

MINNESOTA • REVENUE

SALES AND USE TAX Base Changes and Rate Reduction INDIVIDUAL INCOME TAX Refundable Credit

February 27, 2008

Preliminary Estimates

Department of Revenue

Analysis of H.F. 2163 (Hortman) – As Proposed to be Amended – *Revised to Include General Fund Portion of Lottery In-Lieu Impact*

	Yes	No
DOR Administrative Costs/Savings	X	

	Fund Impact			
	<u>F.Y. 2008</u>	<u>F.Y. 2009</u>	<u>F.Y. 2010</u>	<u>F.Y. 2011</u>
Sales Tax Base Changes - 6.5% Rate			(000's)	
<u>Base Expansions – Sales Taxes on Services</u>				
Sewer Services	\$0	\$30,400	\$34,400	\$35,600
Car Repair	\$0	\$167,800	\$193,100	\$203,500
General Repair	\$0	\$170,900	\$196,100	\$206,000
Legal	\$0	\$104,300	\$119,600	\$125,500
Accounting	\$0	\$21,000	\$24,000	\$25,200
Financial Planning and Brokerage	\$0	\$15,700	\$18,000	\$18,900
Personal Care & Tattoos/Body Piercing	\$0	\$76,200	\$87,700	\$92,400
Funeral Services	\$0	\$19,200	\$22,100	\$23,300
<u>Repeal of Sales Tax Exemptions</u>				
Prescription & Over-the-Counter Drugs	\$0	\$222,900	\$261,000	\$280,500
Prescription Eye Glasses	\$0	\$28,500	\$32,600	\$34,200
Publications	\$0	\$57,900	\$65,200	\$67,300
Motor Fuels	\$0	\$556,200	\$609,800	\$613,500
Tickets to Minnesota Zoo	\$0	\$300	\$300	\$300
Clothing	\$0	\$347,100	\$396,100	\$413,200
Baby Products	\$0	\$500	\$500	\$500
Caskets and Vaults	\$0	\$4,500	\$4,900	\$4,900
Textbooks & Instructional Materials	\$0	\$16,000	\$17,500	\$19,100
Computers Prescribed for Use by Schools	\$0	\$700	\$700	\$700
Residential Heating Fuels	\$0	\$164,100	\$163,200	\$162,200
Residential Water Service	\$0	\$9,200	\$10,400	\$10,900
Feminine Hygiene Products	\$0	\$2,500	\$2,700	\$2,700
YMCA, YWCA, & JCC Memberships	\$0	\$3,400	\$3,800	\$4,000
Total Sales Tax Base Changes - Current 6.5% Rate	\$0	\$2,019,300	\$2,263,700	\$2,344,400
Rate Reduction to 4.5% of Current Base	\$0	(\$1,263,200)	(\$1,420,500)	(\$1,472,000)
Rate Reduction to 4.5% for Base Expansion	\$0	(\$621,300)	(\$696,600)	(\$721,400)
Sales Tax Net Impact	\$0	\$134,800	\$146,600	\$151,000
Lottery In-Lieu Sales Tax Rate Reduction	\$0	(\$2,200)	(\$2,500)	(\$2,500)
Income Tax Credit for Clothing Sales Tax	\$0	(\$40,700)	(\$42,300)	(\$44,000)
General Fund Net Impact	\$0	\$91,900	\$101,800	\$104,500

Lottery In-Lieu Sales Tax Rate Reduction	<u>\$0</u>	<u>(\$2,900)</u>	<u>(\$3,200)</u>	<u>(\$3,200)</u>
Game and Fish Fund	\$0	(\$2,900)	(\$3,200)	(\$3,200)
Lottery In-Lieu Sales Tax Rate Reduction	<u>\$0</u>	<u>(\$2,900)</u>	<u>(\$3,200)</u>	<u>(\$3,200)</u>
Natural Resources Fund	\$0	(\$2,900)	(\$3,200)	(\$3,200)
Total – All Funds	\$0	\$86,100	\$95,400	\$98,100

As proposed to be amended, the effective date for the sales tax changes is July 1, 2008. The income tax credit would be effective beginning with tax year 2008.

EXPLANATION OF THE BILL

Sales and Use Tax Base Expansion to Services

The bill includes the following services in the definition of a sale or purchase (i.e. makes these services subject to the sales and use tax): sewer services, car repair services, general repair services, legal services, accounting services, financial planning services, brokerage services, personal services, and funeral services. Section 7 creates a new exemption for sales of legal, accounting, financial planning, and brokerage services when used in a trade or business.

Repeal of Current Law Exemptions from the Sales and Use Tax (sections 4, 5, 6, 8, and 9)

The bill repeals exemptions from the sales and use tax for drugs for human use (including over-the-counter drugs), insulin and medical oxygen for human use, and prescription corrective eyeglasses.

The exemption for publications, regularly issued at average intervals not exceeding 3 months, is repealed. Magazines sold over-the-counter are currently taxable. Repealing the publications exemption will cause newspapers and other publications to be taxable, also.

Currently, if the motor fuels excise tax has been paid, the fuels are not subject to the sales and use tax. The bill repeals this sales and use tax exemption for petroleum products. The exemption for admissions at the Minnesota Zoological Garden subject to the sales and use tax is repealed. Finally, the exemptions for clothing, baby products, caskets and vaults, textbooks and instructional materials, computers prescribed for use by schools, residential heating fuels, residential water services, feminine hygiene products, and YMCA, YWCA, JCC memberships are repealed in the last section of the bill.

Sales Tax Rate Reduction

Section 3 of the bill lowers the sales tax rate from 6.5% to 4.5%. The lottery in-lieu sales tax, which is linked to the general sales tax rate of 6.5%, would also be lowered to the 4.5% rate. **As proposed to be amended**, the rate for the motor vehicle sales tax would remain at 6.5%.

EXPLANATION OF THE BILL (*continued*)

The bill does not provide for a reduction to the cigarette sales tax and does not provide transition language (e.g. contracts and capital equipment refunds). It is assumed that the sales tax on the new services is not offset by capital equipment or production exemptions.

Income Tax Credit for Clothing Sales Tax

The bill allows a refundable credit against the individual income tax equal to \$40 for a married couple filing a joint return and \$20 for all others, plus \$40 for each qualifying child, up to a maximum of two such children. The credit is reduced by 1% of total household income in excess of a threshold. The threshold is \$48,000 for married couples filing joint returns, \$36,000 for singles and heads of household, and \$24,000 for married persons filing separately.

REVENUE ANALYSIS DETAIL

Sales and Use Tax Base Expansion to Services

- The estimates are based on information developed from an earlier version of the Minnesota Tax Consumption Model. The estimates will need to be updated when the current tax consumption model revisions are completed and the services exemption estimates for the *2008 Minnesota Tax Expenditure Budget* are finalized.
- The estimates assume annual growth rates developed for, and applied in, the Minnesota Tax Consumption Model.
- In most cases the model uses national BEA information that is apportioned to Minnesota based on income and population.
- The fiscal year 2009 impact was reduced to reflect 11 months of collections.

Repeal of Current Law Exemptions from the Sales and Use Tax

- The estimates of current law sales and use tax exemptions are based on information developed for the *2008 Minnesota Tax Expenditure Budget*.
- The estimates assume various (category specific) annual growth rates.
- The fiscal year 2009 impact was reduced to reflect 11 months of collections, except for heating fuels and textbooks.

Sales Tax Rate Reduction

- Current collections information is provided by the November 2007 state economic forecast by the Department of Finance.
- Adjustments are made to the forecast numbers to remove items currently included with a rate other than 6.5% that will not be changing – e.g., 6.2% car rental tax, 2.5% liquor gross receipts tax. Collections are then estimated at the 4.5% rate using a model that creates a proportional equivalence.
- The fiscal year 2009 impact was reduced to reflect 11 months of collections.

REVENUE ANALYSIS DETAIL (*continued*)

Income Tax Credit for Clothing Sales Tax

- The estimates are based on the 2009 projections contained in the 2007 Tax Incidence Study.
- It is assumed that all dependents are qualifying children.
- All qualifying income tax filers are assumed to claim the credit. In 2009, 933,135 households are expected to qualify for the credit, with an average credit amount of \$42.35.
- It is assumed that, of those households not required to file an income tax return, the top 20% in terms of credit amount eligibility would file in order to claim the credit. There are expected to be 48,772 households in this group with an average credit amount of \$57.29.
- Growth of 4% per year is assumed.
- The credit is assumed to apply starting with tax year 2008.
- Tax year impacts are allocated to the following fiscal year.

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