MINNESOTA · REVENUE

INDIVIDUAL INCOME TAX
CORPORATE FRANCHISE TAX
SALES AND USE TAX
Subtraction for Pass-Through Income
Phaseout of Corporate Tax
Upfront Exemption and Expansion of the Capital Equipment Exemption

March 11, 2011

	Yes	No
DOR Administrative Costs/Savings	X	

Preliminary Analysis

States Taxes Only – See Separate Analysis for Property Tax Provisions

Department of Revenue
Analysis of H.F. 841 (Buesgens) Sections 2 through 8

	Fund Impact			
	F.Y. 2012	**F.Y. 2013**	**F.Y. 2014**	**F.Y. 2015**
	(000's)			
Income Tax Subtraction for Pass-Through Income	($59,400)	($63,600)	($74,900)	($78,700)
Phaseout of Corporate Tax	($135,700)	($190,300)	($312,900)	($433,900)
Upfront Capital Equipment Sales Tax Exemption	($93,900)	($48,400)	($21,700)	($16,400)
Capital Equipment Sales Tax Exemption Expansion	($47,300)	($54,800)	($57,200)	($60,300)
General Fund Total	($336,300)	($357,100)	($466,700)	($589,300)
Upfront Capital Equipment Sales Tax Exemption	($5,400)	($2,800)	($1,300)	($900)
Capital Equipment Sales Tax Exemption Expansion	($2,700)	($3,200)	($3,300)	($3,500)
Natural Resources and Arts Funds	($8,100)	($6,000)	($4,600)	($4,400)
Total – All Funds	($344,400)	($363,100)	($471,300)	($593,700)

Income tax subtraction and the phaseout of the corporate tax effective beginning with tax year 2011. Capital equipment upfront exemption and expansion 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 10% of nonpassive income received from a partnership or S corporation.

EXPLANATION OF THE BILL (Cont.)

Phaseout of the Corporate Franchise Tax
The bill reduces the corporate franchise tax rate from 9.8% to 0% over a period of eight years. The corporate tax rate is first reduced to 8.8% in tax year 2011, and it is reduced between 1.0 and 1.5 percentage points each year until tax year 2018. In tax year 2018 the rate is reduced to 0%. The rate of the alternative minimum tax (AMT) is reduced 5.8% to 0% over eight years. The minimum fee would not be changed.

Table1. Eight-Year Phase-Out Schedule

Tax Year	Proposed Regular Tax Rate	Proposed AMT Tax Rate
2011	8.8%	5.2%
2012	7.8%	4.6%
2013	6.3%	3.7%
2014	5.5%	3.3%
2015	3.0%	1.8%
2016	2.0%	1.2%
2017	1.0%	0.6%
2018 and after	0%	0%

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.

Capital Equipment Exemption Expansion
The bill would expand the definition of who qualifies for the capital equipment exemption to certain service industries.

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 80,000 tax returns would be affected.

REVENUE ANALYSIS DETAIL (Cont.)

Phaseout of the Corporate Franchise Tax

- 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.
- 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.
- All of tax year 2011 was allocated to fiscal year 2012. Other tax year impacts were allocated 30/70 to fiscal years.
- The 0% tax rate fully affects collections beginning in fiscal year 2019.
- 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).

REVENUE ANALYSIS DETAIL (Cont.)

Capital Equipment Exemption Expansion

- Affected industries include business providing fabrication labor, prepared food, utilities, telecommunications, and installation labor. Lawn care, building cleaning, pet grooming, car washing, software publishing, and detective services would also be impacted.
- The estimate is based on the Department’s consumption tax model and business sales tax model. The Department’s model estimates sales and use tax paid on capital purchases by purchasing business type.
- The revenue by detailed type of service industry from U.S. Census Annual & Quarterly Service report is used to refine the Department’s model.
- Most telecommunications equipment is already exempt, but this bill would exempt wire, cable, fiber, poles, and conduit.
- Expenditures are increased annually by the growth in expenditures for industrial equipment based on data published in February 2011 by Global Insight, Inc.
- 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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