MINNESOTA · REVENUE

Governor's Tax Bill

February 18, 2005

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

Department of Revenue
Analysis of S.F. 753 (Ortman)/ H.F. 660 (Krinkie)

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
	(000's)			
Federal Update				
*Military Family Tax Relief Act of 2003** (retroactive, various dates)	($680)	($330)	($340)	($350)
Medicare Prescription Drug, Improvement, And Modernization Act of 2003				
- Health Savings Accounts (1/1/04)	($6,400)	($3,600)	($3,900)	($4,300)
- Income Exclusion for Federal Subsidies to Employers with Pres. Drug Plans for Retirees (subsidy begins 1/1/06)	($2,900)	($6,200)	($7,100)	($7,800)
Working Families Tax Relief Act of 2004				
- Uniform Definition of Qualifying Child for Various Provisions (1/1/05)	($190)	($160)	($170)	($175)
- Include Combat Pay in Earned Income for Earned Income Credit/Working Family Credit (Tax years 2004 and 2005)	($80)	$0	$0	$0
Extend Expiring Provisions to 2004 and 2005				
- Deduction up to $250 for Teacher Expenses	($2,400)	$0	$0	$0
- Other Provisions*	($1,310)	$90	$55	$45
American Job Creation Act of 2004				
- Increased Expensing with 80% Addback and 5-Year Subtraction (2006 and 2007)	($125)	$1,600	$4,200	$2,175
- All Other Provisions (except Deduction for U.S. Production Activities)*	$8,705	$10,585	$15,420	$15,290
Individual Income Tax				
- Exempt State Active Service by the National Guard (1/1/05)	($42)	($42)	($42)	($42)
- Eliminate Deduction Offset for Long Term Care Insurance Credit (1/1/05)	($300)	($330)	($360)	($400)
- Dairy Investment Credit (1/1/06)	$0	($2,900)	($3,500)	($4,000)
- Change Partnership/S Corporation Withholding Payment from Annual to Quarterly (1/1/06)	$14,200	$900	$950	$1,000

* Detail available upon request.

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
	(000's)			
Corporate Franchise Tax				
- Change Qualifications for Foreign Operating Corporations (1/1/05)	$1,300	$980	$650	$500
- Single Sales Factor Phased In Over Eight Years (1/1/07)	$0	($1,800)	($7,600)	($15,200)
Sales Tax				
- No MN State Govt. Contracts Unless Vendor Collects MN Sales Tax (1/1/06)	$680	$2,730	$4,300	$4,410
- Up-Front Sales Tax Payment on Motor Vehicle Leases (7/1/05)	$27,100	$15,500	$1,400	$1,100
- Natural Gas Pipelines Taxable (7/1/05)	$1,600	$3,200	$3,200	$3,200
- Cigarettes Exempted from Sales Tax, Subject to a New Tax at the Distributor Level (8/1/05)	$5,800	$0	$0	$0
- Repeal Sunset Date for 6.2% Additional Tax on Car Rentals (1/1/06)	$4,740	$14,580	$15,300	$16,090
- Impose 2.5% Gross Receipts Tax on Alcoholic Beverages (1/1/06)	$24,830	$60,040	$61,870	$63,150
Other Taxes				
- Impose Insurance Premiums Tax on Stop-Loss Insurance (1/1/06)	$1,400	$3,700	$4,500	$5,400
- Change Disposition of Solid Waste Management Taxes (7/1/05)	($12,107)	($12,310)	($12,561)	($12,837)
Property Tax Credits and Aids				
- Property Tax Refund for Renters – Change Percent of Rent from 19% to 16% (1/1/05) then 15% (1/1/06)	$0	$30,400	$41,100	$41,500
- Change Market Value Credit Calculation for Fractional Homesteads (starting pay 2006)	$0	$500	$500	$500
- Reduced Reimbursement of Market Value Credit for Certain Cities (2005 and 2006)	$19,300	$19,000	$0	$0

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
	(000's)			
Designated Zones				
- Tax Benefits in the Biotechnology and Health Sciences Industry Zone	($1,000)	$0	$0	$0
- International Development Zone	$0	($700)	($1,050)	($1,050)
Other Provisions				
Eliminate:				
- State-Funded Campaign Checkoff and Appropriation (1/1/05)	$160	$5,400	$160	$2,400
- Political Contribution Refund (7/1/05)	$4,000	$6,500	$4,800	$5,100
General Fund Total	$86,281	$147,333	$121,782	$115,706
Health Care Access Fund				
- Impose Insurance Premiums Tax on Stop-Loss Insurance (1/1/06)	$800	$2,300	$2,700	$3,300
- Exempt Tricare Program Payments from MNCare Taxes (1/1/05)	($1,730)	($1,410)	($1,500)	($1,580)
Health Care Access Fund Total	($930)	$890	$1,200	$1,720
Environmental Fund				
- Change Disposition of Solid Waste Management Tax (7/1/105)	$12,107	$12,310	$12,561	$12,837
Environment Fund Total	$12,107	$12,310	$12,561	$12,837
State Elections Campaign Fund				
- Eliminate State-Funded Campaign Checkoff, Establish Taxpayer-Funded Checkoff (1/1/05)				
Change in Fund Revenues	($80)	($1,950)	($80)	($450)
Change in Fund Expenditures	$80	$1,950	$80	$450
State Elections Campaign Fund Total	$0	$0	$0	$0

EXPLANATION OF THE BILL

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

REVENUE ANALYSIS DETAIL

Federal Update

- The estimates are based on the estimates for the federal legislation prepared by the Joint Committee on Taxation (JCT).
- If both the individual income and corporate franchise taxes would be affected, the federal estimates were divided between the two taxes based on information related to that provision.
- The federal estimates were apportioned to Minnesota based on a measure related to that provision. Federal and state marginal rates appropriate to each provision were then applied.
- The estimates were converted from federal fiscal years to state fiscal years.
- For the proposal to adopt increased expensing with an 80% addback, which would then be deducted in equal parts over the next five years, additional calculations were required. The increased expensing was extrapolated from the JCT estimates. The increased expensing was divided into categories based on the likely distribution by the class life of the property. The difference between current law and the proposal was then calculated for each category for each tax year affected.

Exempt State Active Service by the National Guard

- Data provided by the State Department of Military Affairs for 1991 through 2003 shows that the amount of wages paid for such service varies greatly from year to year. The average of the wages paid for the last five years was about $700,000.
- An average marginal tax rate of 6% yields a revenue loss of $42,000.
- 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.
- An estimated 850 taxpayers would be affected each year.

Eliminate Deduction Offset for Long Term Care Insurance Credit

- Data from the income tax sample for tax year 2002 show that about 4,300 taxpayers both itemized medical expenses and claimed the long term care credit for less than the maximum amount. If those taxpayers had been able to claim the credit at the same average rate as all other filers who claimed the credit, they would have claimed an additional credit amount of about $52 per return, for an additional aggregate credit amount of $225,726.
- Growth of 10% per year is assumed.
- About 5,700 returns would be affected for tax year 2005.

Dairy Investment Credit

- Data sources were an industry survey taken by the Minnesota Department of Agriculture and the 2002 Census of Agriculture published in February and June of 2004.
- Survey participation rate for dairy enterprises is 25%.
- Inflation is assumed to be 1.85% per year.
- Acquisitions of entire farms are assumed not to qualify.
- It was assumed that 33% of the credit generated would be used to offset tax in the first year, with the remainder taken equally in each of the next 12 years.
- Approximately 1,400 farms per year are expected to use this program.

Change Partnership/S Corporation Withholding Payment from Annual to Quarterly

- In calendar year 2003, withholding payments were $9.3 million from partnerships for nonresident partners and $12.8 million from S corporations for nonresident shareholders.
- Collection amounts are projected based on individual income tax growth rates from the November 2004 forecast.
- A quarterly payment schedule would shift 50% of the total annual withholding payment to the preceding fiscal year.
- About 1,270 partnerships and 775 S corporations would be affected.

Change Qualifications for Foreign Operating Corporations

- The revenue estimates are based on data from returns filed in calendar year 2003.
- Runs of tax calculation programs against corporate data were used to calculate the revenue impact of the proposal.
- Growth in overall corporate tax collections as projected by the Department of Finance in the November 2004 forecast is used to project future revenue gains.
- It is assumed that the revenue gain would decrease over time as corporations make changes to meet the proposed requirements for an FOC.
- An estimated 20 to 40 companies would be affected by the bill.

Single Sales Factor Phased In Over Eight Years

- The revenue estimate is based on data from returns filed in calendar year 2003.
- A program was run against corporate data to calculate the revenue effect from changing the current law weighting to the series of weightings in the bill, starting with tax year 2007.
- Growth in overall corporate tax collections as projected by the Department of Finance in the November 2004 forecast is used to project future revenue losses.
- 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 businesses.
- The tax liability of about 9,000 corporations would be affected, including both increases and decreases.

No Minnesota State Government Contracts Unless Vendor Collects Minnesota 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.
- The two states' tax bases were averaged and multiplied by the 6.5% Minnesota sales tax rate.
- Apportionment to Minnesota was based on state population estimates from the U.S. Census Bureau.
- Annual growth of 2.5% was used. Only new contracts are affected so the impact is phased in.

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. The average of the 2002 and 2003 figures was calculated for a FY 2003 base number.
- This amount was increased by 25% to include leases to businesses.
- The adjusted amount was apportioned to Minnesota at 1.7%, the state's portion of national new passenger car and truck registrations, and multiplied by the 6.5% sales tax rate.
- The potential amount of tax was reduced to exclude lease payments for vehicles over 10,000 lb. The adjustment was based on information from a number of sources.
- The potential amount of tax was further reduced by 2.5% to exclude tax currently collected on insurance premiums, service contracts, and vehicle registration tax when these charges are included in periodic lease payments.
- 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 November 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 2006 estimate was reduced by one half because capital equipment refunds would be paid in FY 2006 for purchases made before the effective date of July 1, 2005.
- Annual estimates were held steady because basic qualifying activity for the capital equipment exemption is on-going but major outlays appear to be sporadic.
- An estimated seven companies would be affected.

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 November 2004 forecast of the cigarette excise tax, an estimated 324,650,000 packs of cigarettes will be sold in fiscal year 2006, or about 27 million packs per month.
- At a projected average retail price of $3.31 per pack for fiscal year 2006, the sales tax on cigarettes is estimated to be $5,800,000 per month.
- The new tax would be remitted by seventy distributors.

Repeal Sunset Date for 6.2% Additional Tax on Car Rentals

- The Department of Finance provided estimates of the revenue that would be gained by repealing the sunset date for the 6.2% additional sales tax on short-term car rentals. The estimates are consistent with the November 2004 forecast.

Impose 2.5% Gross Receipts Tax on Alcoholic Beverages

- The Department of Finance provided estimates of the revenue that would be gained by repealing the sunset date for the 2.5% additional sales tax on alcoholic beverages. The estimates are consistent with the November 2004 forecast.
- It is assumed that the revenue under the proposed 2.5% gross receipts tax would be the same as under the additional 2.5% sales tax.

Impose Insurance Premiums Tax on Stop-Loss Insurance

- Tax refund claims information resulting from the decision in *BCBSM, Inc. vs. Commissioner of Revenue* and information from insurance company annual statements were used to estimate stop-loss premiums in calendar year 2003.
- Articles by insurance industry experts indicate stop-loss premiums are expected to increase by 20% or more per year. This estimate is based on an annual 20% growth rate from 2003.
- Tax year data were allocated 40/60 to fiscal years.
- An estimated fifteen insurance companies would be affected.

Change Disposition of the Solid Waste Management Taxes

- The estimates are based on the November 2004 forecast.

Property Tax Refund for Renters

- The base year for the estimates was tax year 2003 returns filed in 2004.
- The PTR model was used to develop these estimates.
- The estimates are consistent with the November 2004 forecast.
- For tax year 2005, the estimated number of renter refund claims is estimated to decrease from 275,000 under current law to 262,000 under the proposal.

Change Market Value Credit Calculations for Fractional Homesteads

- This analysis was completed on a county level, using residential homestead values.
- Proposed credits were calculated on a payable 2003 basis, compared to current law, and the difference computed. Current law 2003 was based on the 2002 assessment abstract, and the 2003 tax list abstract.
- Fractional homestead percentages of total homesteads were from county surveys.
- There are about 3,600 fractional homesteads in the state.

Reduced Reimbursement of Market Value Credit for Certain Cities

- The certified 2003 market value credit reduction equaled about $20 million for 103 cities.
- It was estimated that the 2005 market value credit reduction would be approximately $19.3 million. This amount is slightly less than the certified reduction because some cities have market value homestead credit amounts less than their certified reduction amount. Based on a forecasted decrease in total market value credit payments to cities, it was estimated that the actual reduction amount would continue to decrease.
- Calendar year market value homestead credit payments are made in the following fiscal year.

Tax Benefits in the Biotechnology and Health Sciences Industry Zone

- It is expected that the total amount of authorized tax benefits would be used.

International Development Zone

- The estimates are based on the revenue analysis for S.F. 1801/H.F. 2298 from the 2004 Session.

Eliminate State-Funded Campaign Checkoff and Appropriation

- The estimates for eliminating the state-funded checkoff are based on the November 2004 forecast. The estimates include eliminating the $1.5 million appropriation which would occur in fiscal years 2007 and 2009.
- It is assumed that the total amount from a taxpayer-funded checkoff would be about one-half of the state-funded checkoff.

Eliminate Political Contribution Refund

- On average, about 100,000 individuals receive the $50 political contribution refund annually.
- This estimate corresponds to the November 2004 Department of Finance economic forecast.
- The fiscal year 2006 impact was adjusted to reflect the effective date. It is expected that amounts paid for refund claims in process as of July 1, 2005, will be similar to the historical average monthly refund claims paid in a non-election year for the months of July and August and would be about $350,000. An additional $150,000 will be disbursed in fiscal year 2006 for refund claims filed after July 1, 2005, for contributions made from January through June.

Exempt Tricare Program Payments from MinnesotaCare Taxes

- TriWest Healthcare Alliance is the Department of Defense's contractor that administers the Tricare program in Minnesota, along with 15 other states. In FY 2003, TriWest spent $53.75 million on health care for its Minnesota beneficiaries, and this is expected to grow to $79.2 million by 2009.
- Although Minnesota beneficiaries are able to obtain health care in other states, and beneficiaries from other states are able to obtain health care in Minnesota, it is assumed that these are roughly equal.
- Calendar estimates were allocated to fiscal years. Hospitals and surgical centers make their estimated payments monthly, and health care providers make quarterly payments.

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

2005 GOVERNOR'S BILL SUMMARY

MINNESOTA·REVENUE

Appeals and Legal Services Division
600 North Robert Street
Saint Paul, Minnesota 55146-2220

Bill Date: 02/02/05 (Rev. No. 05-0400)
Summary Date: 02/02/05

ARTICLE 1: INDIVIDUAL INCOME AND CORPORATE FRANCHISE

Section 1. Payment by Partnerships and "S" Corporations of Withholding on Nonresident Income. Amends Minn. Stat. § 289A.20, subd. 2, to require partnerships with nonresident partners to pay the Minnesota withholding on Minnesota source income on a quarterly basis during the year, like all other taxpayers, rather than paying with the entity's return filed after the tax year has ended. Effective for tax years beginning after December 31, 2005.

Section 2. Foreign Operating Corporation. Amends Minn. Stat. § 290.01, subd. 6b, to require a foreign operating corporation to have 80 percent or more of its average of payroll and property, measured as those factors are determined for apportionment of income, outside of the United States. It requires minimum amounts of payroll, $1 million, and property, $2 million, before a corporation can qualify as a foreign operating corporation. It also permits the flow-up of partnership factors, and the aggregation of partnerships, when determining if the payroll threshold is met. Effective for tax years beginning after December 31, 2004.

Section 3. Investment Tax Credit for Dairy Farms. Amends Minn. Stat. § 290.06 to allow a nonrefundable credit against the taxes imposed under Minn. Stat. ch. 290 in the amount of 10% of the amount of purchases of depreciable capital assets, other than farm animals, used in a dairy farm operation. The credit is limited to purchases on or between January 1, 2006 and December 31, 2011. The maximum credit available to any taxpayer over the six year period is $30,000. The $30,000 cap applies at individual, husband and wife, flow-through entities, and corporate levels. Credits that exceed the tax in a year can be carried over to the next year for up to15 years. Effective for tax years beginning after December 31, 2005.

Sections 4 and 5. Long Term Health Insurance Credit. Amends Minn. Stat. § 290.0672, subds. 1 and 2, to provide that taxpayers who use long term health insurance premiums as an itemized deduction in computing federal taxable income can use the same payments to calculate the Minnesota credit similar to a self-employed individual who can only use the payments as a deduction in determining federal adjusted gross income. Effective for tax years beginning after December 31, 2004.

Sections 6 and 7. Apportionment of Income, Single-Factor. Amends Minn. Stat. § 290.191, subds. 2 and 3, to provide for the apportionment of income using a single factor, sales. Amendments to subd. 2 provide for generally applicable single factor apportionment, phased in over eight years. Subdivision 3 is amended to implement single factor apportionment, phased in over eight years, for financial institutions. Effective for tax years beginning after December 31, 2006.

Section 8. Withholding for Individual Independent Contractors Performing Construction Work in Minnesota. Amends Minn. Stat. § 290.92 to require businesses who hire individual independent contractors to perform construction work in Minnesota to withhold and remit to Minnesota 2% of the amount they are paying independent contractors, if the payments are over $600 (level for which payer is required to issue a federal 1099 to the independent contractor) as if the independent contractor were an employee. Effective for payments made after July 31, 2005.

ARTICLE 2: FEDERAL UPDATE

Overview

Minnesota income and franchise tax is based on "federal taxable income" for regular Minnesota tax purposes; "federal alternative minimum taxable income" for Minnesota alternative minimum taxable income; and "federal adjusted gross income" for household income used for the Minnesota dependent care credit, education credit, and property tax refund. The current Minnesota law has adopted these federal concepts as the federal law stood on June 15, 2003. Since June 15, 2003 the federal government has enacted four laws that have changed the concepts.

In late 2003, the Military Family Tax Relief Act of 2003 and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 were enacted. The military act provides a number of new exclusions and deductions for members of the military retroactively effective to the beginning of 2003. The drug act provides for the tax treatment of health savings accounts that were first allowed in 2004.

In late 2004 the Working Families Tax Relief Act of 2004 and American Jobs Creation Act of 2004 were enacted. The Working Families Act extended the sunset dates of a number of expiring tax provisions (teacher material expense, Archer medical accounts, clean fuel vehicle deduction), modified the definitions of "dependent" and "qualifying child" to make them similar, increased the standard deduction available to married couples, and made a number of technical changes. The Jobs Act was a large act that contained a large number of business provisions which limited some business deductions, created some new deductions and closed some perceived loopholes. It also contained provisions allowing the itemized deduction of the greater of state income taxes or state sales taxes and limited the Internal Revenue Code, section 179, expensing of Sport Utility Vehicles (SUV's).

Section 1. Update of Tax Administration Provisions. Amends Minn. Stat. § 289A.02, subd. 7, to adopt federal tax administrative provisions made between June 15, 2003 and December 31, 2004 that Minnesota piggybacks on for state tax administration purposes. None of the four federal acts mentioned in the overview changed federal provisions that Minnesota provisions piggyback upon in Minn. Stat. ch. 289A. Effective the day following final enactment.

Section 2. Update to Federal Definition of Taxable Income. Amends Minn. Stat. § 290.01, subd. 19, to adopt all of the federal changes to taxable income effective at the same time the federal changes were effective. The federal changes of note were:

The Military Family Tax Relief Act of 2003

- Increases the exclusion from income of the death gratuity benefit paid to survivors of members of the military who are killed in the line of duty from $3,000 to $12,000 (also increased the benefit from $6,000 to $12,000). Effective for deaths after September 10, 2001.

- Excludes from taxable income the cost of dependent care assistance provided by the military to a service member. Effective beginning in tax year 2003.

- Excludes from taxable income payments from the Department of Defense Homeowner Assistance program which offset the adverse effects of military base closings on housing values. Effective for payments made after November 11, 2003.

- Suspends the running of the five-year period for purposes of meeting the two out of five year "use of house as principal residence" test used to qualify for the exclusion of the gain on sale of the residence for up to 10 years for members of the military on official extended duty. Effective for sales after May 6, 1997.

- Provides a deduction from federal adjusted gross income for unreimbursed travel, meal, and lodging expenses of members of the National Guard and reserves when they travel at least 100 miles and must stay overnight to attend a guard or reserve meeting. Prior law allowed most of these expenses as a miscellaneous itemized deduction. Effective beginning in tax year 2003.

- Exempts astronauts who lose their life on a space mission from income tax. Effective for deaths after December 31, 2002.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003

- Allows the deduction of contributions to a health savings account (HSA) for individuals with high-deductible medical health plan coverage. The maximum deduction is $2,250 for individuals with self-only coverage and $4,500 for individuals with family coverage. The maximum deduction is $500 higher for individuals age 55 or older, and is increased by an additional $100 per year until tax year 2009, when it will be $1,000 higher than the maximum deduction for individuals under age 55. "High-deductible" plan is defined as having an annual deductible of at least $1,000 for self-only coverage and $2,000 for family coverage, and having a maximum combined deductible and out-of-pocket expense requirement of at most $5,000 for self-only coverage and $10,000 for family coverage. Earnings on amounts contributed to HSAs are tax-exempt. Distributions from HSAs are tax-exempt if used for medical expenses. Effective beginning in tax year 2004.

- Exempts federal subsidies paid to employers who provide prescription drug coverage for their retirees. Provides for federal subsidies to be paid beginning in 2006.

Working Families Tax Relief Act of 2004

- Increase standard deduction for married taxpayers starting in 2005 and ending in 2011 to twice the standard deduction of an unmarried single taxpayer. Old law was 174% for 2005; 184% for 2006; 187% for 2007; 190% for 2008; 200% for 2009 and 2010. In 2011, the deduction reverts back to 170%.

- $250 deduction in the computation of federal adjusted gross income for teachers' unreimbursed expenses for material used in K-12 was extended to apply to 2004 and 2005.

- Fair market value deduction for corporations donating computer hardware and software to charities extended to 2004 and 2005.

- Deduction for purchase of a clean-fuel vehicle in 2004 or 2005 will not phase-out 25% and 50%

respectively. The 75% phase-out in 2006 and complete phase-out of deductions after 2006 will still occur.

- Limit on percentage depletion deduction for marginal production oil and gas wells was removed for 2004 and 2005.

American Jobs Creation Act of 2004

- Phase-out exclusion of net income generated by sales outside the United States (for Minnesota this directly affects some resident individuals and some corporations under Minn. Stat. § 290.01, subd. 19d(17)). The extraterritorial income exclusion phases out 20% in 2005; 40% in 2006; and 100% in 2007 and thereafter.

- Phase in deduction for percentage of net income from manufacturing activities in the United States. For 2005 and 2006, deduction is 3% of the lesser of the taxpayer's taxable income or qualified production activity income. The percentage increases to 6% for 2007, 2008, and 2009, and becomes 9% in 2010 and thereafter. The deduction cannot exceed 50% of the wages paid by the taxpayer.

- The current ability to expense rather than depreciate up to $100,000 of newly purchased business assets was extended to 2006 and 2007. The $400,000 investment limitation was also extended. Without the change, the $100,000 would have been capped at $25,000 and the $400,000 would have reverted to $200,000 starting with assets placed in service after December 31, 2005.

- The ability to expense the business purchase of SUV's over 6,000 lbs. in weight is limited to $25,000 for SUV's placed in service after October 22, 2004.

- Leasehold improvements to real property are allowed to be depreciated over 15 years on a straight line basis rather than over the longer 39 year life of the buildings. Effective for improvements placed in service after October 22, 2004 and before January 1, 2006.

- Improvements to restaurants receive the same treatment as the above leasehold improvements.

- First year 30% bonus depreciation for noncommercial aircraft used in a trade or business is extended for new aircraft first put in service in 2005 but purchased before 2005 (same treatment as passenger and cargo aircraft under the old law).

- Reforestation expenditures can be expensed in the year incurred or paid up to a $10,000 limit. As under the old law, the remaining expenditures are amortized over 84 months. Effective for expenses incurred after October 22, 2004.

- Mail carriers who use their own vehicle to deliver the mail are allowed to claim the excess of their actual vehicle expenses over their employer reimbursement as an itemized deduction of employee business expense starting in 2004.

- Attorneys fees and court costs in wrongful discrimination cases where the recovery of damages is taxable income is changed from an itemized deduction to a deduction allowed in the computation of federal adjusted gross income to the extent of the amount of taxable damages effective for costs paid after October 22, 2004.

- Starting in 2005 the charitable deduction for motor vehicles, boats, or planes donated to a charity is limited to the price the charity receives from selling the vehicle if the item donated is sold "as is" and is worth more than $500. The charity must notify the donor of the use of the item by the charity or the proceeds of the sale, if sold.

- Effective for contributions after June 3, 2004, the deduction for charitable contributions of patents or other intellectual property is limited to the donor's basis in the property or its fair market value. After the property is donated, the donor is allowed to deduct a percentage of the net income generated by the charity from the donated property. The percentage starts at 100% the first two years after donation and decreases 10% each year thereafter until no deduction is allowed in the 13^{th} year.

- Livestock sold because of drought, flood, or weather related conditions are considered to be involuntarily converted for the purposes of deferring the gain on the sale. The period for replacing the sold livestock increased from two years to four years. (Old law only allowed this treatment if livestock was sold because of soil contamination.)

- In 2004 and 2005, individuals are allowed to deduct as an itemized deduction the greater of the state income taxes they pay or the state sales and use tax they pay on consumer purchases.

- Current law requires that a rural electric co-op is only a tax exempt entity if at least 85% of its income is derived from its members. The new law effective for tax years beginning after October 22, 2004, excludes from the income used in the 85% test, income derived from the sale of transmission service or ancillary service provided on a nondiscriminatory open market basis. Provision sunsets after December 31, 2006.

- In the case of the exclusion of gain on the sale of a personal residence if the residence was acquired in a like-kind exchange, the residence must have been owned by the taxpayer for at least five years to qualify for the exclusion. The old law only required at least two years of ownership to qualify. Effective for sales after October 22, 2004.

- For property leased to tax exempt entities under a lease entered into after March 10, 2004, the amount of deduction allowed to the lessor is limited to the amount of lease income for the tax year. Excess deductions are carried forward to succeeding tax years.

- A corporation is only allowed to deduct entertainment expenses for amounts incurred for a corporate officer, 10% or more shareholder, or director to the extent the expenses are included in the income of the officer, shareholder, or director. Effective for expenses incurred after October 22, 2004.

- For movies and television shows made in the United States (75% of compensation paid for work in the United States), the first $15 million of expense of production costs of taxpayers can be deducted in the year rather than deducted on an income forecast method as prescribed under the old law. The $15 million is increased to $20 million if production is made in a low income community. Effective for productions started after October 22, 2004 and sunsets after December 31, 2008.

- The income forecast method of depreciating the cost of a film or television show was changed to include the cost of projected future residuals and participations in the adjusted basis of the film or show. Effective for films or shows placed in service after October 22, 2004.

- Business start-up expenses of up to $5000 may be deducted in the year the business starts (taxpayer election). The remaining expense must be amortized over 180 months. The old law, which applies if the election is not made, provides for amortizing all the start-up expenses over 60 months. Effective for start-up costs paid after October 22, 2004.

- The price paid for sports franchises and player contracts is treated as any other intangible business asset, amortized over a fifteen year period. Old law allowed more rapid deduction of the purchase price. Effective for franchises and contracts acquired after October 22, 2004.

- Exclusion from income of a health care worker in certain areas for the amount of student loans paid by the National Health Service Corporation Loan Program. Effective for 2004 and thereafter.

- The ability of employees to defer the recognition of income from unqualified deferred compensation was limited by making the requirements to define both funded and unfunded unqualified deferral compensation plans harder to attain. Effective for income deferred after December 31, 2004.

- Where a corporation is transferring assets in a tax free transaction from an entity not subject to United States tax and the transferee's basis in the transferred assets is greater than the fair market value of the assets, the transferor's tax basis in the acquired assets is the fair market value of the assets rather than the transferee's tax basis as was the case under the old law. Effective for transactions after October 22, 2004.

- The definition of disqualified debt instrument (debt that will be repaid in stock of the issuer of debt or in stock owned by issuer) was expanded. Interest deduction by the debtor is not available for interest on disqualified debt instruments. Effective for debt issued after October 3, 2004.

- Currently deductible charitable contributions for tidal wave relief made in January of 2005, at the election of the taxpayer, can be deducted as a charitable contribution for the 2004 tax year. Effective for the calendar 2004 tax year.

Section 3. Additions to Federal Taxable Income for Individuals, Trusts, and Estates. Amends Minn. Stat. § 290.01, subd. 19a, to require individuals, trusts, and estates to add back to federal taxable income the new manufacturer's deductions; the difference between the standard deduction for married couples allowed under the 2003 Internal Revenue Code and the deduction allowed under the current Internal Revenue Code; 80% of the difference between the I.R.C. section 179 expenses allowed under the 2003 Internal Revenue Code; and the amount allowed under the current Code; and the amount of deduction a taxpayer claims for non-business state sales and use tax, but only to the extent the deduction generates a federal tax benefit using the 2003 Internal Revenue Code standard deductions. Generally effective for tax years beginning after December 31, 2004, except add-back of consumer sales taxes deducted is effective for tax years beginning after December 31, 2003.

Section 4. Subtractions from Federal Taxable Income for Individuals, Trusts, and Estates. Amends Minn. Stat. § 290.01, subd. 19b, to allow a subtraction for one fifth of the addition required for I.R.C. section 179 expenses in section 3 above which exceeds the taxpayer's net operating loss generated in the year of the addition, in each of the 5 years succeeding the year of the addition (similar to the subtraction for bonus depreciation). Also allows those taxpayers who do not itemize deductions on their federal returns to elect to use contributions made in January 2005 for tidal wave relief when computing their 2004 Minnesota charitable contributions. Finally, allows a subtraction for all federal active duty pay and state payments to National Guard members for state active duty within the state of Minnesota. Effective for tax years beginning after December 31, 2004, except that the charitable contribution change is effective for contributions made in January, 2005.

Section 5. Additions to Federal Taxable Income for Corporate Franchise Tax. Amends Minn. Stat. § 290.01, subd. 19c, to require "C" corporations to add to federal taxable income the new federal manufacturer's deduction and 80% of the difference between the I.R.C. § 179 expenses allowed under the code and the amount that would have been allowable under the 2003 Internal Revenue Code (similar to a modification made by individuals). Effective for tax years beginning after December 31, 2004.

Section 6. Subtraction from Federal Taxable Income for Corporate Franchise Tax. Amends Minn. Stat. § 290.01, subd. 19d, to allow a subtraction from federal taxable income for one fifth of the amount of add-back for I.R.C. § 179 expenses required in section 5 above, in each of the five years succeeding the year of add-back. Effective for tax years beginning after December 31, 2004.

Section 7. Update to Other References to the Internal Revenue Code in Chapter 270. Amends Minn. Stat. § 290.01, subd. 31, to adopt federal changes to federal adjusted gross income used for computing individual alternative minimum tax and household income which is used to compute the dependent care and education credit; changes to the definitions of "dependent" and "qualified child" used for the individual refundable credit; change to the federal earned income tax credit; and the changes to qualifications for electing "s" corporation status. The main changes to federal adjusted gross income are described in section 2.

The federal changes to "dependent child" and "qualified child" were designed to make the two terms synonymous. The main change in "dependent child" is that under the old dependency test the taxpayer must have provided more than half of the support of the child. Under the new test the child meets the test if the child does not provide more than half their own support (scholarships are disregarded). The three tie breakers where more than one taxpayer can claim a child are: 1) closeness of relationship, 2) if two parents can claim child, the tie breaker goes to the parent whom the child lived with longer, or 3) if the child lived with each parent the same amount of time during the year, the child is the qualifying child of the parent with the higher adjusted gross income

For the federal earned income credit that Minnesota uses as a basis for the Working Family Credit, the new federal law provides that combat pay which is excluded from federal adjusted income and earned income for employment tax purposes, if elected by the taxpayer, is nevertheless earned income for purposes of generating the federal earned income tax credit for tax years 2004 and 2005.

In the area of "S" corporations the main change was to increase the number of shareholders a corporation electing "S" status can have from 75 to 100 shareholders and to treat families (parents, children, grandchildren, aunts, uncles, nieces, nephews, as opposed to just husband and wife) owning stock in one corporation as one shareholder. Effective for 2005 and thereafter.

The proposed Minnesota changes would adopt the federal changes effective at the same time the federal changes were effective.

Sections 8 and 9. Technical Change to Additional Tax on Certain Lump Sum Pension Plan Distribution. Amends Minn. Stat. § 290.032, subds. 1 and 2, to correct an obsolete cite to a section of the Internal Revenue Code that has been removed from the Code and made an uncodified provision of federal law. Effective for tax years beginning after December 31, 1999.

Section 10. Change in Ratio Non-resident Individuals Use to Compute Minnesota Tax for Federal Changes Not Adopted. Amends Minn. Stat. § 290.06, subd. 2c to provide that the numerator of the ratio used by non-residents, which is Minnesota assignable federal adjusted gross income, is modified for the portion of the additions for the manufacturing and I.R.C. § 179 expensing additions and subtractions to the extent the modifications are assignable to Minnesota. The denominator is modified by the total amount of the modifications. Effective for tax years beginning after December 31, 2004.

Section 11. Household Income Change for Dependent Care Credit and Education Credit. Amends Minn. Stat. § 290.067, subd. 2a, to provide that the new manufacturer’s deduction and deductions for contributions to health savings accounts are not allowed as deductions in computing household income which is used to phase out the dependent care and education credits. Effective for tax years beginning after December 31, 2003.

Section 12. Old Standard Deduction Used in the Computation of Marriage Penalty Credit. Amends Minn. Stat. § 290.0675, subd. 1, provides that in calculating the marriage penalty credit (additional amount a married couple pays in Minnesota tax over what they would have paid as two single taxpayers which is attributable to the tax brackets) the old federal standard deduction rather than the new standard deduction is used, since Minnesota is not adopting the new standard deduction. Effective for tax years beginning after December 31, 2004.

Section 13. Change to the Individual Alternative Minimum Tax. Amends Minn. Stat. § 290.091, subd. 2, to include the new additions for I.R.C. § 179 expenses and the manufacturer’s deduction and the new subtraction for I.R.C. § 179 expenses in the computation of Minnesota alternative minimum taxable income. Effective for tax years beginning after December 31, 2004.

Section 14. Household Income for Property Tax Refund. Amends Minn. Stat. § 290A.03, subd. 3, to make parallel changes to the definition of household income for the property tax refund, as were noted in section 11. Effective for property tax refunds based on household income for 2004 and thereafter.

Section 15. Update of References to Internal Revenue Code in the Property Tax Refund Chapter. Amends Minn. Stat. § 290A.03, subd. 15, to adopt the federal changes that affect household income which uses the definition of federal adjusted gross income as a starting point and the definition of a dependent, as discussed in sections 2 and 7. It should be noted that the new federal exclusions and exemptions from federal adjusted income will still not be applicable to the computation of household income. Only new federal deductions from income that are not specifically mentioned in section 11 will lower household income from current law. Effective for property tax refunds based on property taxes payable on or after December 31, 2004 or rent paid after December 31, 2004.

ARTICLE 3: SALES, USE, AND SPECIAL TAXES

Section 1. State Contracts with Sales and Use Tax Permit Holders. Amends Minn. Stat. § 16C.03 to provide that the department of administration and the legislature must cancel a contract for goods or services with any vendor or bar a vendor from future contracts 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. The commissioner of revenue shall provide to the department of administration and the legislature a list of vendors who are subject to being debarred or having their contracts cancelled. The proposal provides that the cancellation and debarment provisions may be waived if the vendor is the sole source of goods or services, in the case of an emergency or when it is in the best interests of the state. Effective for contracts entered into after December 31, 2005.

Section 2. Tricare Program. Amends Minn. Stat. § 295.53, subd. 1, by adding an exemption from the MinnesotaCare tax for payments received under the federal Tricare program. Tricare is a medical program for active duty members, retirees and their dependents. The new provision clarifies that enrollee deductibles, coinsurance, and co-payments are subject to tax. Effective for gross revenues received under the federal Tricare program after December 31, 2004.

Section 3. Liquor Gross Receipts Tax. Amends Minn. Stat. ch. 295 by adding a new section 295.75. The additional 2.5 percent sales tax on alcoholic beverages is scheduled to end on December 31, 2005. This is a proposal to replace this revenue by enacting a 2.5 percent gross receipts tax on retail liquor sales.

Subd. 1. Definitions. For purposes of this tax, the following terms are defined: commissioner, gross receipts, liquor, liquor retailer, and retail sale.

Subd. 2. Gross receipts tax imposed. This subdivision provides for the imposition on each liquor retailer of a 2.5 percent tax on gross revenues from the sales in Minnesota of liquor.

Subd. 3. Use tax; credit for taxes paid. This subdivision provides for a use tax and a credit for taxes paid to another jurisdiction.

Subd. 4. Tax collection required. This subdivision requires certain liquor retailers with nexus in Minnesota to collect the use tax.

Subd. 5. Taxes paid to another jurisdiction; credit. This subdivision provides that a liquor retailer that has paid a similar tax to another jurisdiction is entitled to a credit for the tax paid to another jurisdiction.

Subd. 6. Exemptions. This subdivision provides that all the exemptions applicable to the sales and use taxes are applicable to the taxes imposed under this section.

Subd. 7. Sourcing of sales. This subdivision provides that all of the sourcing provisions related to the sales and use taxes apply to the taxes imposed by this section.

Subd. 8. Payment; reporting. This subdivision provides that the reporting must be made on a form prescribed by the commissioner and that the tax must be filed and paid using the filing cycle and due dates provides for the taxes imposed under chapter 297A.

Subd. 9. Administration. This subdivision provides that the audit, assessment, refund, penalty, interest, enforcement, collection remedies, appeal and administrative provisions of chapter 270 and 289A that are applicable to the sales and use taxes apply to the taxes imposed under this section.

Subd. 10. Interest on overpayments. This subdivision provides that interest must be paid on an overpayment or credited to the taxpayer from the date of payment of the tax until the refund is paid or credited; and the date of payment is the due date of the return or the date of actual payment of the tax, whichever is later.

Subd. 11. Deposit of revenues. This subdivision provides that the commissioner shall deposit all revenues, including penalties and interest, derived from the tax imposed by this section in the general fund.

This section is effective for sales and purchases occurring on or after January 1, 2006.

Section 4. Motor Vehicle Leases. Amends Minn. Stat. § 297A.61, subd. 4, to provide that a retail sale occurs for leases of most licensed motor vehicles when the lease is executed. For leases of vehicles with a gross weight rating greater than 10,000 pounds and leases of vehicles for not more than 28 days, a retail sale occurs each time period when an obligation to make a lease payment becomes due. Currently, all leases of motor vehicles 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, 2005.

Section 5. Motor Vehicle Lease Sales Price. Amends Minn. Stat. § 297A.61, subd. 7, to provide that the sales price for a lease of a motor vehicle, subject to the acceleration of sales tax, is the total amount of consideration to be paid during the term of the lease. The section also provides how to calculate the sales price when charges are determinable at the time the lease is executed and when the lease is open-ended. Effective for leases entered into after June 30, 2005.

Section 6. 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, 2005.

Section 7. 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. This provision does not apply to blending of petroleum or biodiesel fuel. Effective for sales and purchases made after June 30, 2005.

Section 8. 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. This provision does not apply to machinery or equipment used to blend petroleum or biodiesel fuel. Effective for sales and purchases made after June 30, 2005.

Section 9. Motor Vehicle Leases. Adds a new section to Minn. Stat. ch. 297A, that provides how to calculate the motor vehicle lease price when an accelerated sales tax is due on a motor vehicle lease. The section provides that sales tax may be refunded when a lease is terminated within 90 days or when the vehicle is returned to the manufacturer under Minnesota's "Lemon Laws." This section also provides how a lease is taxed in Minnesota when the lease originated in another state and provides a credit for taxes paid to another state if the other state had previously taxed the lease payments. Effective for leases entered into after June 30, 2005, and for vehicles registered in Minnesota after June 30, 2005, if the lease originated in another state.

Section 10. Bad Debt. Amends Minn. Stat. § 297F.14, subd. 4, that contains the cigarette tax bad debt provisions to clarify when the offset may be claimed and that any recovery of the debt must be reimbursed to the commissioner. Effective for claims filed on or after July 1, 2005.

Section 11. Cigarette Sales Tax. Adds a new section, Minn. Stat. § 297F.25. This section provides for a tax on the sale of cigarettes from distributors to retailers and cigarette subjobbers.

Subd. 1. Imposition. The tax is imposed at the rate of 6.5 percent of the weighted average retail price that must be determined annually by the commissioner of revenue by surveying cigarette retailers statewide.

Subd. 2. Payment. This subdivision provides that the tax payments must be made on the same dates prescribed for the cigarette excise taxes.

Subd. 3. Return. This subdivision provides that the tax return must be filed on the same dates prescribed for the cigarette excise tax returns.

Subd. 4. Form of Return. This subdivision provides that the tax return must contain the information and be in the form prescribed by the commissioner.

Subd. 5. Tax as Debt. This subdivision provides that the tax is required to be collected by the distributor and is a debt from the retailer or subjobber to the distributor recoverable at law in the same manner as other debts and that retailers and subjobbers must pay the tax to the distributor before the 12th day of the month following the month in which the cigarettes were purchased from the distributor.

Subd. 6. Sales Tax Stamp. This subdivision provides that payment of the cigarette tax and of the tax imposed by this section is evidenced by a dual purpose single stamp affixed to each package.

Subd. 7. Administration. This subdivision provides that the administrative provisions of Minn. Stat. Chapter 297F apply to this tax.

Subd. 8. Deposit of Revenues. This subdivision provides that the tax and penalties and interest are to be deposited in the general fund.

This section is effective for all sales made on or after August 1, 2005.

Section 12. Allocation of Revenues. Amends Minn. Stat. § 297H.13, subd. 2, that provides for the allocation of the revenues collected by the solid waste management tax to (1) appropriate annually to the department of revenue the amounts necessary to cover its costs in administering these taxes and (2) increases the revenues going to the environmental fund from $22 million or 50 percent of the amounts remitted, whichever is greater, to $33,760,000 or 70 percent of the amounts remitted, whichever is greater. This section is effective for amounts remitted on or after July 1, 2005.

Section 13. Direct Business. Amends Minn. Stat. § 297I.01, by adding a new subdivision to define direct business and include premiums related to stop loss coverage. This would overturn the Minnesota Supreme Court decision in *BCBSM, Inc. vs. Commissioner of Revenue,* 663 N.W.2d 531 (Minn. 2003) decided on June 12, 2003. Effective for insurance premiums received after December 31, 2005.

Section 14. Disposition of Proceeds. Amends Minn. Stat. § 473.843, subd. 2, that provides for the disposition of proceeds collected through the Metropolitan Solid Waste Landfill Fee to appropriate annually to the department of revenue the amounts necessary to cover its costs in administering this fee. Effective for amounts remitted on or after July 1, 2005.

Section 15. Rental Motor Vehicle Tax. 2001 Minn. Laws, 1st Spec. Sess., ch. 5, art. 12, sec. 95 is amended to reimpose the rental motor vehicle tax that was scheduled to be repealed effective for sales and purchases made after December 31, 2005. Effective the day following final enactment.

Section 16. Floor Stocks Tax. This section creates a floor stocks tax that is imposed on all persons engaged in the business in this state of selling cigarettes as distributors, retailers, subjobbers, vendors, manufacturers, or manufacturer's representatives who have stamped cigarettes and unaffixed stamps in their possession on August 1, 2005. Effective August 1, 2005.

ARTICLE 4: INTERNATIONAL ECONOMIC DEVELOPMENT ZONE

Section 1. Property Tax Exemption. Amends Minn. Stat. § 272.02 by adding a subdivision to provide for an exemption from property tax for improvements to real and personal property located in the International Economic Development Zone and used as a regional distribution center. Also provides an exemption for any other improvements to real and personal property located in the Zone that are occupied by July 1 of the assessment year by a qualified business conducting freight forwarding operations. Effective beginning for property taxes payable in 2008.

Section 2. Subtraction from Federal Taxable Income for Individuals, Estates and Trusts. Amends Minn. Stat. § 290.01, subd. 19b, to provide for a subtraction from income for tax-free International Economic Development Zone income (as discussed in Section 18). Effective for tax years beginning after December 31, 2006.

Section 3. **Taxable Income of a Corporation**. Amends Minn. Stat. § 290.01, subd. 29, to provide an exemption from corporate taxable income for International Economic Development Zone income (as discussed in Section 19). Effective for tax years beginning after December 31, 2006.

Section 4. Taxation of Nonresidents. Amends Minn. Stat. § 290.06, subd. 2c, to provide that tax-exempt International Economic Development Zone income is excluded from the numerator and denominator of the nonresident allocation fraction. Effective for tax years beginning after December 31, 2006.

Section 5. International Economic Development Zone Job Credit. Amends Minn. Stat. § 290.06 by adding a new subdivision allowing a refundable credit against tax for job creation in the International Economic Development Zone (as discussed in section 20). The provision is effective the day following final enactment, but no credits will be allowed until tax year 2007.

Section 6. Child and Dependent Care Credit. Amends Minn. Stat. § 290.067, subd. 1, to clarify that individuals with exempt International Economic Development Zone income must prorate their child and dependent care credit in the same manner as a nonresident. Effective for tax years beginning after December 31, 2006.

Section 7. Working Family Credit. Amends Minn. Stat. § 290.0671, subd. 1, to clarify that individuals with exempt International Economic Development Zone income must prorate their working family credit in the same manner as a nonresident. Effective for tax years beginning after December 31, 2006.

Section 8. **Individual Alternative Minimum Taxable Income**. Amends Minn. Stat. § 290.091, subd. 2, to allow a subtraction from individual alternative minimum taxable income for tax exempt International Economic Development Zone income. Effective for tax years beginning after December 31, 2006.

Section 9. Corporate Alternative Minimum Taxable Income. Amends Minn. Stat. § 290.0921, subd. 3, to allow a subtraction from corporate alternative minimum taxable income for tax-exempt International Economic Development Zone income. Effective for tax years beginning after December 31, 2006.

Section 10. Minimum Fee Exemption. Amends Minn. Stat. § 290.0922, subd. 2, to exempt from the minimum fee any qualified business with all of its Minnesota payroll and property in the International Economic Development Zone. Effective for tax years beginning after December 31, 2006.

Section 11. **Minimum Fee Modification.** Amends Minn. Stat. § 290.0922, subd. 3, to exclude zone payroll and zone property of a qualified business from the calculation of the minimum fee. Effective for tax years beginning after December 31, 2006.

Section 12. Sales Tax Exemptions. Amends Minn. Stat. § 297A.68 by adding a new subdivision allowing an exemption from state and local sales and use tax for purchases of tangible personal property or taxable services purchased for use in the International Economic Development Zone by a qualified business that has signed a business subsidy agreement. Effective the day following final enactment but applies only to purchases made by a qualified business after December 31, 2006.

Provides an exemption from state and local sales and use tax for building materials, supplies and installed equipment used to improve real property for use by a qualified business in the furtherance of its freight forwarding operations. Also provides an exemption from state and local sales and use tax for building materials, supplies and installed equipment used to construct a regional distribution center. The building exemptions apply to purchases made by the qualified business or by a contractor. The construction exemptions are available for sales made after June 30, 2006.

Section 13. Definitions. Amends Minn. Stat. ch. 469 by adding a new section 469.321. The new section contains definitions for the substantive provisions of the International Economic

Development Zone program.

Subdivision 1 limits the scope of the section to the provisions of the International Economic Development Zone laws.

Subd. 2. "Foreign trade zone" means the same as the phrase is used in the United States Code.

Subd. 3. "Foreign trade zone authority" means the Greater Metropolitan Foreign Trade Zone Commission number 119; a joint powers authority created by the county of Hennepin; the cities of Minneapolis and Bloomington; and the Metropolitan Airports Commission, and any other political subdivisions that enter into the authority after its creation.

Subd. 4 defines "International Economic Development Zone" or "Zone," as that geographic area designated by the foreign trade zone authority that is entitled to the tax benefits of this article.

Subd. 5 defines "person" to include an individual, corporation, partnership, limited liability company, association or any other entity.

Subd. 6 defines "qualified business" as the owner or operator of the regional distribution center who has signed a business subsidy agreement, or a freight forwarder who has signed a business subsidy agreement and is carrying on a trade or business at a place of business located in the International Economic Development Zone and who is certified by the foreign trade zone authority as a trade or business that furthers the purpose of developing international distribution capacity and capability.

Also requires qualified businesses to pay each employee total compensation, including benefits not mandated by law, of at least 110 percent of the federal poverty guidelines for a family of four.

Subd. 7 defines "regional distribution center" as a distribution center developed within a foreign trade zone. It must have as its primary purpose the facilitation of the gathering of freight for the purpose of centralizing the functions necessary for the shipment of freight in international commerce, including, but not limited to, security and customs functions.

Subd. 8 defines "International Economic Development Zone percentage" or "zone percentage." This percentage is used to determine the amount of exempt income of a business that operates partly within and partly without the International Economic Development Zone. It is calculated as a fraction. The numerator is the sum of the ratio of the taxpayer's property factor under section 290.191 located in the International Economic Development Zone and used as a regional distribution center or in freight forwarding operations over the total Minnesota property factor calculated under section 290.191 plus the ratio of the taxpayer's International Economic Development Zone payroll over the total Minnesota payroll determined under section 290.191. The denominator is two. If the business is part of a unitary business, the denominator of the payroll and property factors is the entire Minnesota payroll and property of the unitary business.

Subd. 9 defines "International Economic Development Zone payroll factor" as that portion of payroll as defined in section 290.191 that represents wages paid for operating or maintaining the regional distribution center, or for freight forwarding related services, performed in the International Economic Development Zone and wages paid for those services performed by persons with offices in the International Economic Development Zone if the employment requires the person to work outside the International Economic Development Zone and such work is incidental to the work performed by the individual within the Zone. However, wages paid for services performed outside the Zone are not International Economic Development Zone payroll if more than 10% of the services performed by the employee are performed outside the Zone.

Subd. 10 defines “freight forwarder” as a business that, for compensation, ensures that goods produced or sold by another business move from point of origin to point of destination.

The entire section is effective the day following final enactment.

Section 14. Application for Designation. Amends Minn. Stat. ch. 469 by adding section 469.3215. The section describes the process by which local government units make application to the Foreign Trade Zone Authority for International Economic Development Zone status. An application can be submitted by a local government unit or units, or by a joint powers board. A local government unit, however, cannot submit more than one application.

The application must include a resolution or ordinance from each city, town or county in which the Zone is located, agreeing to provide the property tax and local option sales tax benefits provided by the International Economic Development Zone law. It must also include an agreement to treat International Economic Development Zone tax benefits as business subsidies under the Minnesota business subsidy law, as well as supporting evidence necessary for the Foreign Trade Zone Authority to evaluate the application.

The applications must be submitted by December 31, 2005.

Effective the day following final enactment.

Section 15. Designation of International Economic Development Zone. Amends Minn. Stat. ch. 469 by adding a new section 469.322 which allows the Foreign Trade Zone Authority to designate one International Economic Development Zone. The Zone must include a regional distribution center. It must consist of between 500 and 1,000 contiguous acres. The Zone must be located within 60 miles, or 90 minutes drive time, from the Minneapolis-St. Paul International Airport. Designation must occur by June 30, 2006. The duration of the Zone is 12 years, starting January 1, 2007.

In making the zone designation, the Authority, in consultation with the Minnesota Departments of Employment and Economic Development, Revenue and Transportation, and the Metropolitan Council must consider:

1. access to major transportation routes,
2. consistency with current state transportation and air cargo planning,
3. adequacy of the size of the site,
4. access to airport facilities,
5. present and future capacity at the designated airport,
6. the capability to meet integrated present and future air cargo, security, and inspection services, and
7. access to other infrastructure and financial incentives

to maximize the security, efficiency and volume of Minnesota’s export shipments.

Prior to designation, the Foreign Trade Zone Authority, in consultation with the applicant local government unit, must conduct a transportation impact study based on the regional model and utilizing traffic forecasting and assignments. The results must be used to evaluate the effects of the proposed use on the transportation system and identify any needed improvements. If the site is in the metropolitan area the study must also evaluate the effect of the transportation impacts on the Metropolitan Transportation System plan as well as the comprehensive plans of the municipalities that would be affected. The cost of the study must be paid by the applicant. Effective the day following final enactment.

Section 16. Foreign Trade Zone Authority Powers. Amends Minn. Stat. chapter 468 by adding section 469.323. Requires the Foreign Trade Zone Authority to create a development plan for the regional distribution center. In developing the plan, the Authority must consult with interested municipalities as well as interested businesses, potential financiers, and appropriate state and federal agencies.

Also requires the Authority to prepare a business plan for the International Economic Development Zone. The plan must establish, at a minimum, the amount of investment, the number of jobs, and the amount of freight handled at the end of three, five, and 10 year periods by the Zone. It must also include an analysis of the economic feasibility of the regional distribution center once it becomes operational and of the operations of freight forwarders and other businesses that choose to locate within the boundaries of the Zone. If the Authority determines that the analysis does not establish the economic feasibility of the regional distribution center, a Zone cannot be designated.

Also authorizes the Authority to establish a port authority.

Finally, provides that International Economic Development Zone tax benefits are paid by the local government for purposes of the Minnesota prevailing wage and business subsidy laws. Effective the day following final enactment.

Section 17. Tax Incentives. Amends Minn. Stat. ch. 469 by adding section 469.324 that provides a general list of the tax benefits available to International Economic Development Zone businesses and their property. As discussed more fully in other sections, exemptions are available for sales and use tax, corporate franchise tax (including the alternative minimum tax and the minimum fee), individual income tax (including the alternative minimum tax), and property tax. In addition, qualified businesses may be eligible for a refundable jobs credit.

Section 18. **Income Tax Exemption**. Amends Minn. Stat. ch. 469 by adding section 469.325, that describes income tax exemptions available to individuals, estates and trusts for International Economic Development Zone activities. They are:

1. Exemption from tax for net rents derived from the rent of real or tangible personal property located and used in the Zone by a qualified business. If the tangible property was used both within and without the Zone, the subtraction is prorated based on the number of days that the property was used in the Zone.

2. Exemption from tax on net income from operation of a qualified business. The exemption is calculated by multiplying the net income of the business by its zone percentage. The maximum exemption is 20% of the sum of the business's International Economic Development Zone payroll plus the adjusted basis of property at the time the property is first used in the Zone.

3. Exemption from taxation on capital gains.

    1. Gains from the sale or exchange of real property located in the Zone. If the property was held prior to Zone designation, the exemption must be prorated based on the number of days the asset was held during the period of Zone designation.

    2. Gains from the sale or exchange of tangible personal property used by a qualified business in the Zone. If the tangible property was used both within and without the Zone, or owned prior to Zone designation, the subtraction is prorated based on the number of days that the property was used in the Zone.

    3. Gains from the sale of a qualified business. The exemption is calculated by multiplying the gain by the business's Zone percentage in the year prior to the sale. (For this calculation the denominator of the Zone percentage is the total payroll and property factors of the business, not simply its total Minnesota payroll and property. This exemption applies to the sale of a corporation, s-corporation or partnership interest, provided the Zone percentage exceeds 25%. At the request of the individual, the qualified business must certify to the individual in writing the applicable Zone percentage.

The entire section is effective for tax years beginning after December 31, 2006.

Section 19. Corporate Tax Exemption. Amends Minn. Stat. ch. 469 by adding section 469.326 which provides an exemption from the corporate franchise tax, the corporate alternative minimum tax and the minimum fee for Zone activities of a qualified business. The exemption from franchise tax and alternative minimum tax is calculated by multiplying the corporation's net taxable income, or alternative taxable income, by its Zone percentage. The exemption from the minimum fee is calculated by excluding Zone property and payroll from the computations. The maximum exemption is 20% of the sum of the corporation's International Economic Development Zone payroll plus the adjusted basis of property at the time the property is first used by the corporation in the Zone. Effective for tax years beginning after December 31, 2006.

Section 20. Jobs Credit. Amends Minn. Stat. ch. 469 by adding section 469.327 which provides a refundable jobs credit to any qualified business operating in the International Economic Development Zone. The credit is calculated as follows:

1. The taxpayer determines the lesser of the following two differences:
    a. The increase in the business's payroll within the Zone since the year that the Zone was designated by the Foreign Trade Zone Authority, or
    b. The increase in the business's total Minnesota payroll since the year of designation.

2. From the difference is then subtracted the product of $30,000 times the number of full time equivalent employees employed by the business in the Zone.

3. The result is multiplied by 7% to determine the credit.

The $30,000 amount is adjusted annually for inflation beginning in 2005. The amount necessary to pay any refunds is appropriated to the commissioner of revenue from the general fund.

Effective for tax years beginning after December 31, 2006.

Section 21. Repayment of Tax Benefits. Amends Minn. Stat. ch. 469 by adding section 469.328 which requires the repayment of two years of tax benefits if a business breaches the terms of its business subsidy agreement. The business is required to make any repayment of state taxes or local sales taxes to the commissioner of revenue within 30 days after ceasing to do business in the Zone as a qualified business. If the taxpayer fails to make the repayment, the commissioner can issue an order assessing the tax within two years of the date that the business ceased operating in the Zone as a qualified business, or within any other applicable period of limitation under chapter 289A. The assessment is made, and unpaid amounts collected, using procedures established in chapter 270 and 289A for the collection of tax. Penalties and interest imposed under chapter 289A are applicable.

For the repayment of a property tax, the tax is due 30 days after the county auditor sends a tax statement to the business. It the business fails to pay, the repayment shall be added to the property tax for payment in the year following the year that the treasurer discovers that the business is no longer operating in the Zone as a qualified business.

The repayment provision can be waived by the commissioner of revenue if he determines, in consultation with the Foreign Trade Zone Authority and other state and local government officials including the commissioner of employment and economic development, that repayment would not be in the best interest of the state or the Zone, or that the cessation of business was the result of circumstances beyond its control, such as loss of major supplies or customers, natural disaster or unforeseen industry trends. The entire section is effective the day following final enactment.

Section 22. Zone Performance Reporting. The successful International Economic Development Zone applicant must annually report to the commissioner of employment and economic development on its progress in meeting the zone performance goals under, and the applicant's compliance with, the business subsidy law under Minn. Stat. §§ 116J.993 to 116J.995. Effective the day following final enactment.

ARTICLE 5: MISCELLANEOUS

Section 1. Designation for Political Checkoff. Amends Minn. Stat. § 10A.31, subd. 1 to change the state elections campaign fund checkoff. Under the change, the amount designated to the state elections campaign fund will no longer be paid from the general fund, but instead will be added to the tax or subtracted from the refund otherwise payable by or to the taxpayer. The taxpayer may contribute $1 to $25 ($50 for a joint return) on their original individual income tax return and on their original property tax refund return. Effective for designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005.

Section 2. Political Checkoff Instructions. Amends Minn. Stat. § 10A.31, subd. 3 so that the income tax and property tax refund instructions published by the commissioner of revenue are consistent with the changes made to Minn. Stat. § 10A.31, subd. 1 above. Effective for designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005.

Section 3. Appropriation. Amends Minn. Stat. § 10A.31, subd. 4 to remove the appropriation from the general fund for the taxpayer designations to the state elections campaign fund. Requires the amounts designated and paid by taxpayers to be transferred and credited to the state elections campaign fund. Also repeals the $1.5 million biennial appropriation from the general fund to the state elections fund. Effective for designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005. The repeal of the $1.5 million appropriation is effective for elections occurring after December 31, 2004.

Section 4, 6, 7, and 11. Repeal of the Political Contribution Refund. Section 11 repeals the political contribution refund found in Minn. Stat. § 290.06, subd. 23 and the political contribution receipt in Minn. Stat. § 10A.322, subd. 4. Sections 4, 6, and 7 remove references to the political contribution refund in Minn. Stat. §§ 270A.03, subd. 7 (Revenue Recapture Act), 289A.01, subd. 6 (definition of person eligible to receive a refund), and 289A.50, subd. 1 (definition of overpayment). Effective for political contributions based on contributions made on or after July 1, 2005.

Section 5. Homestead Market Value Credits. Amends Minn. Stat. § 273.1384, subd. 1, to change the computation of homestead market value credits for residences that are part homestead and part nonhomestead. This happens when one or more of the owners, or a spouse of the owner, does not use the property as their homestead. Under current law, the credit is computed using the value of the homestead portion. This can result in a larger credit (and lower taxes) for a part-owner residing in a home, than if a full-owner resided in that same home; depending on the value of the home. The proposed language will prevent that from occurring by prorating the credit in those situations based on the occupant's percentage of ownership or to 50% in the case of an absent spouse. Effective for taxes payable in 2006 and thereafter.

Section 8. Rent Constituting Property Taxes. Amends Minn. Stat. § 290A.03, subd. 11 to reduce rent constituting property tax from 19% of gross rent paid to 16% of gross rent paid in 2005, and 15% of gross rent paid in 2006 and thereafter. Effective for rent constituting property taxes payable based on rent paid after December 31, 2004.

Section 9. Biotechnology and Health Sciences Funding. Amends Minn. Stat. § 469.335 to allow the commissioner of employment and economic development to issue $1,000,000 in tax benefit certificates in fiscal year 2006 to qualified businesses in the Biotechnology and Health Sciences Zone. Certificates not issued in 2006 can be awarded in fiscal year 2007.

Section 10. 2005 and 2006 City Aid Payments. An uncodified section extends the market value credit reimbursement reductions for cities for 2005 and 2006. Each city's reduction amount for 2005 and 2006 will be the lesser of its 2003 reduction or the amount of its current year reimbursement. Effective the day following final enactment.

Section 12. Repealer. Repeals Minn. Stat. §§ 10A.322, subd. 4 and 290.06, subd. 23, relating to the political contribution refund. Also repeals Minn. Stat. § 16A.522, subd. 4, to eliminate transfer of unrestricted general fund balances to the tax relief account. Effective the day following final enactment.