MINNESOTA · REVENUE

SALES AND USE TAX
Capital Equipment

May 4, 2006

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of S.F. 1735 (Tomassoni), Delete Everything Amendment (A06-1605)

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
		(000's)		
Repair and Replacement Parts	$0	($16,900)	($5,100)	($2,600)
Other Capital Equipment	$0	$0	($82,200)	($22,500)
General Fund Total	$0	($16,900)	($87,300)	($25,100)

Effective July 1, 2006, for repair and replacement parts
Effective July 1, 2007, for other capital equipment

EXPLANATION OF THE BILL

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

To qualify, the items must be acquired by the user. Machinery and equipment purchased by a contractor under a lump-sum contract are not exempt.

The exemption is administered as a tax refund. Tax must be paid on the purchase, lease, or use of the equipment and a claim for refund submitted to the Department of Revenue. A business may file no more than two capital equipment refund claims in a calendar year, but a claim can be for multiple transactions.

Proposed Law: Effective for sales made on or after July 1, 2006, the bill repeals the refund requirement for tax paid on repair and replacement parts for capital equipment, making the exemption available at time of purchase. Effective for sales made on or after July 1, 2007, the bill repeals the refund requirement for tax paid on all other capital equipment, making the exemption available at time of purchase or lease. Capital equipment other than parts would remain exempt by refund for sales made from July 1, 2006, through June 30, 2007.

REVENUE ANALYSIS DETAIL

- The estimate was based on data from the 2002 U.S. Census report *Annual Capital Expenditures.* These are the most recent statistics available to date. The national data were apportioned to Minnesota chiefly on the state's share of the U.S. manufacturing sector gross product.
- Total estimated qualifying expenditures were adjusted to exclude contractor purchases and non-essential equipment and to include parts, accessories, foundations, and special purpose buildings.
- Total adjusted expenditures were multiplied by the 6.5% tax rate and increased annually by growth in expenditures for industrial equipment based on data published in February 2006 by Global Insight, Inc., to arrive at amounts for fiscal years 2007 to 2009.
- Projected capital equipment sales tax refunds prepared for the February 2006 state revenue forecast were subtracted from the estimated tax on total qualifying expenditures to arrive at preliminary annual revenue impacts.
- The estimates for capital equipment were further adjusted to account for tax refunds for purchases prior to July 1, 2007, which will be paid after the bill's effective date. A portion of the refunds granted each year reflects tax paid in previous years. Businesses have 3-1/2 years from the date of purchase to file refund claims.
- The revenue estimate for repair and replacement parts was done separately and followed the same steps used for capital equipment as described above, except that a July 1, 2006, effective date was calculated. It was assumed that accessories for equipment are included in the parts exemption.
- The revenue impact from an up-front exemption plus refund claims payable for purchases in a prior year is greatest in the first year and declines until after four to five years capital equipment refunds are negligible or sporadic.

Number of Taxpayers: There are approximately 10,000 potential beneficiaries. Between 2,000 and 2,500 capital equipment refund claims are received each year. A sizeable number of claims seek refunds for tax paid on parts and accessories.

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