MINNESOTA CONSTITUTIONAL STUDY COMMISSION

FINANCE
COMMITTEE REPORT

This report constitutes committee recommendations to the Constitutional Study Commission. See the Final Report for the Commission's action which in some cases differed from the committee recommendations.

November, 1972

COMMITTEE

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All recommendations of the Finance Committee were accepted by the Commission with one minor exception. The 90-day limit on suits to test the validity of state bonds (see pp. 9 and 16) was changed by the Commission to 120 days (see Article IX, Sec. 10, subd. 1).

I. INTRODUCTION

The Finance Committee submits herewith recommendations for changes in the Minnesota Constitution. We have approached our task as an effort to identify those issues which cause problems in the functioning of the state financial system. We are proposing a number of separate amendments to the constitutional provisions relating to financial matters, but are not proposing a comprehensive redrafting of the entire article.

This committee has worked closely with other committees of the Commission, particularly the Transportation Committee regarding highway-user taxes and the railroad gross earnings tax, and with the Education and Natural Resources Committees regarding the trust funds. We are not making recommendations regarding the highway-user tax, believing that to be the province of the Transportation Committee.

Certain recommendations of the Structure and Form Committee and the Executive Branch Committee will also have an impact upon our recommendations.

II. THE "PIGGYBACK" INCOME TAX

Recommendation

The committee recommends amendment of Article IX, Sec. 1, to permit the State to levy taxes computed as a percentage of federal taxes or based on federal taxable income or other terms defined by federal law.

Comment

In levying state income taxes, the Legislature has relied upon the definition of terms which appear in the federal income tax laws, e.g., "adjusted gross income." This method of referring to federal law saves the Legislature the difficulty of adopting and revising the full text of all provisions included in the Internal Revenue Code. It saves the taxpayer the difficulty of computing his taxes twice, once using a federal formula and once using a state formula.

In 1971, the Minnesota Supreme Court ruled that the Legislature may adopt the federal law as the basis for state tax law, but that it may adopt that law only as it exists at a particular moment in time. Wallace v. Commissioner of Taxation, 184 N.W. 2d 588 ruled that the Legislature could not prospectively adopt future amendments and interpretations of the federal tax law from p.3.

Therefore, the advantages of using the federal tax definitions as the basis for state taxes continues only so long as the federal law remains unchanged. As soon as there is a change in federal law, the Legislature must reconsider and readopt the new federal

definitions. The Legislature has, in fact, followed this course and will probably continue to do so. Each session, it amends the State Tax Code so that all references are to be the most recent edition of the Internal Revenue Code.

The Supreme Court decision was based on the language of Article IX, Sec. 1, prohibiting the "contracting away" of the taxing power.

We believe that the use of federal tax definitions is a sensible way to operate a modern state revenue system. We are not concerned that the delegation to Congress of the power to make tax definitions will violate the rights of the citizens of Minnesota. In the first place, Congress is a responsible political body; we are not "contracting away" the power to tax to some private person or company. In the second place, the Legislature would retain the power to repeal the delegation of power, if it became dissatisfied with definitions made by Congress.

Hence we recommend that the Legislature be permitted to use federal tax definitions in administering state taxes, without the need for periodic readoption of the Internal Revenue Code.

III. STATE BORROWING AND PUBLIC IMPROVEMENTS

The Finance Committee recommends substantial changes in the limitations on state borrowing and on the kinds of improvements for which state funds may be expended. A constitutional amendment to accomplish these purposes follows. Since the matter is highly technical, we are setting forth the amendment in full, then providing an explanation of it under separate headings. In summary, our proposal would accomplish the following results:

(a) remove the prohibition on state expenditures for "internal improvements" and replace it with a requirement that state expenditures be for a "public purpose;"

(b) simplify and consolidate the provisions relating to the contracting of public debt by the State;

(c) spell out those cases in which the State could guarantee the payment of loans made to its political subdivisions or agencies and the amount of such guarantee.

As in other financial matters, careful scrutiny of every word and detail is important. We urge those studying this proposal to examine closely the text of our proposal, rather than to rely upon the summary of it.

TEXT OF PROPOSAL: (New language is underlined. Language to be deleted is stricken out.)

A bill for an act

proposing an amendment to the Constitution of the State of Minnesota, amending Article IX, Sections 6 and 10, Article XVI, Section 12, and Article XIX, Section 2, and repealing Article IX, Sections 5, 7, and 11 and Article XVII, for the purpose of redefining and clarifying the purposes and methods for the use of state credit including the incurring of state debt, repealing the prohibition against state participation in works of internal improvements, and eliminating duplicate and obsolete provisions.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. An amendment to the Constitution of the State of Minnesota is proposed to the people of the State for their approval or rejection, under which amendment, if adopted:

(a) Article IX, Section 6 shall be amended to read as follows:

POWER TO CONTRACT ~~PUBLIC DEBTS~~ STATE DEBT; PURPOSES; ~~CERTIFI~~CATES OF INDEBTEDNESS; BONDS. Sec. 6. Subdivision 1. The state may contract ~~public debts~~ debt, for the payment of which its full ~~faith,~~ and credit, and taxing powers may be pledged, at ~~such~~ the times and in ~~such~~ the manner ~~as shall be~~ authorized by law, but only for the purposes and subject to the conditions stated in this section. State debt includes any obligation payable directly, in whole or in part, from a tax of state-wide application on any class of property, income, transaction or privilege, but does not include any obligation which is payable from revenues other than taxes, or any guaranty or insurance of the payment of obligations of state agencies or subdivisions, except in the amount of any state bonds actually issued to provide funds for such payment.

Subd. 2. ~~Public~~ State debt may be contracted:

(a) for the acquisition and betterment of ~~public~~ land, easements, and other ~~public~~ improvements of a capital nature, including purchase, condemnation, site preparation, construction, reconstruction, improvement, extension, replacement, restoration, repair, remodeling, and furnishing ~~and~~;

(b) to provide ~~moneys~~ money to be appropriated or loaned to any agency or ~~political~~ subdivision of the state for such ~~purposes~~ purpose; ~~provided any law authorizing such debt is adopted by the vote of at least three fifths of the members of each branch of the legislature;~~

~~(b) as authorized in any other section or article of this Constitution;~~

(c) to create or maintain a fund to guarantee or insure the payment of obligations incurred by any agency or subdivision of the state for such purpose;

~~(c)~~ (d) for temporary borrowing as authorized in subdivision 3;

~~(d)~~ (e) for refunding ~~outstanding bonds~~ obligations of the state or any of its agencies or subdivisions, whether or not the full faith and credit of the state has been pledged for the payment of ~~such bonds~~ the obligations refunded; ~~and for refunding certificates of indebtedness authorized by the legislature prior to January 1, 1963.~~

(f) for repelling invasion or suppressing insurrection in time of war;

(g) for promoting forestation and preventing and abating forest fires, including the compulsory clearing and improving of wild lands whether public or private.

Subd. 3. As authorized by law, certificates of indebtedness may be issued during ~~each~~ a biennium~~, commencing on July 1 in each odd numbered year and ending on and including June 30 in the next~~

~~odd-numbered-year;~~ in anticipation of the collection of taxes ~~levied~~ for and other revenues appropriated to any fund of the state for expenditure during that biennium. No such certificates shall be issued ~~with-respect-to-any-fund-when-the~~ in an amount ~~thereof~~ which wich interest thereon to maturity, added to the then outstanding certificates against the ~~same~~ fund and interest thereon to maturity, will exceed the then unexpended balance of ~~all-moneys-which-will be-credited-to-that-fund-during-the-biennium-under-existing-laws; except-that~~ money so appropriated. The maturities of ~~any-such~~ certificates may be extended by refunding to a date not later than December 1 of the first full calendar year following the biennium in which ~~such~~ the certificates were issued. If ~~moneys~~ money on hand in any fund ~~are~~ is not sufficient to pay all non-refunding certificates of indebtedness issued on ~~such~~ the fund during any beinnium and all certificates refunding the same, plus interest thereon, which are outstanding on December 1 immediately following the close of ~~such~~ the biennium, the state auditor shall levy upon all taxable property in the state a tax collectible in the ~~then~~ ensuing year sufficient to pay the same on or before December 1 of ~~such-ensuing~~ that year, with interest to the date or dates of payment.

Subd. 4. ~~Public~~ State debt other than certificates of indebtedness authorized in subdivision 3 shall be evidenced by the issuance of ~~the~~ bonds of this state pursuant to a law adopted by the vote of at least two-thirds of the members of each house of the legislature. ~~All-bonds-issued-under-the-provisions-of-this section-shall-mature-within-not-more-than-20-years-from-their respective-dates-of-issue;-and~~ Each law authorizing the issuance of ~~such~~ bonds shall distinctly specify the

purpose or purposes and the maximum amount and maximum term thereof, and the maximum amount of the proceeds authorized to be expended for each purpose, or the officer or agency by whom and the criteria or conditions upon which the amounts and times of expenditures for each purpose shall be determined. The state treasurer shall maintain a separate and special state bond fund on his official books and records, ~~and when~~ to be used only for the payment of the principal and interest of bonds for which the full faith and credit of the state has been pledged ~~for the payment of such bonds~~. The state auditor shall levy each year on all taxable property within the state a tax sufficient, with the balance then on hand in ~~said~~ this fund, to pay all such principal and interest on ~~state bonds issued under the provisions of this section~~ due and to become due ~~within the then ensuing year and~~ to and including ~~July~~ January 1 in the second ensuing year. The legislature may ~~by law~~ appropriate funds from any source to the state bond fund, and the amount of ~~moneys~~ such funds actually received and on hand ~~pursuant to such appropriations prior to the levy of such tax~~ in any year, shall be used to reduce the amount of tax otherwise required to be levied.

(b) Article IX, Section 10 shall be amended to read as follows:

CREDIT OF THE STATE LIMITED. Sec.10. Subdivision 1. The credit of the state shall never be given or loaned in aid of any individual association, or corporation, except ~~as hereinafter provided. Not shall there be any further issue of bonds denominated "Minnesota State Railroad Bonds," under what purports to be an amendment to Section Ten (10) of Article nine (9) of the Constitution, adopted April 15th, 1858, which is hereby expunged from the Constitution, saving, excepting and reserving to the State, nevertheless, all rights, remedies and forfeitures accruing under said amendment. Provided, however,~~

~~that for the purpose of developing the agricultural resources of the state, the State may establish and maintain a system of rural credits and thereby loan money and extend credit to the people of the State upon real estate security in such manner and upon such terms and conditions as may be prescribed by law, and to issue and negotiate bonds to provide money to be so loaned. The limit of indebtedness contained in Section 5 of this Article shall not apply to the provisions of this Section, and~~ for a public purpose paramount to any resulting private use or benefit. The purposes for which the credit of the state ~~or the aforesaid municipal subdivision thereof~~ may be given or loaned as ~~herein~~ provided in subdivision 2 are declared to be ~~public~~ such purposes. The existence of such a purpose for any other grant or loan of state credit authorized by law is subject to judicial review; but no decision of this issue in any action shall impair the validity of any conveyance, contract, or obligation made, entered into, or incurred before the date of the decision or the validity or enforceability of any legal rights or duties created by any such conveyance, contract or obligation unless the action is commenced within 90 days after the adoption of the law. Such an action may be commenced by any citizen.

Subd. 2. The state may appropriate money to establish and maintain special funds to guarantee or insure the payment of obligations of state agencies or subdivisions, including any county or town and any municipal, school, or other public corporation, district, council, board, authority, commission, body, or unit of whatsoever kind, exercising any power of state or local government. However, if such obligations are otherwise payable exclusively from revenues other than taxes, the state shall not become obligated to appropriate money or to incur debt for this purpose in excess of the balance from

time to time on hand in the guaranty or insurance fund.

(c) Article XVI, Section 12 shall be amended to read as follows:

BONDS. Sec.12. The legislature may provide ~~by law~~ in accordance with the provisions of Article IX for the issue and sale of the bonds of the state ~~in such amount as may be~~ for capital expenditures necessary to carry out the provisions of ~~section 2 of~~ this ~~article; provided, however, that the total amount of such bonds issued and unpaid shall not at any time exceed $150,000,000 par value. The proceeds of the sale of such bonds shall be paid into the trunk highway fund. Any bonds so issued and sold shall mature serially over a term not exceeding 20 years. They shall not be sold for less than par and accrued interest and shall not bear interest at a greater rate than five percent per annum. In case the trunk highway fund shall not be adequate to meet the payment of the principal and interest of the bonds authorized by the legislature as hereinbefore provided, the legislature may provide by law for the taxation of all taxable property of the state in an amount sufficient to meet the deficiency, or it may, in its discretion, appropriate to such fund moneys in the state treasury not otherwise appropriated.~~

(d) Article XIX, Section 2 shall be amended to read as follows:

Sec. 2. For the purpose of carrying on or assisting in carrying on such work it may expend monies, including such monies as the legislature may see fit to appropriate, may incur debts, and may issue and negotiate bonds ~~to provide money therefor. The provisions of Section 5 of Article 9 of the Constitution shall not apply to the provisions of this section, and the purposes for which the credit of the state may be given or loaned as herein provided are declared to be public purposes~~ as provided in Article IX.

(e) Article IX, Sections 5, 7 and 11, and Article XVII are repealed.

Sec. 2. This proposed amendment shall be submitted to the people of the state for their approval or rejection at the general election for the year 1974, in the manner provided by law for the submission of amendments to the Constitution. The votes thereon shall be counted, canvassed, and the results proclaimed as provided by law. The ballots used at the election shall have printed thereon the following:

"Shall Article IX, Sections 5, 7 and 11 and Article XVII of the Constitution of the State of Minnesota be repealed and Article IX, Sections 6 and 10, Article XVI, Section 12, and Article XIX, Section 2 thereof amended to redefine and clarify the purposes and methods for the use of state credit including the incurring of state debt, repealing the prohibition upon state participation in works of internal improvements, and eliminating duplicate and obsolete provisions with reference thereto?

Yes _____

No _____"

A. Internal Improvements

In studying limitations upon state indebtedness and upon the purposes for which the State may expend money, the Finance Committee has reached the conclusion that the pertinent provisions of Article IX require substantial amendment.

There have been two major kinds of restrictions upon state borrowing and expenditures. The first of these is the "internal improvements" provisions of Article IX, Sec. 5, coupled with the "public purpose" doctrine which has been developed independently by the courts. The second is the more detailed provisions of Sec.6, relating to the power to contract debt, coupled with limitations on loaning the credit of the State, contained in Sec.10. A number of other provisions are also affected by our recommendations.

The "internal improvements clause" states that "the State shall never be a party in carrying on works of internal improvements" except in certain circumstances. In its original form, this meant that the State could construct buildings or carry on works which were necessary for governmental purposes, but it could not construct buildings or other structures for nongovernmental purposes. Thus the State could spend money for the capitol, or a prison, or schools and universities, all of which were conceded to be governmental purposes, but it could not engage in building roads, railroads, or industrial facilities, or in developing underpopulated regions of the State.

These limitations fit the requirements of a century in which the prevailing political philosophy called for minimal government. They also may have been imposed to prevent the kind of log-rolling which the draftsmen of our Constitution had observed in other states, granting some communities large public subsidies at the expense of the state as a whole.

The "internal improvements" limitations have been modified in three ways over the century since adoption of the Constitution:

1. The first is specific constitutional amendment. Article XVI (highways), XVII (forest fire prevention), XVIII (forestation), and XIX (airports) were all passed to make it possible for the State to spend money for these purposes. The "internal improvements" language had been thought to prohibit state construction of highways, fire breaks, airports, etc., before these amendments were added. Other qualifications to the rule can be found in Secs. 5 and 10 of Article IX.

2. Relaxation of the stringent requirements of the "internal improvements" rule has also come through judicial interpretation. The courts have been increasingly willing to find that state construction projects have a sufficient governmental purpose to make them exempt from the old rule. Thus only recently the courts have held that state support for construction of sewage facilities is not a work of "internal improvement."

3. The third modification is that the constitutional restriction has been held to apply only to the State, not to units of local government. Thus a municipality could engage in works of "internal improvement," like building an auditorium, without running afoul of this constitutional limitation. Municipalities were, however, restricted by a different, judicially developed doctrine which limits public expenditures to "public purposes."

Thus the "internal improvements clause limits some kinds of state expenditures, or at least brings them into question. It serves as an impediment, making many desired programs subject to question. It seldom serves as a total obstacle, since some manner of providing state finance can normally be found through use of one of the exceptions to the doctrine. The usual result is that

there is some question about the constitutionality of the proposed plan. In order to assure leaders and contractors, it is usually necessary to initiate litigation to test the validity of the program. Consequently, there is frequent delay in the implementation of programs.

The "public purpose" doctrine is related to the "internal improvements" doctrine, but must be kept separate. The public purpose doctrine requires that public expenditures be made only for public purposes. It was developed by the courts; there is no explicit language in the Constitution referring to it, although the courts treat it as a matter of constitutional law. It applies both to state expenditures and to the expenditures of local governmental units.

In many cases application of the public purpose doctrine and the internal improvements doctrine have the same result. In other cases one or the other may apply.

The public purpose doctrine is beset by many of the same ambiguities which trouble the internal improvements doctrine. If both public and private interests will benefit from some public expenditure, is the purpose "public" or "private "? Take, for example, industrial development bonds: private companies and their employees benefit from the creation of municipally financed "industrial parks," but there is also a public benefit in reduction of unemployment. A state scholarship plan would provide a private benefit to the recipients of the scholarships, but also a public benefit in greater educational opportunities in the State (from p.15) The litigation is frequently necessary before the bonds are saleable and the expenditure permissible causes needless delay. The exact limitations of the public purpose doctrine must be derived from judicial decisions.

Recommendation

Our proposal eliminates completely the "internal improvements" section of the Constitution. This is accomplished by repealing Section 5. We believe that this obsolete doctrine is now so riddled with exceptions as to provide little protection for the State against unwise spending, while providing many impediments to programs which are generally accepted as wise and desirable. Hence our proposed constitutional amendment would repeal Section 5 of Article IX completely.

We would replace the "internal improvements" limitation with a "public purpose" doctrine, which may, indeed, already apply. (See our proposed amendments to Sec. 10.) The public purpose doctrine has proven more flexible than the internal improvements language. We believe that it should be written into the Constitution and defined there.

In Sec.10, subd.1, we say that state credit may be given or loaned only for a "public purpose paramount to any resulting private use or benefit."

We also specify that the purpose spelled out in subd.2, the creation of guarantee funds, is a public purpose. We hope that it will not be necessary to have judicial review of every bond issue, since most will fall within the category of cases plainly authorized by the Constitution.

In order to reduce the need for time-consuming and costly litigation testing the validity of bonds, we have included the final two sentences of subd. 1. These shift the burden of instituting litigation to those who actually oppose the bond issue or loan of credit.

Present practice makes it necessary for someone to institute litigation to test the validity of bonds under the internal improvements and public purpose standards before they become marketable. No intelligent investor will lend large sums if there is a reasonable doubt that the investment is legal. Hence a test case must be arranged. In one recent instance, the Pollution Control Agency had to sue the State Auditor, in order to obtain a declaration of the validity of bonds which the Legislature authorized. This caused a one year delay and considerable expense.

Our recommendation shifts the burden of challenging the validity of a loan of credit to taxpayers who wish to challenge it. If they believe that an issue is not for a public purpose, they may bring suit within 90 days of enactment of the legislation. The final sentence guarantees them access to the courts, even though the bonds may not yet have been issued. A law suit commenced within this period will determine the validity of any bond issued or credit loaned under the challenged statute, even if the final decision is not rendered until after the 90-day period. After the 90 days, a taxpayer or taxpayers group could still commence litigation but it would not affect the validity of transactions which had already taken place. Such a determination would be prospective only. Thus if no suit was filed in the first 90 days, the State Auditor (or other authorized official) could proceed with the program without waiting for judicial determination in a test case.

If litigation was commenced, there would be real adverse parties, one clearly opposed to the program, one clearly in favor; the courts believe this to be the ideal form for litigation. After the first 90 days, a citizen would retain the right to prevent further loaning of credit or borrowing, but would not have the right

to upset transactions already entered into. We believe that this is fair for protesting taxpayers, yet should simplify and expedite the fiscal business of the State.

B. Power to Contract Debt

The original State Constitution contained a nearly absolute prohibition on state debt. The State was limited to a debt of $200,000. Other sections of the Constitution authorized additional state debt for other limited purposes, for example, to repel invasion (Article IX, Sec.7), to construct highways (Article XVI, Sec.12), to prevent and abate forest fires (Article XVII, Sec.1), to build airports (Article XIX, Sec.2), and to finance the veterans bonus (Article XX, Sec.1).

A constitutional amendment in 1962 removed the ceiling on state debt, but limited the purposes for which it may be issued. With some exceptions long-term state debt may be issued only for capital projects (buildings and other permanent "investments" of the State) and not for current operating expenses. The State may also engage only in short-term borrowing for current expenses. Long-term state debt may be issued only on a vote of three-fifths of each house of the Legislature. (There are some exceptions in which only a majority vote is required.)

Recommendations

Our recommendations on this matter may be found throughout our proposed Sec.6. The proposals are aimed mainly at simplifying the law relating to public borrowing. For a discussion of the proposed amendments to subdivision 1, see the section "Loan of Credit" below. The purposes for which debt may be contracted are spelled out in subdivision 2. The changes are as follows:

Paragraph (a) involves only clarification of existing language.

Paragraph (b) likewise involves only clarification. We are moving the requirements of a three-fifths vote to subd. 4, and making the three-fifths vote applicable to all state borrowing.

Old paragraph (b) is obsolete, since we are including here references to all authorized borrowing in other sections of the Constitution.

Paragraph (c) is new. Its import is discussed below together with the implications of paragraph (e). Paragraph (d) is unchanged, except for the order in which it appears in the list.

Paragraphs (f) and (g) are transferred from other portions of the Constitution. Paragraph (f) was Article IX, Sec.7. Paragraph (g) is the present Article XVII, reduced to its operative provisions.

The changes which we recommend in subdivision 2 are linguistic. We assume that they would have no substantive effect.

In subdivision 4, we do make a number of minor, but substantive changes. First we require all state debt (other than short-term certificates of indebtedness) to be approved by a three-fifths vote of the Legislature. Presently only that debt mentioned in subdivision 2(a) is covered by this requirement. We believe that state borrowing should be supported by more than a bare majority in the Legislature. We have eliminated the 20-year maximum term on bonds; in modern circumstances financing may well be spread out over a longer period. We have also allowed the Legislature to delegate the authority to fix the relative portions of bond revenues to be used for different purposes, although the Legislature itself would have to establish the maximum amount of indebtedness which could be incurred. Thus the Legislature could authorize the issue of bonds for construction of public buildings, but set guidelines (rather than a fixed dollar

sum) for each building.

C. Loan of Credit

Article IX, Sec.10, now prohibits the State from giving or loaning its credit. This essentially means that the State cannot guarantee the debts of others.

Two matters now contained in Section 10, the railroad bonds of 1858 and the rural development credits of the 1920's, are both matters of history. They no longer have practical effect. We are recommending their repeal.

The prohibition on the loaning of credit has presented two kinds of problems in recent years. One of these is the extent to which the State can lend its credit to municipalities. Backing municipal debt with the "full faith and credit" of the State means that, if a city or village or school district fails to pay its bond obligations, the State must pay them. Since there is greater security for the loan, the interest rate is lower. Based on the language of the present Section 10, arguments can be made either way. This leads to unnecessary doubt and delaying litigation.

The second problem is the extent to which State guarantees may be used to insure loans made by private individuals to other private individuals. The provision of low-income housing is one example of this. The interest rates on borrowing for construction of low-income housing may be reduced if there is some element of guarantee on the repayment of the loans. (In some kinds of housing the FHA provides this kind of guarantee to lenders.) Can the State make these guarantees? Should the State be permitted to make these guarantees?

Recommendation

We are recommending substantial revision in this section.

Our recommendation is intended to permit the State to guarantee the borrowing of local government agencies and of state agencies, but to limit the liability of the State in the most risky circumstances. Under our proposal, contained in Section 10, subd. 3 and 4, of the draft, the State could give unlimited guarantee to municipal general obligation bonds, but only limited guarantee to municipal or state revenue bonds.

The State could issue an unlimited guarantee for municipal general obligation bonds which meet the same "public purposes" test required of state bonds. See Section 10, subd. 4. No state bonds would be issued until the municipal bonds fell into default. The State might be able to recover against the municipality by requiring it to levy taxes to reimburse the State. Although the Legislature might put a dollar amount limitation on these bonds, the Constitution would not require it to do so. A municipal bond issue fully guaranteed by the State would have the advantage of a very good credit rating and consequently would carry a lower interest rate.

The Legislature could also guarantee municipal revenue bonds or the revenue bonds of state agencies. Subdivision 3 of Section 10 would limit this guarantee to a single cash amount, designated at the time of making the guarantee, and set aside in a special reserve or guarantee account. Thus the Legislature might grant a $10 million guarantee on a $100 million issue of municipal industrial development revenue bonds. The Legislature would authorize the borrowing of $10 million and place it in a reserve guarantee account. (The money would earn interest until used to pay a guarantee or repay the bonds.) If the municipality defaulted on the original industrial development

bonds, the State would be liable for the $10 million which it had already set aside, but no more. This form of partial guarantee is useful, because total default on bonds is very rare. A similar device is used in New York to guarantee housing bonds, resulting in a bond rating which is only one level lower than the general obligation bonds of the state. While this lowers the interest rate, it also provided substantial protection for the taxpayer against future public liabilities, since the amount of the guarantee has already been borrowed and limited at the time of the guarantee.

The State could also use this device to guarantee the revenue bonds of public agencies, like the Higher Education Facilities Authority.

D. Other Matters

Our major recommendations require a number of other minor amendments to Article IX:

Old Provision	Disposition
Art.IX, Sec.5, Highway user taxes.*	Repealed as redundant. See Art.XVI. No substantive change intended.
Art.IX, Sec.7, Power to borrow to repel invasion, etc.	Repealed, incorporated in Sec.6, subd. 2.
Art.IX, Sec.8, Disposition of funds received for bonds.	Repealed as unnecessary.
Art.IX, Sec.11, Publication of receipts and expenditures.	Repealed as obsolete.
Art.XVI, Sec.12, Bonds for state highways.	Repealed, incorporated into Art.IX,Sec.6,subd.2(a).
Art.XVII, Forest fires.	Repealed, incorporated into Art.IX,Sec.6, subd.2(g).
Art.XIX, Sec.2, Bonds for airports.	Repealed, incorporated in Art.IX, Sec.6,subd. 2(a).

* In transferring authority to borrow for state highway purposes from Article XVI to Article IX, we have made this borrowing subject to the same limitations as other state borrowing. It will now require a three-fifths vote of the Legislature. The maximum rate of interest will be repealed.

E. Summary

We believe that the proposed amendment, relating to the problems of public improvements, borrowing, and the guarantee of municipal borrowing, should serve to alleviate some of the fiscal problems of the State. By substantially clarifying the constitutional limitations on state borrowing, it should make it possible to issue state bonds without the necessity for test cases on the validity of the bonds. This should expedite the accomplishment of the goals sought by the Legislature. When it is necessary to provide "matching" state funds to obtain federal grants for certain purposes, the delay of litigation may well eliminate the possibility of obtaining the funds.

We are also eliminating obsolete provisions that reflect political policy which is no longer current. The State is engaged in transportation services (highways, airports, etc.) and other social service activities which were not thought of when the Constitution was drafted in 1857. Such obsolete provisions as the internal improvements section are a barrier to goals which all would like to see accomplished, yet provide no limitation against other perils facing present governments.

Finally, we believe that this amendment will assist in shortening and simplifying the Constitution.

IV. RAILROAD GROSS EARNINGS TAX

Recommendation

The Finance Committee recommends the repeal of Article IV, Sec. 32(a), the gross earnings tax on railroads. We believe that railroad companies should be treated like all other companies which do business in Minnesota. The Legislature should set the rate and form of taxation, as it does for other businesses in Minnesota.

Comment

The railroad gross earnings tax was adopted in 1871. The tax is currently 5% of the gross earnings of the railroad, paid in lieu of real property tax, business personal property tax, corporate income tax, etc. on their railway operations. The gross earnings tax may have represented a realistic assessment of the railroads' relative share of the fiscal burdens of the State at one time. It does not do so now. Section 32(a) makes it especially difficult to adjust the rate of this tax, since amendments must be submitted to popular referendum, unlike the taxes paid by other business, which are set by the Legislature. Thus, while the corporate income tax (for other businesses) has been adjusted many times in recent years, the railroad gross earnings tax has been unaltered for many years.

We believe that there are adequate methods for assessing and apportioning property taxes and income taxes. We believe that railroads should be treated like all other businesses which

operate in Minnesota.

We conducted a hearing on this matter on May 29 in St. Paul. We are pleased to report a general (although not unanimous) acceptance among the railroad companies of this proposal and a recognition of their obligation to provide equally with other segments of commerce and industry for the finances of the State.

V. STATE TRUST FUNDS

As to state trust funds and their investment, we make no recommendation for constitutional change.

There are three major trust funds. The Permanent School Fund and the Permanent University Fund are provided in Article VIII, Secs. 4 through 7. The Internal Improvements Land Fund is provided in Article IV, Sec. 32(b). In addition, Article IX, Sec. 12, contains some regulations regarding the administration of these funds.

All of the funds reflect the proceeds from lands donated to Minnesota by the federal government at the time of statehood. The State undertook to use the proceeds from these lands for specified purposes. We do not believe that we can or should recommend any change in these uses.

We have not examined the question of administration of lands which are the property of the three trust funds. The Natural Resources Committee has already reported to the Commission on this question. We have only examined the question of the financial management of the money already in the trust accounts.

We believe that the language of the three sections is sufficiently broad to permit the wise investment of the funds. The restrictions on the Permanent School Fund, in particular, are most progressive and up-to-date.

We have been informed that the Structure and Form Committee is recommending the abolition of the Internal Improvements Land

Fund. We do not oppose this suggestion, since the sum in that trust fund is so small that it could reasonably be merged with one of the other trust funds.

VI. OTHER ISSUES

The Finance Committee has considered a number of other issues, but because of lack of time, is making no recommendation on them. We do not believe them to be as important as the matters discussed above. We are listing them here because we do believe they merit further study and attention.

1. The entire question of uniformity in classification in taxation is raised by Article IX, Sec.1. Is this uniformity provision adequate to meet modern needs? Should it be changed, either to restrict the manner in which the Legislature can classify for tax purposes or to open this power still further?

2. Should the State, as well as local municipalities, be clearly authorized to levy special assessments against benefited property? The last clause of the second sentence of Article IX, Sec.2 now permits municipalities to do this. In some cases may it be desirable to have direct state construction or operation of certain kinds of facilities?

3. Should the nearly obsolete provisions of Article IX, Sec.13, dealing with banks and banking law, be repealed? The present language requires a two-thirds vote to pass a banking law. Should this be changed to a majority vote?

4. Should the nearly obsolete provisions of Article IX, Sec.15 be repealed? This section limits the amount of bonds which a

municipality may issue to support railroads. It was inserted into the Constitution in the nineteenth century when many towns and villages were incurring major indebtedness to lure railroads in their direction.

5. Should the provision of Article IV, Sec.10, that revenue bills originate in the House of Representatives, be repealed? This provision was copied from the federal Constitution. It was originally in the federal document because the United States Senate was not popularly elected in the first century of our history.

6. While this report was in preparation, the Committee received a suggestion which it did not have a full opportunity to discuss and evaluate, but which clearly appears to merit further study. This would change Article IX, Sec.10, to provide:

> The credit of the State shall never be given or loaned in aid of any private individual, association, or corporation except for a public purpose paramount to any resulting private use or benefit. Every gift or loan of credit authorized by law is presumed to be for such a purpose, but is subject to judicial review. No payment, contract, right or obligation made, entered into, or created pursuant to law, prior to the institution of litigation questioning the public purpose of the law, shall be invalidated or impaired by a judicial decision that such purpose is not paramount to the resulting private use or benefit.

In effect, this would shift a burden now placed upon public agencies to those who wish to challenge their actions. At the present time, public agencies which issue bonds (or the potential purchasers of bonds or potential contractors) must test the validity of state bonds before they become safe investments. This is expensive and may cause needless delay. Under this proposal, bonds and contracts would be presumed constitutional unless some adverse party instituted litigation to challenge them.

We express no opinion on this proposal but do advise further study.

VII. SUMMARY

The Finance Committee is recommending several changes to the Minnesota Constitution. They are:

1. An amendment to Article IX, Sec.1, which would permit a "piggyback" income tax.

2. A major amendment to Article IX, which would clarify the state's spending authority (repealing the "internal improvements" limitation), its borrowing authority, and its authority to guarantee the borrowing of local government units and state agencies.

3. Repeal of the railroad gross earnings tax and the treatment of railroads on an equal basis with other businesses.

The Committee is recommending no change in the constitutional provisions relating to trust funds.

A P P E N D I X A

A bill for an act

proposing an amendment to the Minnesota Constitution, Article IX, Section 1; providing as the basis for determining income tax, the federal income or federal tax.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. The following amendment to Minnesota Constituion, Article IX, Section 1, is proposed to the people of the state. The section, if the amendment is adopted, shall read as follows:

Section 1. The power ot taxation shall never be surrendered, suspended or contracted away. but a law may adopt as the basis for determining Minnesota income, privilege, or excise tax, either the income or the tax as determined by the laws of the United States for the taxable year of the taxpayer. Taxes shall be uniform upon the same class of subjects, and shall be levied and collected for public purposes, but public burying grounds, public school houses, public hospitals, academies, colleges, universities, and all seminaries of learning, all churches, church property and houses of worship, institutions of purely public charity, and public property used exclusively for any public purpose, shall be exempt from taxation except as provided in this section, and there may be exempted from taxation personal property not exceeding in value $200, for each household, individual or head of a family, and household goods and farm machinery, as the legislature may determine; provided, that the legislature may authorize municipal corporations to levy and collect assessments for local improvements upon property benefited thereby without regard to a cash valuation. The legislature may by law define or limit the property exempt under this

section, other than churches, houses of worship, and property solely used for educational purposes by academies, colleges, universities and seminaries of learning.

Sec. 2. The proposed amendment shall be submitted to the voters for their approval or rejection at the general election for the year 1974. The ballots used at the election shall have the following question printed thereon:

"Shall Article IX, Section 1, of the Minnesota Constitution be amended to enable the legislature to adopt the federal income or a percentage of the federal income tax as the basis for Minnesota income taxation?

Yes _____

No _____"