Individual Income Tax
Corporate Franchise Tax
Cigarette and Tobacco Taxes, Others

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

April 25, 2003

Preliminary Analysis

Department of Revenue
Analysis of S.F. 1504 (Hottinger)

	Revenue Gain or (Loss)			
	F.Y. 2004	**F.Y. 2005**	**F.Y. 2006**	**F.Y. 2007**
		(000's)		
Individual Income Tax				
New Bracket at 9.4% (1/1/04)				
(8.625% for 2003)	$180,000	$248,200	$260,000	$273,300
Corporate Franchise Tax				
Foreign Operating Corporations (1/1/03)	$22,500	$24,500	$24,100	$23,300
Throwback Sales (1/1/03)	$13,900	$15,100	$14,900	$14,400
Dividend Received Deduction (1/1/03)	$43,300	$47,100	$46,300	$44,800
Sales Tax Accelerated June Payment				
Reinstate at 85% (6/04)	$175,320	$11,230	$10,080	$8,660
Cigarette Excise Tax				
Increase of $1 Per Pack (7/1/03)				
Excise Tax	$237,406	$261,539	$263,696	$265,672
Sales Tax	$6,442	$7,184	$7,320	$7,447
Floor Stocks Tax	$25,000	$0	$0	$0
Tobacco Products Tax				
Increased from 35% to 74% (7/1/03)				
Excise Tax	$14,232	$16,069	$16,632	$17,214
Sales Tax	$414	$468	$484	$501
Floor Stocks Tax	$2,500	$0	$0	$0
Accelerated June Payment for Excise				
Taxes at 85% (6/04)	$39,600	$400	$600	$500
General Fund Total	$760,614	$631,790	$644,112	$655,794
Minnesota Future Resources Fund	($1,022)	($1,055)	($1,001)	($949)
Total All Funds	$759,592	$630,775	$643,111	$654,845

EXPLANATION OF THE BILL

Individual Income Tax Rate Increase
This proposal adds a new top bracket at a rate of 8.625% for tax year 2003 and 9.4% for the following years. The new bracket starts at taxable income at $200,000 for married joint, $100,000 for married separate, $113,120 for single, and $170,340 for head of household for tax year 2003. Starting with tax year 2004, the brackets are adjusted annually for inflation. The Department of Revenue is instructed to adjust the withholding tables by July 1, 2003.

Corporate Franchise Tax – Foreign Operating Corporations
Minnesota allows certain income of a unitary group to be classified as the income of a foreign operating corporation (FOC). This income is considered a deemed dividend, and up to 80% of this income may be claimed as a dividend received deduction. A corporation can be classified as an FOC if the average of the percentages of its property and payrolls assigned to locations inside the United States 20% or less.

Under the proposal, the requirements to be classified as an FOC would be changed. For a corporation to qualify, the average of its percentages of property and payroll assigned to locations outside the United States must be 80% or greater. The corporation must also have at least $2 million of property and $1 million of payroll. The dividend received deduction would not be allowed on dividends, interest, royalties, or capital gains received by the FOC included in the deemed dividend.

Corporate Franchise Tax – Throwback Sales
Income is apportioned to Minnesota on a weighted three-factor formula of 12.5% of the Minnesota property ratio, 12.5% of the Minnesota payroll ratio, and 75% of the Minnesota sales ratio. The Minnesota sales ratio is determined by the destination of the sales. However, if the taxpayer has no nexus in the state of destination, the taxpayer is not subject to tax in that state.

The proposal would modify the calculation of the sales ratio if the taxpayer was not taxable in the state of delivery and the property was shipped from an office, factory, warehouse, or other place of storage in Minnesota. In those cases, sales of tangible personal property would be attributed ("thrown back") to Minnesota. A similar change is made regarding sales of services.

Corporate Franchise Tax – Dividend Received Deduction
In computing Minnesota taxable income, a corporation adds back the federal dividend received deduction and determines a separate Minnesota dividend received deduction which is subtracted after income is apportioned. The dividends can be deducted only to the extent they are included in apportioned Minnesota taxable net income. The deduction is 80% of the dividends received from another corporation if the recipient owns 20% or more of the stock of the paying corporation, and it is 70% if the recipient own less than 20%. Under certain circumstances, the deduction can be 100%.

The proposal changes the percentages. If the combined gain of the three corporate provisions is to hit a target of $160 million for the FY 2004-05 biennium, the 100% would be changed 45%, the 80% to 36%, and the 70% to 32%.

Accelerated June Payment for Sales Tax
Under current law the June accelerated payment would be repealed, effective beginning with June 2004. The proposal eliminates the repeal and increases the percentage of June liability paid in June from 75% to 85%.

Cigarette and Tobacco Tax Rate Increases
The excise tax on a pack of 20 cigarettes would be increased by $1 to $1.48. The excise tax on tobacco products other than cigarettes would be increased from 35% to 74% of wholesale price. The tax increases would be effective July 1, 2003. A floor stocks tax would be imposed on cigarettes equal to the tax increase applied to cigarettes in the possession of the distributor, retailer, subjobber, vendor, or manufacturer on July 1, 2003. Similarly, a floor stocks tax would be imposed on tobacco products in the possession of distributors on July 1, 2003. The discount rates for cigarette and tobacco distributors are adjusted.

Under current law, 2¢ per pack of the cigarette tax goes to the Minnesota Future Resources Fund, and 46¢ goes to the general fund. Under the proposal, the Minnesota Future Resources Fund would continue to receive 2¢ per pack, and the general fund would receive $1.46. All refunds would continue to be paid from the general fund.

Accelerated June Payment for the Excise Taxes
Until June 2001, there was an accelerated June payment provision for the excise taxes on cigarettes, tobacco products, and alcoholic beverages. The proposal would reinstate an accelerated June payment for these excise taxes, effective beginning in June 2004. The proposal would require that 85% of the June liability be paid in June.

REVENUE ANALYSIS DETAIL

Individual Income Tax Rate Increase
- The House Income Tax Simulation (HITS) Model version 5.2. was used to estimate the tax year revenue impact.
- These simulations assume the same economic conditions used by the Minnesota Department of Finance for the forecast published in February 2003. The model uses a stratified sample of 2000 individual income tax returns compiled by the Minnesota Department of Revenue.
- In allocating the tax year impacts to fiscal years, a standard rule of thumb formula was applied.
- About 55,100 returns would be affected in tax year 2004.

Corporate Franchise Tax – Foreign Operating Corporations

- Data from the returns received during calendar year 1997, 1998, and 2001 were used to produce estimates for this proposal.
- Since 1997, the revenue loss from FOC provisions in Minnesota law has been growing at an annual rate of up 50%. This analysis assumes most of the revenue decrease between the calendar year 1998 data and calendar year 2001 data was due to non-operating income from corporations classified as foreign operating corporations under Minnesota law.
- Annual percentage changes in overall corporate tax collections as projected by the Department of Finance in the February 2003 forecast are used to estimate subsequent years.
- Number of Taxpayers Affected: About 200 corporations will be affected by the proposal.

Corporate Franchise Tax – Throwback Sales; Dividend Received Deduction

- A model using data from corporate returns received during calendar year 2001 was used to compute the revenue effect.
- Annual percentage changes in overall corporate tax collections as projected by the Department of Finance in the February 2003 forecast are used to estimate subsequent years.

Accelerated June Payment for Sales Tax

- The estimates are based on the amount of the accelerated payment in June 2002 and projections based on the February 2003 forecast.

Cigarette and Tobacco Tax Rate Increases

- February 2003 forecast is used.
- An elasticity factor of -0.550 was used. The Minnesota Future Resources Fund would incur a revenue loss because it would receive 2¢ per pack on a lower level of consumption.
- It is estimated that 25 million packs of cigarettes would be subject to the floor stocks tax, and the floor tax for tobacco products would be 10% of the cigarette floor stocks revenue.

Accelerated June Payment for the Excise Taxes

- The estimates are based on the amount of the accelerated payments in June 2001, the last year for which there was an accelerated payment under prior law. The estimates for taxes under current-law rates were projected based on the February 2003 forecast. The estimates were adjusted to reflect the increase in the cigarette and tobacco taxes contained in this bill.

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