SALES AND USE TAX
Capital Equipment: Water Pressurization

March 8, 2001

	Yes	No
Separate Official Fiscal Note Requested		X
Fiscal Impact		
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of S.F. 366 (Scheid) / H.F. 1211 (Daggett)

	Revenue Gain or (Loss)			
	F.Y. 2002	**F.Y. 2003**	**F.Y. 2004**	**FY2005**
	(000's)			
General Fund	$(1,650)	$(1,830)	$(1,910)	$(2,010)

Effective July 1, 2001

EXPLANATION OF THE BILL

Current Law: Machinery and equipment essential to the integrated production process are exempt from the sales and use tax when used by the purchaser or lessee primarily for manufacturing, fabricating, mining, or refining tangible personal property to be ultimately sold at retail and for electronically transmitting results retrieved by a customer of an on-line computerized data retrieval system. The definition of exempt capital equipment also includes machinery and equipment used for research and development, repair and replacement parts and accessories, certain computer software, equipment foundations, and special purpose buildings.

The treatment of water is included in the definition of "refining."

To be exempt, the items must be acquired by the user; machinery and equipment purchased by a contractor under a lump-sum contract do not qualify.

The exemption is administered by means of a tax refund. Tax must be paid on the purchase, lease, or use of the equipment and a claim for refund filed with the Department of Revenue.

Proposed Law: The bill adds the pressurization of water to be sold at retail to the definition of refining, making such equipment eligible for the capital equipment exemption.

The bill also amends the statute to exempt materials and the electricity or other fuel used for water treatment and to power pressurization equipment. The exemption of fuels and materials used or consumed in production is available at time of purchase; no refund claim is required.

REVENUE ANALYSIS DETAIL

Capital Equipment

- The capital equipment portion was based on 1996 data from the U.S. Environmental Protection Agency's Water Infrastructure Needs Survey.
- It was estimated that Minnesota's investment in water transmission and distribution equipment averages $68,720,000 annually.
- This amount was reduced by 45 percent to account for installation labor, which was included in the survey.
- It was estimated that 90 percent of the expenditures represent items exempted by the bill.
- The adjusted amount was further reduced by 60 percent to exclude contractor-purchased equipment.
- The resulting figure was increased by 18 percent to include repair and replacement parts, accessories, etc.
- Because this is a capital equipment provision, requiring a claim for refund documenting that the tax has been paid and that the equipment meets the qualifications for exemption, five percent was subtracted off the 1996 base year expenditure amount. The analysis assumed that five percent of potentially qualifying refunds will go unclaimed.
- Annual growth was calculated as the annual percentage change in state and local expenditures for fixed capital according to DRI, Inc.
- The estimate for fiscal year 2002, the initial year of exemption, was reduced by another five percent to account for likely unclaimed refunds in the first year.
- The actual capital equipment impact for each fiscal year may vary depending on the date refund claims are filed and the time required to act on the claims.

Electricity or Other Energy Used to Power Equipment

- The estimate was based on recent State Auditor reports on the operating expenses of city water enterprises.
- It was estimated that 2.5 percent of the total amount was attributable to energy (mostly electricity, some steam) used to power the equipment exempted by the bill.
- The estimated expenses based on the cities' report were increased by five percent to account for other entities that may provide water for sale.
- Annual growth was calculated as the annual change in the gross domestic product price index according to DRI. The estimate for fiscal year 2002 was adjusted to reflect an effective date of July 1, 2001 (11 months of impact).

Number of Taxpayers Affected: State Auditor reports show approximately 700 city water enterprises. The number of other qualifying entities is not known.

ADMINISTRATIVE/OPERATIONAL ISSUES

There are no administrative or operational costs to the Department of Revenue in administering this bill.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/polic.html#analyses

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