SALES AND USE TAX
Capital Equipment Exemption
Repeal of Refund Requirement

March 17, 2004

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

Department of Revenue
Analysis of H.F. 1715 (Osterman) / S.F. 2915 (Tomassoni)

	Revenue Gain or (Loss)			
	F.Y. 2004	F.Y. 2005	F.Y. 2006	F.Y. 2007
		(000's)		
General Fund	$0	($86,500)	($26,800)	($15,100)

Effective for sales and purchases after June 30, 2004

EXPLANATION OF THE BILL

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

To take advantage of the exemption, 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 as a tax refund. Tax must be paid on the purchase, lease, or use of the equipment and a claim for refund submitted to the Department of Revenue. A business may file no more than two claims in a calendar year, but claims can be for multiple purchases and there is no dollar limit to the amounts claimed.

Proposed Law: The bill repeals the refund procedure for capital equipment, making the exemption available at time of purchase or lease.

REVENUE ANALYSIS DETAIL

- The estimate was based on capital equipment expenditures taken from the 2002 U.S. Census report *Annual Capital Expenditures.* The national data were apportioned to Minnesota chiefly on the state's share of the U.S. manufacturing sector's gross product.

REVENUE ANALYSIS DETAIL (cont.)

- Total estimated qualifying expenditures were adjusted to exclude contractor purchases and non-essential equipment and to include parts, accessories, foundations, and special purpose buildings.
- Total adjusted expenditures were multiplied by the 6.5 percent tax rate and increased annually by growth calculated from data from Global Insight, Inc., for February 2004 to arrive at amounts for fiscal years 2005 to 2007.
- Forecast tax refunds were subtracted from the tax on total estimated qualifying expenditures to arrive at preliminary annual revenue impacts.
- The estimates were further adjusted to account for tax refunds for purchases prior to July 1, 2004, which will be paid after the bill's effective date. A portion of the refunds granted each year reflect tax paid in previous years. Businesses have 3-1/2 years from the date of purchase to file claims.

  Note: This "doubling up" phenomenon, with impacts from an up-front exemption plus refund claims payable, is greatest in the first year and declines until after four to five years capital equipment refunds are negligible or sporadic. The revenue impact for the first year is larger than it had been prior to 2003. As part of balancing the state budget for fiscal year 2003, an administrative change was adopted which delays payment of capital equipment refunds by about 90 days. That practice continues and accounts for about $50 million of the revenue loss for fiscal year 2005.

Number of Taxpayers: Estimated at approximately 10,000 potential beneficiaries. Between 2,000 and 2,500 capital equipment refund claims are received each year.

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

hf1715/sf2915-1.doc
/tfe