State General Fund	$900,000	$900,000	$900,000	$0

Maximum possible fiscal impact for all occupation, royalty, and sales tax expenditures relating to taconite mining companies.

CHAPTER 16: PROPERTY TAX

Collections and History

Net property tax collections were $2.8 billion for property taxes payable in 1988. 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. The state does not levy a general property tax. Although the property tax is entirely a local source of revenue, nearly all aspects of the tax are controlled by state statute.

The property tax was already in place when the first book of statutes was compiled for the Territory of Minnesota in 1851. Numerous changes have been made to the property tax since that time, a few of which are highlighted here.

The classification system was first enacted in 1913 with four classes of property. In 1933 the number of classes was expanded to provide preferential treatment for homestead property, both platted and unplatted. The number of classes of property has continued to increase over time.

Many important changes to the property tax system were enacted 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. Enacted that year were the homestead credit, the rent credit, and the senior citizen credit. These credits have been changed several times.

A number of changes in the taxation of the personal property of business began in 1967. In that year, livestock and agricultural machinery were exempted from the tax, and businesses were given the option to have either their inventories or their tools and machinery exempted. In 1971 the exemption for business property was expanded to include both inventories and tools and machinery. In 1973 an exemption was also enacted for commercial and industrial equipment attached to and considered as real property, known as attached machinery.

In 1971 levy limitations and local government aids were enacted which are important in determining the amount of the property tax levy. Modifications have been made to both of these programs since that time.

In 1988 several provisions were enacted that significantly altered a number of features of the system as it emerged after 1971. The concept of assessed value, calculated by multiplying classification ratios times estimated market value to obtain the taxable portion of value, was replaced by a tax capacity concept. Tax capacities are based on effective tax rates applied to market values, and tax rates now are expressed as percentages of total tax capacity in a taxing area rather than as mill rates. Agricultural credit and state-paid homestead credit, long prominent features of Minnesota's property tax system, will be replaced by a transition aid in 1990. A new disparity reduction aid will provide aid to high tax rate areas beginning in 1989.

Tax Base

For purposes of this study, the tax base for the property tax is the market value of real and personal property in Minnesota. 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 tax expenditures.

Computation of the Tax

The computation of the property tax is different from the computation of other types of taxes in

Minnesota with regard to how the total yield of the tax is determined. This difference is important in understanding how the fiscal impacts of the property tax expenditures are different from the fiscal impacts of tax expenditures in other taxes.

The impact of a property tax expenditure affects the distribution of the tax rather than the total yield of the tax.

For the other taxes, the taxable amount (income, sales price, volume sold, etc.) is multiplied by a rate or set of rates specified by statute to yield the total tax. A preferential provision has an impact on the total yield of the tax. Any redistribution of that impact would require legislative action.

For the property tax, the taxable amount (tax capacity, which is market value times effective tax rate) is determined by statute. The total yield of the tax (the property tax levy) is not the result of a computation but 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 doing so must take into account many factors, including the level of services provided, mandated programs, debt service, levy limitations, and other sources of revenue such as local government aids.

The levy is divided by the total taxable tax capacity of the taxing district to determine the rate of tax (tax capacity rate). For each parcel of property, the tax capacity is multiplied by the aggregate tax capacity rate of the county, city or township, school district, and any special taxing districts to determine the gross tax. An exemption, effective tax rate, or other preferential provision lowers the total tax capacity and results in a higher tax capacity rate that is applicable to all taxable property. Therefore, although the total yield from the tax is not affected, the tax is shifted from preferential to nonpreferential property.

Net tax is determined by subtracting from gross tax the applicable credit(s), if any. With the exception of the taconite homestead credit and the power line credit (Items 16.06 and 16.07), all these credits are reimbursed by the state to the local government units. They are included in the state budget as open and standing appropriations of the general fund; and, therefore, they are not included in this study as tax expenditures.

The 1987 and 1988 law changes reduced the number of credits by eliminating native prairie and wetlands credits for taxes payable in 1989 and homestead and agricultural credits in 1990. The 1988 law also changed the procedure for calculating net tax for 1989 by mandating the subtraction of disparity reduction aid from total tax capacity rates in taxing areas before computing the final tax capacity rate. For taxes payable in 1990, the 1988 law also lowered the effective tax rates for property formerly receiving homestead credit and agricultural credit and mandated the subtraction of both disparity reduction aid and transition aid when calculating final tax capacity rates. The credits, listed in the order in which they are subtracted from gross tax in 1989 (after disparity reduction aid has been subtracted), are as follows: disaster credit; power line credit; agricultural preserves credit; enterprise zone credit; state agricultural credit; state-paid homestead credit; taconite homestead credit; and supplemental homestead credit.

For taxes payable in 1990, state agricultural credit and state-paid homestead credit are eliminated, but transition aid will reduce gross tax by a similar amount.

Additional tax relief is provided to qualifying homeowners and renters through the property tax refund. The property tax refund is based on the net homestead tax or the tax attributable to the rental unit and on household income, with the amount of refund phasing out as income increases. The property tax refund is paid directly by the state to the claimant.

EXEMPTIONS

16.01 EXEMPT PROPERTY

Minnesota Statutes, Sections 272.02, Subd. 1 and 273.18

Certain types of property are exempt from the property tax by statute, and they are included in the estimates below. Certain other types of property are exempt under either the Minnesota Constitution or federal law, and their exemption is not included in the tax expenditure estimates. These properties are churches, academies, colleges, universities, and Indian reservations.

Since 1926 the county assessors have been required to value exempt property every six years. The most recent valuation of exempt property took place in 1986. The estimates are based on the 1986 values with no growth assumed. The values were multiplied by an assessment rate of 43% for fiscal years 1988 and 1989 and 42% for fiscal years 1990 and 1991. A statewide average mill rate was computed or estimated for each year to arrive at the estimated net property tax figures shown below. In computing the estimates, the mill rates were adjusted to take into account the additional taxable value which would result if the property were not exempt.

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 1988.

	Net Property Tax - Fiscal Year Impact			
Type of Property	1988	1989	1990	1991
Real Property:				
Elementary and secondary schools	$225,000,000	$239,900,000	$239,900,000	$244,800,000
Public burying grounds	5,100,000	5,400,000	5,400,000	5,600,000
Hospitals	75,400,000	80,500,000	80,500,000	82,100,000
Charitable institutions	32,000,000	34,100,000	34,100,000	34,800,000
Federal and state forests, parks, and wildlife refuges	37,400,000	39,900,000	39,900,000	40,700,000
Public property used for public purposes	281,300,000	300,000,000	300,000,000	306,100,000
Total Real Property	$656,200,000	$699,800,000	$699,800,000	$714,100,000
Total Personal Property*	$45,200,000	$48,200,000	$48,200,000	$49,200,000
Total Exempt Property	$701,400,000	$748,000,000	$748,000,000	$763,300,000

* Personal property includes iron ore stockpiles, direct products of furnaces, agricultural products, attached machinery, commerical and industrial personal property.

PREFERENTIAL VALUATIONS

16.02 CLASSIFICATION SYSTEM

Minnesota Statutes, Section 273.13

Each parcel of taxable property is classified by type. Prior to taxes payable in 1989, the market value of the property is multiplied by the appropriate assessment ratio(s), depending upon the type of property. Beginning with taxes payable in 1989, a classification system using tax capacity rates replaces the assessment ratio system.

Due to the classification system, some types of property are treated preferentially compared to other types of property, the extent of the preferential treatment varying by property type. The classification system is considered a tax expenditure because each dollar of market value is not treated the same.

The estimates are summarized by twelve major types of property. The estimates assume that, instead of having many different assessment ratios or tax capacity rates, all types of property are assessed at 100% of market value. However, no new revenue is generated because the mill rates are adjusted to reflect the new assessed values.

The fiscal impacts therefore reflect shifts in tax burdens. A positive figure indicates a tax increase and a negative figure a tax decrease for a group. When the gross tax is computed, the total of the differences between the groups is zero. When the net tax is computed, the differences between groups do not equal zero due to an increase in tax credits for some types of property.

The property tax classification system was enacted in 1913 and was last changed in 1988.

	Net Property Tax - Fiscal Year Impact			
Type of Property	1988	1989	1990	1991
Farm	$42,000,000	$46,600,000	$45,000,000	$45,000,000
Seasonal Recreational Residential	300,000	(1,300,000)	(1,600,000)	(1,600,000)
Seasonal Recreational Commercial	900,000	800,000	900,000	900,000
Residential	173,000,000	156,500,000	162,700,000	162,700,000
Apartments	(45,400,000)	(66,700,000)	(68,900,000)	(68,900,000)
Vacant Land	(19,100,000)	(18,900,000)	(19,400,000)	(19,400,000)
Commercial	(170,300,000)	(232,900,000)	(249,100,000)	(249,100,000)
Industrial	(68,900,000)	(86,400,000)	(91,100,000)	(91,100,000)
Public Utility	(19,500,000)	(26,700,000)	(27,100,000)	(27,100,000)
Mineral	(1,200,000)	(1,100,000)	(1,100,000)	(1,100,000)
Railroad	(5,400,000)	(5,500,000)	(5,600,000)	(5,600,000)
Personal	(36,400,000)	(41,500,000)	(42,200,000)	(42,200,000)

16.03 GREEN ACRES TREATMENT OF AGRICULTURAL LAND

Minnesota Statutes, Section 273.111

In 1967 the Minnesota Agricultural Property Tax Law, commonly referred to as "green acres," was enacted. The law 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 only. A higher value that would result from nonagricultural use is not used for property tax purposes. For example, farm land that is near a commercial development would be valued according to its agricultural use and not according to its potential value for commercial development.

When green acres property no longer qualifies as such or is sold, a tax is due equal to the amount by which the preferential assessment 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, at the statewide average mill rate for towns computed or estimated for each year.

This provision was enacted in 1967 and was last revised in 1984.

	Fiscal Year Impact			
	1988	1989	1990	1991
Green Acres	$5,800,000	$5,900,000	$6,000,000	$6,000,000

16.04 OPEN SPACE PROPERTIES

Minnesota Statutes, Section 273.112

Private outdoor recreational, open space, and park land is given preferential valuation and tax deferment as long as it meets certain criteria.

For property tax purposes, the property is valued at its current use rather than at a higher value that would reflect its potential use. For example, a golf course would be valued at its current use rather than at its potential use for commercial, industrial, or residential development.

When the open space property no longer qualifies for preferential valuation, taxes are due equal to the amount by which the preferential assessment reduced the tax for the previous seven years.

The Minnesota Open Space Property Tax Law was enacted in 1969 and was first effective for property taxes payable in 1971. It was last amended in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
Open Space Properties	$3,300,000	$3,800,000	$4,000,000	$4,400,000

PREFERENTIAL COMPUTATIONS

16.05 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 one of three taxes - the general property tax, 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 that would be paid for those properties. Both taxes are payable and distributed in the same manner as the general property tax.

Qualifying land is designated an auxiliary forest upon application by the owner and approval by the county board. The auxiliary forest tax applies for the duration of the contract. When the contract expires, the land automatically qualifies for the tree growth tax. A law enacted in 1974 prohibits new auxiliary forest contracts from being issued or existing contracts from being extended after June 30, 1974.

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 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.

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.

	Fiscal Year Impact			
	1988	1989	1990	1991
Auxiliary Forest Tax	$400,000	$400,000	$500,000	$500,000
Tree Growth Tax	600,000	700,000	800,000	1,000,000
Total	$1,000,000	$1,100,000	$1,300,000	$1,500,000

CREDITS

16.06 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 of either 57% or 66% of the net tax, the higher percentage applicable to property located in qualifying municipalities. The credit is limited to specified maximums and, prior to taxes payable in 1990, is calculated on the net tax after the regular homestead credit has been subtracted. Beginning with taxes payable in 1990, the taconite homestead credit is calculated so that a homestead will not have a reduction in net tax of more than 5% over the previous year.

The taconite homestead credit was enacted in 1969 and was last changed in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
Taconite Homestead Credit	$10,900,000	$10,800,000	$7,300,000	$7,300,000

16.07 POWER LINE CREDIT

Minnesota Statutes, Sections 273.42, Subd. 2 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 any forty acre parcel of property. The credit is financed by a portion of the property taxes paid by the transmission lines giving rise to the credit.

The power line credit was enacted in 1979 and became effective for property taxes payable in 1982. It was last changed in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
Power Line Credit	$200,000	$200,000	$200,000	$200,000

CHAPTER 17: AIRFLIGHT PROPERTY TAX

Collections and History

Revenues from the airflight property tax were $7.5 million in fiscal year 1988. The proceeds from this tax go to the state airports fund of the state treasury.

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 mill rate determined therefrom.

Tax Base

The tax base is the value of airflight property of airline companies engaged in air commerce.

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 Federal Aviation Administration.

Privately-used aircraft are subject to the aircraft registration tax (Chapter 19) in lieu of the airflight property tax. A privately-used aircraft that is used occasionally in transportation for hire is not subject to the airflight property tax if the person furnishing the transportation is not in the business of transportation for hire.

The value of the airflight property is determined by the Department of Revenue. The value is apportioned to Minnesota by a three-factor formula. The apportioned value is multiplied by an assessment ratio according to the following schedule:

40% for quiet aircraft (Item 17.02)
70% for other airflight property
50% of the above rates for the airflight property of certain airlines (Item 17.03)

The assessed value is multiplied by a mill rate which is determined by dividing the statutorily specified revenue by the total assessed value. For taxes payable in 1988 the mill rate was 75.74 mills.

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

17.01 COMMUTER AIRLINES

Minnesota Statutes, Sections 270.072, Subd. 2 and 360.521

Generally, commercial aircraft are taxed under the airflight property tax, and noncommercial aircraft are taxed under the aircraft registration tax. However, commuter airlines have the option of having their aircraft taxed under one tax or the other, whichever is lower.

Because commuter airlines could be considered commercial, the exemption of commuter airlines from the airflight property tax because they pay the aircraft registration tax is considered a tax expenditure. The estimates reflect the difference between the aircraft registration tax paid by commuter airlines and the airflight property tax they would pay if subject to that tax.

This provision was enacted in 1969.

	Fiscal Year Impact			
	1988	1989	1990	1991
State Airports Fund	*	*	*	*

PREFERENTIAL VALUATIONS

17.02 QUIET AIRCRAFT

Minnesota Statutes, Section 270.074, Subd. 3(a)

Airflight property is generally assessed at 70% of market value for the airflight property tax. However, quiet aircraft are assessed at 40% of market value. The tax expenditure is measured as the difference between the 40% and 70% assessment ratios.

Quiet aircraft include turboprops and aircraft defined as stage III by the Federal Aeronautics Administration. The classification may be extended to other types of qualifying aircraft through rules adopted by the commissioner of revenue.

This provision was enacted in 1987, effective beginning with taxes payable in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State Airports Fund	$0	$1,000,000	$1,100,000	$1,100,000

*Less than $50,000.

17.03 CERTAIN AIRLINES

Minnesota Statutes, Section 270.074, Subd. 3(b)

Quiet aircraft are assessed at 40% of market value and other airflight property is assessed at 70% of market value. If the airflight property is owned by qualifying airlines, the assessment rate is 50% of the above rates (20% for quiet aircraft and 35% for other airflight property).

To qualify, the majority of the aircraft owned or leased by the airline company must be turboprops, and the airline company must provide scheduled passenger service to three or more airports that serve city or towns with a population of 100,000 or less outside the seven-county Minneapolis-St. Paul metropolitan area.

This provision was enacted in 1987, effective beginning with taxes payable in 1988.

	Fiscal Year Impact			
	1988	1989	1990	1991
State Airports Fund	$0	$600,000	$300,000	$300,000

CHAPTER 18: MOTOR VEHICLE REGISTRATION TAX

Collections and History

In fiscal year 1988, a total of $251 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 only 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.

Tax Base

The tax base for the motor vehicle registration tax is motor vehicles that use the public streets and highways in Minnesota. The exemption of off-road vehicles, such as farm machinery, is therefore not considered to be a tax expenditure.

Historically, the tax has been based on weight, value, or a combination of the two, and currently 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, pick-up 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, from 100% in the first year of vehicle life to 10% for the tenth year. The flat tax for vehicles over ten years old and the minimum tax for all vehicles are both $35 ($10 plus $25 minimum additional tax).

The tax on trucks, tractors, and buses is based on the type, weight, and age of the vehicle. A minimum tax applies, the amount of which is determined by the type of the vehicle.

The tax is paid when the vehicle is first registered and annually thereafter when it is reregistered.

EXEMPTIONS

18.01 LOCAL GOVERNMENT VEHICLES

Minnesota Statutes, Section 168.012, Subd. 1, 6, and 10

Vehicles owned or leased by a political subdivision of the state are exempt from the motor vehicle registration tax. Exempt vehicles include ambulances, fire equipment, utility fleets, police vehicles, and buses owned by city transit companies. Publicly owned or leased school buses are included in the estimate for Item 18.02.

The exemption for government vehicles was enacted in 1921 and was last changed in 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$5,100,000	$5,300,000	$5,500,000	$5,800,000

18.02 SCHOOL BUSES

Minnesota Statutes, Section 168.012, Subd. 1 and 10

Vehicles which are used by Minnesota 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 18.01).

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

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$400,000	$400,000	$400,000	$400,000

18.03 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			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	*	*	*	*

*Less than $50,000.

18.04 MEDAL OF HONOR RECIPIENTS

Minnesota Statutes, Section 168.124

Congressional medal of honor recipients may obtain special license plates with the inscription "Medal of Honor" on them. The recipient is issued these plates, as well as all subsequent tabs, stickers, or replacement plates, free of any charges or tax.

This provision was enacted in 1983.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	*	*	*	*

18.05 DISABLED VETERANS

Minnesota Statutes, Section 168.031

Any motor vehicle which has been furnished either free of charge or at reduced cost by the United States government to a disabled war veteran is exempt from the motor vehicle registration tax.

This provision was enacted in 1941 and was last changed in 1971.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	*	*	*	*

18.06 NONPROFIT CHARITIES

Minnesota Statutes, Section 168.012, Subd.1(a)(3)

An exemption from the motor vehicle registration tax is provided for vehicles owned by nonprofit charities and used exclusively to transport handicapped persons for educational purposes.

This exemption was enacted in 1987, effective July 1, 1987.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	*	*	*	*

*Less than $50,000.

CREDIT

18.07 PHYSICALLY HANDICAPPED PERSONS

Minnesota Statutes, Section 168.021, Subd. 2

Physically handicapped persons may obtain special license plates bearing the internationally accepted wheelchair symbol. Although these plates are subject to the full motor vehicle registration tax, a one dollar credit is allowed for each month the vehicle is registered.

This provision was enacted in 1975 and was last changed in 1976.

In fiscal year 1988, this credit was allowed for 23,500 vehicles.

	Fiscal Year Impact			
	1988	1989	1990	1991
Highway User Tax Distribution Fund	$300,000	$300,000	$300,000	$400,000

CHAPTER 19: AIRCRAFT REGISTRATION TAX

Collections and History

In fiscal year 1988, the revenues from the aircraft registration tax were $1.5 million. All the proceeds from this tax go into the state airports fund of the state treasury. Expenses incurred in administering the tax are reimbursed to the general fund each year.

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 non-commercial 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 Civil Aeronautics Board.

Computation of the Tax

Aircraft subject to the aircraft registration tax are those which are used privately and which use the airspace over Minnesota or the airports in Minnesota.

The value used in the computation of the tax 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 tax is 1% of the value. The minimum tax is the greater of: a) 25% of the tax computed on the original base price; or b) $50.

The tax is paid when the aircraft is first registered and annually thereafter.

EXEMPTIONS

19.01 LOCAL GOVERNMENT AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 2

Aircraft owned and used solely in the transaction of official business by local govenment units are exempt from the aircraft registration tax.

This provision was enacted in 1945 and was last amended in 1965.

	Fiscal Year Impact			
	1988	1989	1990	1991
State Airports Fund	*	*	*	*

19.02 CIVIL AIR PATROL AIRCRAFT

Minnesota Statutes, Section 360.55, Subd. 3

Aircraft owned and used solely in the transaction of offical business by the Civil Air Patrol are exempt from the aircraft registration tax.

This exemption was enacted in 1957 and remains unchanged.

	Fiscal Year Impact			
	1988	1989	1990	1991
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 as a supplement to the governor's budget and at the same time as provided for submission of the budget pursuant to section 16A.11, subdivision 1.

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 chairman 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

APPENDIX B: INACTIVE TAXES

Express Companies Gross Earnings Tax. Minnesota Statutes, Section 295.21

Freight Line Companies Gross Earnings Tax. Minnesota Statutes, Section 295.24

Sleeping Car Companies Gross Earnings Tax. Minnesota Statutes, Section 295.29

Taconite Tailing Tax. Minnesota Statutes, Section 298.24

Semi-Taconite Production Tax. Minnesota Statutes, Section 298.35

Agglomerating Facilities Production Tax. Minnesota Statutes, Section 298.393

Iron Bearing Materials Other Than Taconite and Semi-Taconite Production Tax. Minnesota Statutes, Section 298.405

APPENDIX C: TAXES WHICH CONTAIN NO TAX EXPENDITURE PROVISIONS

Hazardous Waste Generator Tax. Minnesota Statutes, Section 115B.22

Pari-Mutuel Betting Tax. Minnesota Statutes, Section 240.15

Severed Mineral Interests Tax. Minnesota Statutes, Section 273.13

Rural Electric Cooperative Membership Tax. Minnesota Statutes, Section 273.41

Taconite Railroad Gross Earnings Tax. Minnesota Statutes, Section 294.22

Telegraph Companies Gross Earnings Tax. Minnesota Statutes, Section 295.32

Trust Companies Gross Earnings Tax. Minnesota Statutes, Section 295.37

Aviation Fuels Excise Taxes. Minnesota Statutes, Section 296.02 and 296.025

Marine Gasoline Excise Tax. Minnesota Statutes, Section 296.02

Controlled Substances Tax. Minnesota Statutes, Section 297D.08

Taconite Production Tax. Minnesota Statutes, Section 298.24

Unmined Taconite Tax. Minnesota Statutes, Section 298.26

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