

MINNESOTA • REVENUE

Governor's Tax Bill

March 4, 2005

Department of Revenue
 Analysis of S.F. 753 (Ortman)/ H.F. 660 (Krinkie)
**Analysis Revised for Updated Estimates and
 February 2005 Forecast**

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

Fund Impact

	<u>F.Y. 2006</u>	<u>F.Y. 2007</u>	<u>F.Y. 2008</u>	<u>F.Y. 2009</u>
	(000's)			
Federal Update				
<i>Military Family Tax Relief Act of 2003*</i> (retroactive, various dates)	(\$680)	(\$330)	(\$340)	(\$350)
<i>Medicare Prescription Drug, Improvement, And Modernization Act of 2003</i>				
- Health Savings Accounts (1/1/04)	(\$5,200)	(\$3,000)	(\$3,300)	(\$3,700)
- Income Exclusion for Federal Subsidies to Employers with Pres. Drug Plans for Retirees (subsidy begins 1/1/06)	(\$3,200)	(\$6,500)	(\$7,200)	(\$8,000)
<i>Working Families Tax Relief Act of 2004</i>				
- 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
<i>American Job Creation Act of 2004</i>				
- 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)	\$13,200	\$850	\$950	\$1,000

* Detail available upon request.

	Fund Impact			
	<u>F.Y. 2006</u>	<u>F.Y. 2007</u>	<u>F.Y. 2008</u>	<u>F.Y. 2009</u>
	(000's)			
Corporate Franchise Tax				
- Change Qualifications for Foreign Operating Corporations (1/1/05)	\$1,800	\$1,300	\$900	\$500
- Single Sales Factor Phased In Over Eight Years (1/1/07)	\$0	(\$2,300)	(\$9,800)	(\$17,200)
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)	\$28,400	\$15,400	\$1,300	\$1,400
- 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)	\$4,790	\$13,800	\$14,500	\$15,200
- Impose 2.5% Gross Receipts Tax on Alcoholic Beverages (1/1/06)	\$23,650	\$60,300	\$62,000	\$63,100
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)	(\$12,171)	(\$12,442)	(\$12,750)	(\$13,072)
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	\$41,000	\$41,200
- 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)	\$17,800	\$17,500	\$0	\$0

	Fund Impact			
	<u>F.Y. 2006</u>	<u>F.Y. 2007</u>	<u>F.Y. 2008</u>	<u>F.Y. 2009</u>
	(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	\$3,700	\$160	\$2,400
- Political Contribution Refund (7/1/05)	<u>\$4,000</u>	<u>\$6,500</u>	<u>\$4,800</u>	<u>\$5,100</u>
General Fund Total	\$85,287	\$143,451	\$119,273	\$112,931
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)	<u>(\$1,730)</u>	<u>(\$1,410)</u>	<u>(\$1,500)</u>	<u>(\$1,590)</u>
Health Care Access Fund Total	(\$930)	\$890	\$1,200	\$1,710
Environmental Fund				
- Change Disposition of Solid Waste Management Tax (7/1/105)	<u>\$12,171</u>	<u>\$12,442</u>	<u>\$12,750</u>	<u>\$13,072</u>
Environment Fund Total	\$12,171	\$12,442	\$12,750	\$13,072
State Elections Campaign Fund				
- Eliminate State-Funded Campaign Checkoff, Establish Taxpayer- Funded Checkoff (1/1/05)				
Change in Fund Revenues	(\$80)	(\$1,100)	(\$80)	(\$450)
Change in Fund Expenditures	<u>\$80</u>	<u>\$1,100</u>	<u>\$80</u>	<u>\$450</u>
State Elections Campaign Fund Total	\$0	\$0	\$0	\$0

EXPLANATION OF THE BILL

A section-by-section summary of the bill was attached to the original analysis.

REVENUE ANALYSIS DETAIL

Federal Update

- For health savings accounts and the income exclusion of federal subsidies to employers with prescription drug plans for their retirees, the estimates are based on information in the federal report, *Estimates of Federal Tax Expenditures for Fiscal Years 2005-2009*, by the Staff of the Joint Committee on Taxation (JCT), January 12, 2005. The estimates for the other items are based on the JCT estimates at the time of the federal legislation. Other than the two items mentioned, the tax expenditure estimates were about the same as the previous estimates.
- 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 amount of 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 2004, withholding payments were \$11.1 million from partnerships for nonresident partners and \$10.6 million from S corporations for nonresident shareholders.
- Collection amounts are projected based on individual income tax growth rates from the February 2005 forecast.
- A quarterly payment schedule would shift 50% of the total annual withholding payment to the preceding fiscal year.
- About 1,370 partnerships and 920 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 February 2005 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 February 2005 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 1.72%, 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 February 2005 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 February 2005 forecast of the cigarette excise tax, an estimated 321,388,000 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 February 2005 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 February 2005 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 February 2005 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 February 2005 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 and for 2004 it was about \$19 million.
- It was estimated that the 2005 market value credit reduction would be approximately \$17.8 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.
- Compared to previous estimates, these revised estimates were done using city-by-city projections for FY 2006 market value homestead credit payments and are based on the February 2005 forecast.
- 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 February 2005 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 February 2005 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.
- Growth is based on the February 2005 forecast change in consumer spending for medical care from Global Insight, Inc.
- 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