INDIVIDUAL INCOME TAX
CORPORATE FRANCHISE TAX
SALES AND USE TAX
Subtraction for Pass-Through Income
Reduction of Corporate Tax to 4.8%
Upfront Exemption of Capital Equipment

March 7, 2011

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 10 (Loon)

	Fund Impact			
	F.Y. 2012	**F.Y. 2013**	**F.Y. 2014**	**F.Y. 2015**
	(000's)			
Income Tax Subtraction for Pass-Through Income	$0	($34,200)	($74,900)	($112,100)
Reduction of Corporate Tax Rate	($12,500)	($50,500)	($91,200)	($129,700)
Upfront Capital Equipment Sales Tax Exemption	($93,900)	($48,400)	($21,700)	($16,400)
General Fund Total	($106,400)	($133,100)	($187,800)	($258,200)
Upfront Capital Equipment Sales Tax Exemption				
Natural Resources and Arts Funds	($5,400)	($2,800)	($1,300)	($900)
Total All Funds	($111,800)	($135,900)	($189,100)	($259,100)

For the income tax subtraction and the reduction in the corporate tax rate, effective beginning with tax year 2012.
For the upfront exemption of capital equipment, effective for sales and purchases made after June 30, 2011.

EXPLANATION OF THE BILL

Subtraction for Pass-Through Income
The bill allows a subtraction from Minnesota taxable income for a percentage of nonpassive income received from a partnership or S corporation, provided that the business entity has employees or tangible property located in Minnesota. The percentage is 5% in tax year 2012, 10% in tax year 2013, 15% in tax year 2014, and 20% in all subsequent years.

Reduction of Corporate Tax to 4.8%
The bill reduces the corporate franchise tax rate from 9.8% to 4.8% over a period of ten years. The corporate tax rate is first reduced to 9.3% in tax year 2012, and it is reduced between 0.3 and 0.7 percentage points each year until tax year 2021. In tax year 2021 the rate is reduced to 4.8%. The rate of the alternative minimum tax (AMT) is reduced 5.8% to 2.8% over ten years. The minimum fee would not be changed.

EXPLANATION OF THE BILL (Cont.)

Table1. Ten-Year Phase-In Schedule

Tax Year	Proposed Regular Tax Rate	Proposed AMT Tax Rate
2012	9.3%	5.5%
2013	8.8%	5.2%
2014	8.5%	4.9%
2015	7.8%	4.6%
2016	7.3%	4.3%
2017	6.8%	4.0%
2018	6.3%	3.7%
2019	5.8%	3.4%
2020	5.3%	3.1%
2021 and after	4.8%	2.8%

Upfront Capital Equipment Exemption
The bill would allow businesses to obtain a sales tax exemption on qualifying capital equipment at the time of purchase or lease, without going through the refund process required under current law.

REVENUE ANALYSIS DETAIL

Subtraction for Pass-Through Income
- The House Income Tax Simulation Model (HITS 5.9) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2011. The model uses a stratified random sample of tax year 2008 individual income tax returns compiled by the Minnesota Department of Revenue. The HITS model extrapolates these data for the applicable tax years according to the economic assumptions of Minnesota Management and Budget.
- Tax year impacts were allocated to the following fiscal year.
- About 81,000 tax returns would be affected.
- It is assumed that all partnerships and S corporations from which Minnesota taxpayers receive active income would qualify for the subtraction.

Reduction of Corporate Tax to 4.8%
- Estimates are based on the February 2011 forecast.
- Under present law the ratio between the AMT rate of 5.8% and the regular tax rate of 9.8% is about 59%. During the phase out the corporate tax, the AMT tax rate would be reduced proportionately. Therefore no adjustment is necessary to reflect increased AMT tax collections.

REVENUE ANALYSIS DETAIL (Cont.)

- The estimates assume no interaction with the individual income tax. Income would be subject to a lower rate under the corporate income tax than under the individual income tax. This could provide an incentive for some taxpayers to run the activities of a non-incorporated business through a C corporation. This incentive could increase if federal changes affected the level of tax on corporations compared to individuals. A reduction in individual income tax collections could be possible due to its interaction with this proposal.
- Tax year impacts were allocated 30/70 to fiscal years.
- The 4.8% tax rate fully affects collections beginning in fiscal year 2022.
- About 50,000 corporations are subject to the corporate franchise tax.

Upfront Capital Equipment Exemption

- The estimate was based on capital equipment expenditures for calendar years 2008 and 2009 from the U.S. Census report *Annual Capital Expenditures.* National expenditures were apportioned to Minnesota based on the state's share of the U.S. manufacturing, mining, and electric utility sectors.
- Total estimated qualifying expenditures were adjusted to exclude contractor purchases and non-essential equipment and to include parts, accessories, foundations, and special purpose buildings, which are part of the definition of capital equipment in the sales tax statute.
- Total adjusted expenditures were multiplied by the 6.875% tax rate, and increased annually by growth in expenditures for industrial equipment based on data published in February 2011 by Global Insight, Inc.
- Capital equipment refunds from the February 2011 state revenue forecast were subtracted from total estimated qualifying expenditures to arrive at the core revenue impacts.
- The estimates were further adjusted to account for tax refunds on purchases made before July 1, 2011, which will be paid after the proposal takes effect. A portion of the refunds paid each year reflects tax paid in previous years. Businesses have 3 ½ years from the date of purchase or lease to file refund claims.
- The estimate for fiscal year 2012 was adjusted for the July 1, 2011, effective date (eleven months of impact in the first year).

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy

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