MINNESOTA · REVENUE

Governor's Tax Bill

March 18, 2004

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

Department of Revenue
Analysis of H.F. 3051 (Abrams)/ S.F. 2910 (Belanger)

	Revenue Gain or (Loss)			
	F.Y. 2004	**F.Y. 2005**	**F.Y. 2006**	**F.Y. 2007**
		(000's)		
Individual Income Tax				
- Exempt State Active Service by the National Guard (1/1/04)	$0	($42)	($42)	($42)
Corporate Franchise Tax				
- Change Qualifications for Foreign Operating Corporations (1/1/04)	$0	$1,300	$975	$650
- Single Factor Sales Phased In (1/1/05)	$0	($1,900)	($8,700)	($15,200)
Sales Tax				
- No Contracts with MN State Government Unless Vendor Registered to Collect MN Sales Tax (1/1/05)	$0	$650	$2,600	$4,150
- Up-Front Sales Tax Payment on Motor Vehicle Leases (7/1/04)	$0	$35,600	$18,500	$1,250
- Natural Gas Pipelines Taxable (7/1/04)	$0	$1,600	$3,200	$3,200
- Cigarettes Exempted from Sales Tax; Subject to a New Tax at the Distributor Level (8/1/04)	$0	$7,000	$0	$0
Property Tax				
- Change Market Value Credit Calculation for Fractional Homesteads (starting pay 05)	$0	$0	$500	$500
Biotechnology and Health Sciences Industry Zone				
- Increase Limit on Tax Credit Certificates from $1 million to $2 million for FY04/05	$0	($1,000)	$0	$0
General Fund Total	$0	$43,208	$17,033	($5,492)

EXPLANATION OF THE BILL

A section-by-section summary of the bill is attached.

REVENUE ANALYSIS DETAIL

Exempt State Active Service by the National Guard

- Data provided by the State Department of Military Affairs for 1991 through 2003 shows that the total amount of wages paid for such service varies greatly from year to year. The average wages paid for the last five years was about $700,000.
- At an average marginal tax rate of 6%, the revenue loss is $42,000 for an average year.
- Because wages paid for such service fluctuate greatly depending on the number of Guard personnel in active service and the duration of that service, and because no trends over time are apparent, the average was used for all years, with no growth assumed.

Change Qualifications for 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 corporate tax collections as projected by the Department of Finance in the February 2004 forecast are used to project future revenue impact.
- It is estimated that the proposal would result in a gain in the first year equal to about 5% of the revenue decrease due to non-operating income of FOCs. The gain would tend to decrease over time as corporations made changes to meet the proposed qualifications for an FOC.

Single Factor Sales Phased In

- The revenue estimate is based on data from returns received by the Department of Revenue in calendar year 2001. The model was adjusted to reflect changes in tax law since that time.
- Programs were run against the corporate data to calculate the revenue impact from changing the current law weighting to the series of weightings in the bill.
- No change in revenue is assumed for corporations that have 100% of their economic activity in Minnesota.
- Growth in corporate tax collections as projected by the Department of Finance in the February 2004 forecast is used to project future revenue losses.
- Tax year revenue estimates are allocated to fiscal years using a 30% / 70% ratio.
- This law change also affects the apportionment of income generated by entities other than C corporations, mainly S corporations. The estimate was adjusted to include these other businesses.

REVENUE ANALYSIS DETAIL (cont.)

No Contracts with MN State Government Unless Vendor Registered to Collect MN Sales Tax

- The estimate was based on revenue estimates and actual tax receipts from North Carolina and Virginia, states which have a similar requirement. The base year was FY 2003.
- The numbers from the two states were divided by their respective sales tax rates to arrive at a tax base.
- Apportionment to Minnesota was based on 2001 state population estimates by the U.S. Census Bureau.
- The two states' tax bases were averaged and multiplied by the 6.5% Minnesota sales tax rate.
- Because the proposal would apply to contracts entered into after December 31, 2004, the impact would be phased in, which is reflected in the estimates for fiscal years 2005 and 2006. The estimate for FY 2005 was further reduced to reflect five months of collection. For FY 2007 the full base-year amount was increased 3.5% for expected growth.

Up-Front Sales Tax Payment on Motor Vehicle Leases

- The estimate was based on national personal consumption expenditures for motor vehicle leases as provided by the U.S. Bureau of Economic Analysis. An average of 2002 and 2003 amounts was calculated for a FY 2003 figure.
- This amount was increased by 25% to include leases to businesses.
- The adjusted amount was apportioned to Minnesota at 1.92%, the state's share of U.S. personal income, and multiplied by the 6.5% sales tax rate.
- The estimate assumes that the average lease is three years.
- Annual growth was based on the growth of motor vehicle sales tax according to the February 2004 state revenue forecast.

Natural Gas Pipelines Taxable

- The estimate was based on information from the Census Bureau, sales tax refund claims by gas pipeline businesses, and the Minnesota Office of Pipeline Safety.
- The FY 2005 estimate was reduced by one half because capital equipment refunds would be paid in FY 2005 for purchases made before the effective date of July 1, 2004.

Cigarettes Exempted from Sales Tax; Subject to a New Tax at the Distributor Level

- It is estimated that moving the tax from the retail sale to the purchase by the retailer will accelerate the tax by approximately one month, resulting in a one-time fiscal year shift.
- Based on the February 2004 forecast of the cigarette excise tax, an estimated 335 million packs of cigarettes will be sold in fiscal year 2005, or about 28 million packs per month. At an average retail price of $3.88 per pack, the sales tax on cigarettes is about $7 million per month.

REVENUE ANALYSIS DETAIL (cont.)

Change Market Value Credit Calculation for Fractional Homesteads

- Detailed information on fractional homesteads was obtained from a sample of counties. The information from the sample counties was used to estimate the total for the state.

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

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2004 GOVERNOR'S BILL SUMMARY

MINNESOTA · REVENUE

Appeals & Legal Services Division
600 North Robert Street, Mail Station 2220
St. Paul, MN 55146-2220

ARTICLE 1 INDIVIDUAL INCOME AND CORPORATE FRANCHISE TAXES

Section 1. Foreign Operating Corporation. Amends Minn. Stat. § 290.01, subd. 6b, the definition of foreign operation corporations, requires that the average of the percentages of property and payroll are more than 80 percent outside the United States and requires a minimum amount of property, $2,000,000, and payroll, $1,000,000. The amendments require a foreign operating corporation to be foreign and operating. Effective for tax years beginning after December 31, 2003.

Section 2. Subtractions from Federal Taxable Income. Amends Minn. Stat. § 290.01, subd. 19b, to allow a subtraction for all pay for National Guard service performed at the request of the Governor. The subtraction for National Guard pay is effective for tax years beginning after December 31, 2003.

Section 3. Phase-in of Single Sales Apportionment. Amends Minn. Stat. § 290.191, subd. 2, to replace the present weighted apportionment formula with single sales apportionment over an 8-year period. The table below shows the phase-in.

Tax Year	Sales Factor	Property Factor	Payroll Factor
Present Law	75%	12.5%	12.5%
2005	78%	11%	11%
2006	81%	9.5%	9.5%
2007	84%	8%	8%
2008	87%	6.5%	6.5%
2009	90%	5%	5%
2010	93%	3.5%	3.5%
2011	96%	2%	2%
2012 and later	100%	0	0

Effective the day following final enactment.

Section 4. Phase-in of Single Sale Apportionment for Financial Institutions. Amends Minn. Stat. § 290.191, subd. 3, to adopt the same phase-in above for financial institutions effective the day following final enactment.

Background: Apportionment using more heavily weighted sales factor (or exclusively sales) will generally lower taxes for a corporation whose Minnesota sales factor is lower than the average of its property and payroll factor. Thus, corporations with proportionately larger operations (property and payroll) in Minnesota than their sales (*i.e.*, they export or sell their products outside of Minnesota) will tend to benefit. Conversely, the bill will increase taxes on corporations with the reverse situation, *i.e.*, proportionately more of their sales than of their property and payroll in Minnesota.

Sections 5 and 6. Apportionment Factors for Occupation Mining Taxes. Amends Minn. Stat. § 298.01, subds. 3 and 4, respectively, to clarify that the current 75% sales and 12.5% payroll and property ratio will continue to apply to calculating the occupation mining tax. Effective for tax years beginning after December 31, 2004.

ARTICLE 2 SALES AND USE TAXES

Section 1. State Contracts with Sales and Use Tax Permit Holders. Amends Minn. Stat. § 16C.03 to provide that the department of administration cannot contract for goods or services with any vendor who has not registered to collect sales or use tax on its taxable sales in Minnesota. This section only applies to the executive and legislative branches of government and does not apply to the judicial branch contracts nor does it apply contracts with Minnesota state colleges and universities. Effective for contracts entered into after December 31, 2004.

Sections 2 and 3. Accelerated Sales Tax on Vehicle Leases. Amends Minn. Stat. § 297A.61, subds. 4 and 7, to provide that the sales tax on lease payments on licensed motor vehicles, taxable under the sales tax on motor vehicles, will be accelerated and the tax will be due on the full stream on lease payments when the lease begins and that the lease will be treated as a "sale." Currently leases are treated as a series of sales with multiple obligations and sales tax is due on each lease payment when it becomes due. Effective for leases entered into after June 30, 2004.

Section 4. Sales Tax on Cigarettes. This section provides a sales tax exemption, Minn. Stat. § 297A.67, subd. 32, for the sale of cigarettes that are subject to a new tax under Minn. Stat. § 297F.25 which is imposed upon the sale of cigarettes by distributors to retailers and cigarette subjobbers. Effective for sales and purchases made after July 31, 2004.

Section 5. Industrial Production. Amends Minn. Stat. § 297A.68, subd. 2, to provide that the transportation, transmission or distribution of petroleum, liquefied gas, natural gas, steam, or water through pipes, lines, tanks or mains would not qualify as industrial production. Effective for sales and purchases made after June 30, 2004

Section 6. Capital Equipment. Amends Minn. Stat. § 297A.68, subd. 5, to provide that equipment used primarily in the transportation, transmission or distribution of petroleum, liquefied gas, natural gas, steam, or water through pipes, lines, tanks or mains would not qualify as capital equipment. Effective for sales and purchases made after June 30, 2004.

Section 7. Cigarette Wholesale Tax. Adds a new section, 297F.25. This section provides for a tax on the sale of cigarettes from distributors to retailers and cigarette subjobbers. The tax is imposed at the rate of 6.5 percent of 112 percent of the gross invoice price of the cigarettes from the distributor to the retailer and on 6.5 percent of 112 percent of the presumed cost of doing business by retailers for cigarettes sold to subjobbers. Due dates for payments and returns and all other administrative provisions of Minn. Stat. ch. 297F apply to this tax. The tax is to be deposited in the general fund. The tax is effective for sales of cigarettes made on or after August 1, 2004.

Section 8. Floor Stocks Tax. This section creates a floor stocks tax that is imposed on retailers and subjobbers who have cigarettes in their possession on August 1, 2004. Effective the day following final enactment.

ARTICLE 3 MISCELLANEOUS

Section 1. Use of Unrestricted General Fund Budgetary Surpluses. Amends Minn. Stat. § 16A.152, subd. 2, to allow the commissioner of finance to reduce budgetary shifts in the K-12 education area when a forecast predicts an unrestricted budgetary general fund balance in excess of the statutory levels of the cash flow account and the budget reserve account. The commissioner will first increase aid payment schedules under Minn. Stat. § 127A.45 until it achieves 90 percent, and second will reduce the impacts of the property tax recognition shift under Minn. Stat. § 123B.75, subd. 5. Effective the day following final enactment.

Section 2. Homestead Market Value Credits. Amends Minn. Stat. § 273.1384, subd. 1, to change the computation of homestead market value credits in the case of residential properties that are only partially homesteaded because of split-ownership or an absent spouse. Currently, the credit is computed on only the homestead portion of such properties. However, because the credit phases-out when the market value exceeds $76,000, this often means that a part-owner of homesteaded property receives a smaller tax bill than a full owner would for the same property. The new language changes the credit computation so that it is based on the full value of the residence, reduced to the occupant's percentage of ownership, or to 50 percent in the case of a married couple where only one spouse homesteads the property. Effective for taxes payable in 2005 and thereafter.

Section 3. Biotechnology and Health Sciences Tax Certificates. Amends Minn. Stat. § 469.335 to increase the amount of biotechnology and health sciences tax credit certificates that the commissioner of the department of employment and economic development can issue in fiscal year 2004 from $1,000,000 to $2,000,000. Effective the day following final enactment.

Section 4. Cash Flow Account Transfer. Transfers $350,000,000 from the general fund budget reserve account to the general fund cash flow account on July 2, 2004.

Dated: March 10, 2004