MINNESOTA · REVENUE

Governor's Tax Bill

January 26, 2007

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 304 (Simpson)/ S.F. 293 (Ortman)
As Proposed to be Amended

	Fund Impact			
	F.Y. 2008	**F.Y. 2009**	**F.Y. 2010**	**F.Y. 2011**
	(000's)			
Federal Update*				
Heroes Earned Retirement Opportunities Act	(Negligible)	(Negl.)	(Negl.)	(Negl.)
Pension Protection Act of 2006				
Individual Income Tax	($4,525)	($2,220)	($2,720)	($14,670)
Corporate Franchise Tax	($400)	$0	$0	$0
Total	($4,925)	($2,220)	($2,720)	($14,670)
Tax Relief and Health Care Act of 2006				
Individual Income Tax	($43,750)	($1,105)	($1,010)	($920)
Corporate Franchise Tax	($4,950)	($1,525)	($1,170)	($1,015)
Total	($48,700)	($2,630)	($2,180)	($1,935)
Individual Income Tax				
Military Pension Subtraction, Phased In Over Four Years (1/1/07)	($4,300)	($9,100)	($14,200)	($20,000)
Expansion of Military Pay Subtraction, Phased In Over Four Years (1/1/07)	($1,000)	($2,100)	($3,400)	($4,700)
Dairy Investment Credit (1/1/07)**	($4,800)	($4,800)	($4,800)	($4,800)
Regional Angel Investment Credit**	($6,000)	$0	$0	$0
Corporate Franchise Tax				
Accelerate Phase In to Single Sales Factor (1/1/08)	($4,200)	($15,900)	($23,100)	($28,100)
General Sales and Use Tax				
Eliminate Refund Requirement for Capital Equipment Exemption for:				
Small Businesses (7/1/07)	($5,450)	($3,120)	($2,020)	($470)
Wood Products Industry (7/1/07)	($1,650)	($830)	($280)	($80)

*Details for each federal bill are available separately. Fiscal year 2008 impact includes FY 2007.
**Credit also applies to the corporate franchise tax. Estimates reflect totals for both taxes.

	Fund Impact			
	F.Y. 2008	F.Y. 2009	F.Y. 2010	F.Y. 2011
	(000's)			
General Sales and Use Tax (Cont.)				
Exemption for Construction Materials and Other Items for Legal Reference Office and Data Center Facility (1/1/07 – 12/31/11)	($3,815)	($2,295)	($1,495)	($1,100)
Exemption for Minnesota Department of Transportation Purchases from Trunk Highway Fund (7/1/07)	($4,125)	($4,660)	($4,820)	($4,990)
Exemption for Commuter Rail Construction Materials and Equipment (1/1/07)	($4,600)	($3,100)	$0	$0
Job Opportunity Building Zones				
Allow Tax Benefits for Ten Years After Agreement Is Signed	($100)	($300)	($700)	($1,200)
Property Tax Aids and Credits				
Increase Phase-out Threshold for Market Value Homestead Credit	$0	($47,000)	($44,700)	($42,400)
- Impact on Property Tax Refund	$0	$3,100	$2,900	$2,800
Increase Local Government Aid	$0	($10,000)	($10,000)	($10,000)
Increase Maximum Property Tax Refund for Homeowners	$0	($8,500)	($10,100)	($11,400)
Increase K-12 Operating Capital Aid	$0	($40,076)	($45,578)	($46,021)
- Impact on Property Tax Refund	$0	$1,400	$1,400	$1,400
Transfer to Budget Reserve Account	($47,000)	$0	$0	$0
General Fund Total	($140,665)	($152,131)	($165,793)	($187,666)
H.F. 8, Federal Update for Tax Year 2006*	($25,085)	($885)	($865)	($745)
If H.F. 8 Is Enacted: General Fund Net Impact	($115,580)	($151,246)	($164,928)	($186,921)

*Details for each federal bill are available separately. Fiscal year 2008 impact includes FY 2007.

EXPLANATION OF THE BILL

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

REVENUE ANALYSIS DETAIL

Federal Update

- The estimates for the deductions for tuition and educator expenses are based on the recent history of these deductions taken by Minnesota taxpayers. The House Income Tax Simulation Model was used as a basis for the estimates of the tuition deduction.
- For the other provisions, the estimates are based on the estimates for the federal legislation prepared by the Joint Committee on Taxation.
- For provisions affecting both the individual and corporate taxes, the federal estimates were divided between the two taxes.
- The federal estimates were apportioned to Minnesota based on a measure appropriate to each provision. Federal and state marginal rates were then applied.
- Federal fiscal years were converted to Minnesota fiscal years.
- For tax year 2004, the higher education tuition deduction was claimed on about 111,000 returns filed by Minnesota residents, and the educator expense deduction was claimed on about 54,000 returns. Each of the other provisions would affect a smaller number of returns.

Military Pension Subtraction, Phased In Over Four Years

- According to information from the Department of Defense Statistical Report on the Military Retirement System for federal fiscal year 2005, the number of people receiving military retirement pay in Minnesota was 17,373 for a total amount of $260.7 million.
- Based on federal fiscal year 2005 national data, it is assumed that 39% of retirees are officers with an average annual pension of $23,626, and 61% are enlisted personnel with an average annual pension of $11,841. The average pension for 2,587 survivors was $6,619.
- It is assumed that the proposed law includes taxable military disability pensions.
- It is assumed there is little overlap with the low income elderly subtraction.
- The average marginal rate was assumed to be 6%.
- Annual growth was estimated at 5%.
- Tax year impact was allocated to the following fiscal year.
- Approximately 17,000 to 18,000 taxpayers would be affected.

Expansion of Military Pay Subtraction, Phased In Over Four Years

- According to information from the Department of Military Affairs, over 10,000 members of the Minnesota National Guard and about 7,000 Reservists would be eligible. It is assumed that the average annual military wage eligible for the expanded subtraction for this group is about $3,500.
- The average marginal rate was assumed to be 6%.
- Annual growth was estimated at 5%.
- Tax year impact was allocated to the following fiscal year.
- Approximately 17,000 taxpayers would be affected.

Dairy Investment Credit

- The estimate is based on the experience of Wisconsin with a similar credit for tax years 2004 and 2005. The total credit generated in 2004 was $28 million, of which $13 million was used to offset tax in that year. Preliminary numbers for tax year 2005 indicate a slight decline in the credit generated and in the credit used to offset tax.
- The Wisconsin experience shows that tax liability significantly affects the amount of credit that can be used in a year. Less than 50% of the credit generated in a tax year was used that year.
- It is assumed that Minnesota's experience in the first year would be similar to that of Wisconsin in 2004. The credit generated of $28 million and the credit used to offset tax of $13 million were multiplied by 37%, which is the percentage of the number of dairy cows in Minnesota for 2005 compared to Wisconsin. The estimated Minnesota credit generated is $10.4 million, and the credit used to offset tax is $4.8 million, with a carryover of $5.6 million.
- No growth is assumed in the amount of credit generated or used from 2007 through 2012. The total amount of credit used in those years would be $28.8 million ($4.8 million times six). After 2012, $33.6 million of carryover credit ($5.6 million times six) would be available for ten to fifteen years. If all the available credit can be used to offset tax, the total cost of the program for all years would be $62.4 million.
- Tax year impact was allocated to the following fiscal year.
- The credit would offset tax on an estimated 2,400 returns each year, at an average credit of $2,000.

Regional Angel Investment Credit

- It is assumed that all of the available credit would be authorized.

Accelerate Phase In to Single Sales Factor

- 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 impact from changing the weighting under current law to the proposed weighting for each tax year.
- Growth in overall corporate tax collections as projected by the Department of Finance in the November 2006 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.
- Tax year impact was allocated 30/70 to fiscal years.
- About 9,000 corporations would be affected, including both tax increases and decreases.

Eliminate Refund Requirement for Capital Equipment Exemption for Small Businesses

- The estimate was based on state fiscal year 2003 data from the U.S. Census report *Annual Capital Expenditures* and 2003 data on manufacturing firm size by number of employees from the Department of Employment and Economic Development (DEED). Capital expenditure amounts from the Census were apportioned to Minnesota chiefly on the state's share of the U.S. manufacturing sector gross product.
- Calculations from DEED data showed that manufacturing businesses with 20 or fewer employees came to 6.2% of total manufacturing employees. The portion was increased to 6.5% to account for other qualifying small businesses outside the manufacturing sector. This percentage was used to estimate the amount of total capital equipment expenditures that are covered by the proposal.
- 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 November 2006 by Global Insight, Inc., to arrive at estimates for fiscal years 2008 through 2011.
- The estimates were further adjusted to account for tax refunds on purchases made before July 1, 2007, which will be paid after the proposal takes effect. A portion of the refunds paid each year reflects tax paid in previous years. Businesses have 3½ years from the date of purchase to file refund claims.
- The statutory definition of a small business for production industries is one that has 20 or fewer full-time employees in the preceding fiscal year or had no more than $1 million in gross revenues. Only employment data is available and so was used for the revenue estimate.

Eliminate Refund Requirement for Capital Equipment Exemption for Wood Products Industry

- The estimate was based on national capital equipment expenditures in NAICS 3221 and 321 for a calendar year 2004 estimating base. The national data were apportioned to Minnesota by the state's share of U.S. employment in these areas.
- Total estimated qualifying expenditures were adjusted to exclude contractor purchases and non-essential equipment and to include parts, accessories, foundations, and special purpose buildings, which are part of the definition of capital equipment in the sales tax statute.
- Total adjusted expenditures were multiplied by the 6.5% tax rate.
- Annual growth for pulp and paper manufacturing was -2.17% and for wood product manufacturing 0.98%. These are the average annual changes in employment for the two industries between 2004 and 2014 according to the Department of Employment and Economic Development.
- The fiscal year impacts result from refunds claimed for purchases made before July 1, 2007, that would be paid in decreasing amounts over the following years.

Exemption for Construction Materials and Other Items for Legal Reference Office and Data Center Facility

- It was assumed that the exemption would apply only to the renovation and expansion planned for the Thomson West facility in Eagan.
- The estimate was based on information supplied by Thomson West.
- Normally taxable expenditures are expected to begin during the current fiscal year, FY 2007, and be completed by December 31, 2011 (FY 2012).
- The work is planned in two stages. The first is expansion and renovation of a data center and lab, and construction of a new office building. The second is construction and equipping of a new data center and lab. Computers and other information technology equipment will be acquired throughout the project.
- It was assumed that refunds of tax paid prior to enactment of the exemption would be made in fiscal year 2008.
- Regarding construction contractors, it was assumed that the exemption applies only to construction materials, supplies, and installed equipment and fixtures used in the Thomson West project, and not to construction equipment such as earth-moving equipment, cranes, or scaffolding.

Exemption for Minnesota Department of Transportation (DOT) Purchases from Truck Highway Fund

- The estimate was based on the recent history of DOT sales tax paid from the trunk highway fund. Because tax liabilities have varied somewhat from year to year, an average amount was calculated for a fiscal year 2006 estimating base.
- The fiscal year 2006 estimate was increased annually by 3.5% to arrive at estimates through fiscal year 2011.
- The estimates assume that the exemption applies only to purchases made directly by DOT and not by construction contractors.
- The estimate for fiscal year 2008 reflects 11 months of impact from a July 1, 2007, effective date.

Exemption for Commuter Rail Construction Materials and Equipment

- It is assumed that the federal provisions relating to the taxation of railroad rolling stock (the Railroad Revitalization and Regulatory Reform Act of 1976) would not apply to this intrastate rail operation. Therefore, without a specific exemption, the property would be subject to sales and use tax.
- For fiscal years 2008-2009, the exemption is expected to apply only to the first phase of the Northstar Corridor. The initial phase of the project is a 40-mile line from Big Lake to downtown Minneapolis. An extension of 42 miles (for an 82-mile line total reaching to St. Cloud) is expected as a later project.
- Information was provided by the Minnesota Department of Transportation (DOT) on estimated project costs and timelines.
- It is expected that the initial phase of the commuter rail will be operational prior to the end of fiscal year 2009.
- The project cost for the first phase of the Northstar Corridor is estimated to be $301 million (excluding sales tax) with an expected annual operating cost of $11 million. DOT estimates

that taxable costs will be $118 million, excluding labor costs and other non-taxable items such as right of way costs and professional services.
- It was assumed that refunds of tax paid prior to enactment of the exemption would be made in fiscal year 2008.
- It is assumed that the exemption applies only to construction materials, supplies, and equipment incorporated into the project and not to construction equipment used in completing the project.
- The fiscal impact of this exemption may also apply to future commuter rail corridors after fiscal year 2009 (including the proposed 42 mile extension).

Job Opportunity Building Zones – Allow Tax benefits for Ten Years After Agreement Is Signed
- The proposal would increase costs of the JOBZ program in two ways: businesses entering the program after 2006 would receive tax benefits for one to ten additional years, and more businesses are likely to enter the program through 2015 if tax benefits are available for ten years.
- According to the Department of Employment and Economic Development, there are 287 businesses in the JOBZ program to date. JOBZ program business subsidy agreements signed by year are as follows: 131 in CY 2004, 95 in CY 2005, and 61 in CY 2006.
- Under current law, the number of businesses entering the program would be expected to decline each year. Under the proposal, it is assumed the number of businesses entering the program will stay constant. It is assumed that an average of 35 businesses sign JOBZ subsidy agreements per year from 2007 to 2015.
- It is assumed that the percentage of businesses entering the JOBZ program due to the ten-year extension of tax benefits would be: 5% in FY 2008, 10% in FY 2009, 20% in FY 2010, and 30% in FY 2011. Of the 35 businesses entering the JOBZ program annually, it is assumed that the number attributable to the ten-year extension would be approximately: 2 in FY 2008, 4 in FY 2009, 7 in FY 2010, and 11 in FY 2011.
- It was assumed that the average annual state revenue loss per business would be similar to that reported by JOBZ business submitting Form M500 for tax year 2004, which was approximately $50,000.
- Calendar year impact was allocated to the following fiscal year.
- The annual cost of the proposal is estimated to increase to approximately $8.5 million by 2015 due to a higher percentage of businesses entering the JOBZ program due to the ten-year extension of benefits. The total cost for FY 2008 to FY 2016 is estimated at $28 million.
- Extending the time period businesses would be eligible for tax benefits would result in state costs of approximately $16 million in 2016. Each year thereafter, 35 businesses would cease to receive JOBZ tax benefits, through 2024, and state costs would decrease each year from the previous. The total cost for FY 2017 to FY 2025 is estimated at $79 million.

Increase Phase-out Threshold for Market Value Homestead Credit
- The proposal was estimated using the property tax simulation model based on data for taxes payable in 2007.

- It was assumed that the impact would decrease 5% each year based on the historical reduction in the credit as individual homesteads increase in value.
- A decrease in homestead net taxes would result in lower property tax refunds. The decrease would be $3.1 million for taxes payable in 2008, $2.9 million for pay 2009, and $2.8 million for pay 2010.
- This change increases the credit for homesteads between $76,000 and $456,000 of market value. Approximately 1.3 million homesteads would receive additional credit under this proposal.

Increase Local Government Aid

- The proposal would increase the annual local government aid appropriation by $10 million.
- Changes to the local government formula would change the distribution of aid among cities but would not affect the total amount.

Increase the Maximum Property Tax Refund for Homeowners

- The estimates are based on property tax refund model projections from the November 2006 forecast.
- Approximately 42,000 homeowners currently at the maximum refund would receive an average property tax refund increase of approximately $200 in FY 2009.

Increase K-12 Operating Capital Aid

- Estimates were provided by the Department of Education.
- Increasing the equalizing factor for the operating capital levy would result in increased state aid and reduced levies. The decrease in homestead taxes would result in lower homeowner property tax refunds of $1.4 million annually, starting with taxes payable in 2008.

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

2007 GOVERNOR'S TAX BILL SUMMARY

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

Bill Date: January 19, 2007
Summary Date: January 22, 2007

ARTICLE 1: GOVERNOR'S INITIATIVES

Sections 1 and 2. Budget Reserve Increase. Amends Minn. Stat. § 16A.152, subds. 1b and 2 to increase the general fund budget reserve from $653 million to $700 million in FY 08. Removes the statutory ceiling on the budget reserve. Indexes budget reserve to growth in general fund spending by setting budget reserve goal at five percent of second year expenditures. Allocates portion of any general fund forecast balances until the five percent reserve goal is met.

Section 3. Operating Capital Levy. Amends Minn. Stat. § 126C.10, subd. 13a, to increase the equalizing factor for the operating capital levy from $10,700 to $17,590. The equalizing factor for the operating capital levy was set at $22,222 for FY 2006 and is set at $10,700 for FY 2007 and later. Increasing the equalizing factor for the operating capital levy to $17,590 will reduce the average tax rate for operating capital from 1.82% of adjusted net tax capacity (ANTC) to 1.15% of ANTC. This will provide nearly uniform property tax relief statewide, with 328 of the state's 340 districts receiving a levy reduction. Effective for revenue for fiscal year 2009.

Section 4. Residential Market Value Credit. Amends Minn. Stat. § 273.1384, subd. 1, to eliminate the phase-out of the credit for the first $118,000 of value for each homestead. Under current law, the phase-out starts at $76,000. Effective for taxes payable in 2008 and thereafter.

Section 5. Government Unit Definition. Amends Minn. Stat. § 275.70, subd. 3, to define those units of government subject to overall levy limits as (1) counties and (2) cities of over 2,500 population, for which more than one-third of the county's or city's combined levy-plus-aid amount is state aid. Effective for taxes payable in 2008 and thereafter.

Section 6. Special Levies. Amends Minn. Stat. § 275.70, subd. 5, to amend the definitions of special levies to make the following changes: (1) special levies to fund matching fund requirements are limited to increases in matching funds required for 2008 and thereafter; (2) special levies to fund increases in public employee retirement association employer contributions are limited to increases that are effective after June 30, 2006; (3) the definition of the special levy for county levies to pay court administration costs is amended to eliminate obsolete references; (4) the special levy to fund police or firefighter relief associations is re-defined as the excess over the amount levied for this purpose in the prior year rather than the increase over the amount levied in 2001; and, (5) a new special levy is provided for increases in unreimbursed targeted case management costs. Effective for taxes payable in 2008 and thereafter.

Section 7. Definition. Amends Minn. Stat. § 275.70, by adding the new subdivision 7, to define the term "levy year." Effective for taxes payable in 2008 and thereafter.

Section 8. Application of Levy Limits. Amends Minn. Stat. § 275.71, subd. 1, to clarify that the levy limits in sections 275.70 to 275.74 apply to the covered governmental units for all purposes except special levies and special assessments regardless of the provisions of any charter or prior law. Effective for taxes payable in 2008 and thereafter.

Section 9. Levy Limit Base. Amends Minn. Stat. § 275.71, subd. 2, to provide that the levy limit base for counties and cities of over 2,500 population is equal to: (1) the amount it levied in the prior year; plus (2) aids received in the current year under sections 298.28, 298.282 and 477A.011 to 477A.03 plus any state aid for targeted case management costs; minus (3) amounts levied in the prior year as special levies. For the first year, clause (3) includes amounts that could have been levied as special levies if levy limits had been in effect. Effective for taxes payable in 2008 and thereafter.

Section 10. Adjusted Levy Limit Base. Amends Minn. Stat. § 275.71, subd. 4, to define a governmental unit's adjusted levy limit base as its levy limit base increased for (1) inflation; and (2) growth in the number of households. Effective for taxes payable in 2008 and thereafter.

Section 11. Levy Limit. Amends Minn. Stat. § 275.71, subd. 5, to define a governmental unit's levy limit as its adjusted levy limit base minus: (1) local government aid and county aid certified for payment in the next year under sections 477A.011 to 477A.03; (2) taconite aids to be paid in the next year under sections 298.28 and 298.282; (3) estimated wind energy production tax revenues for the next year under section 272.029; and (4) targeted case management aid. Effective for taxes payable in 2008 and thereafter.

Sections 12 and 15. Military Pension and Expanded National Guard, Reserve, and Federal Active Duty Subtractions. Minn. Stat. §§ 290.01, subd. 19b and 290.091, subd. 2, respectively, are amended to allow a subtraction from income for the Minnesota individual regular and alternative minimum tax for pension and retirement incomes that are included in federal taxable income, and that are received for service in the armed forces of the United States. For 2007, the maximum subtraction is limited to 25 percent of up to $30,000 of military retirement income. For 2008, 50 percent is allowed; for 2009, 75 percent is allowed; and for 2010 and thereafter, 100 percent of all the military retirement income is allowed as a subtraction. This section also removes the current limitations on the National Guard and Reserve subtraction to allow the subtraction for all compensation earned for being a member of the National Guard or Reserve. Finally, this section expands the federal active duty pay subtraction to compensation paid for federal active duty performed in Minnesota by a Minnesota resident. Both expansions of subtractions are phased in over 4 years, where 25% of the expansion is allowed in 2007; 50% in 2008; 75% in 2009; and 100% in 2010 and thereafter. Effective for tax years beginning after December 31, 2006.

Section 13. Dairy Investment Credit. Minn. Stat. § 290.06 is amended to add a new subdivision allowing a new nonrefundable credit against the taxes imposed by Minn. Stat. ch. 290. The credit equals 10 percent of the first $500,000 of qualifying expenditures for improvement of buildings or facilities or acquisition of equipment used for dairy cattle in Minnesota. Qualifying expenditures include: barns; fences; watering facilities; feed storage and handling equipment; scales; milking; robotic, and milk storage equipment; and manure management facilities including digesters and energy production equipment.

The credit is nonrefundable and may only be used to offset liability. Unused credit amounts may be carried forward for up to 15 tax years.

A taxpayer may claim the credit for expenditures made after December 31, 2006 and before January 1, 2013. The maximum credit is $50,000; this maximum applies to entities such as partnerships and S corporations as well as to individual taxpayers. Effective for tax years beginning after December 31, 2006.

Section 14. Angel Investor Fund Credit. Amends Minn. Stat. § 290.06 to provide a credit against income and franchise taxes for investments made to qualified regional angel investment funds that invest primarily in small businesses located in Minnesota. The commissioner of employment and economic development is authorized to make up to $6,000,000 of credits available to up to twenty qualified funds that apply for the credits. No fund can be awarded more than $600,000 of credits.

The credit is equal to twenty five percent of the taxpayer's investment in the fund. Taxpayers can carry forward unused credits for up to ten years. Effective the day following final enactment.

Section 16. Apportionment Formula of General Application; Acceleration of Single Sales Factor. Amends Minn. Stat. § 290.191, subd. 2, to accelerate the full phase in of use of a single factor, sales, for the apportionment of income from 2014 to 2011. Effective for tax years beginning after December 31, 2006.

Taxable Year Beginning	**Current Sales Factor Percent**	**Proposed Sales Factor Percent**
2008	81	85
2009	84	90
2010	87	95
2011	90	100
2012	93	100
2013	96	100
2014	100	100

Section 17. 25 Percent Increase of Maximum Homeowner Property Tax Refunds. Amends Minn. Stat. § 290A.04, subd. 2, to increase the maximum homeowner property tax refunds on a decreasing rate as income goes up. The maximum increases 25% for homeowners who copay 15% or 20%; 20% for copays of 25% or 30%; 15% for copays of 35% or 40%; and 10% for all other homeowners. Effective beginning with refunds based on property taxes payable in 2008.

Section 18. Capital Equipment. Amends Minn. Stat. § 297A.68, subd. 5, to provide that purchases of capital equipment by the wood products industry are exempt from sales tax at the time of purchase. Under current law, the tax must be paid at the time of sale and a claim for refund must be filed with the commissioner of revenue. This provision contains a definition of the term "wood products industry" and listing of businesses that are not considered to be in the wood products industry.

This section provides that capital equipment that is purchased by a small business is exempt from the sales tax at the time of purchase. The provision provides that the term "small business" is defined in Minn. Stat. § 645.445, subd. 2, and in that subdivision a small business is a business that is not an affiliate or subsidiary of a business dominant in its field of operation and has (1) 20 or fewer full-time employees, (2) less than $1,000,000 of annual revenues in the preceding fiscal year, or (3) less than $2,500,000 of annual gross revenues in the preceding fiscal year, if it is providing a technical or professional service.

Effective sales and purchases made after June 30, 2007.

Section 19. Trunk Highway Fund Purchases. Amends Minn. Stat. § 297A.70, subd. 2, to provide a sales tax exemption for purchases made by the Department of Transportation from the trunk highway fund. Effective for sales and purchases made after June 30, 2007.

Section 20. Legal Reference Office and Data Center Facility. Amends Minn. Stat. § 297A.71, by adding a subdivision that provides an exemption for materials and supplies used or consumed and equipment incorporated into the construction, improvement or expansion of a legal reference office and data center facility provided that (1) the facility is engaged in the provision of print or online legal reference products and (2) the total capital investment in the facility is at least $60 million. The exemption also applies to machinery, equipment, furniture and fixtures to construct and equip the facility but does not apply to equipment owned or leased by a contractor. Effective for sales and purchases made after December 31, 2006, and before January 1, 2012.

Section 21. Commuter Rail Purchases. Amends Minn. Stat. § 297A.71, by adding a subdivision that provides a sales tax exemption for materials and supplies used or consumed and equipment incorporated into the construction, equipment or construction of a commuter rail system. The exemption also applies to railroad cars and related equipment. Effective for sales and purchases made after December 31, 2006.

Sections 22 and 23. Capital Equipment Refunds. Amends Stat. § 297A.75, subds. 1 and 3, to reflect that purchases of capital equipment by the wood products industry and by small businesses are exempt from the sales tax at the time of purchase and they do not have to pay the sales tax at the time of purchase and file for a refund of the tax. Effective for sales and purchases made after June 30, 2007.

Section 24. Qualified Businesses Allowed Ten Years of JOBZ Tax Benefits. Amends Minn. Stat. § 469.312, subd. 5, to allow new or expanding businesses locating in a job opportunity building zone or businesses relocating from outside a zone ten full years of JOBZ tax benefits as long as they fully execute a business subsidy agreement by December 31, 2015. Effective the day following final enactment.

Section 25. City LGA Distribution Amounts. Amends Minn. Stat. § 477A.013, subd. 9, to change the local government aid distribution amounts for cities ("LGA") for aid distributed in 2007 and thereafter. The new distribution amounts are the average of the distribution amounts computed for the current and the prior years. In this computation, the distribution amounts for each year are not subject to the limits in current law on the amount by which any city's aid can increase or decrease in one year, but the final distribution amount is. Effective the day following final enactment.*****

Section 26. City LGA Increases. Amends Minn. Stat. § 477A.013, by adding the new paragraph 11, that requires aid increases for cities of over 100,000 population be spent on public safety. Effective for aid payable in 2007 and thereafter.*****

Section 27. City LGA Appropriation. Amends Minn. Stat. § 477A.03, subd. 2a, to increase the LGA appropriation by $10 million for aid distributed in 2007 and thereafter. Effective the day following final enactment.*****

(*****The effective dates for Sections 25, 26, and 27 will be changed by amendment. Upon amendment, they will each be effective for aid payable in 2008 and thereafter.)

ARTICLE 2: FEDERAL UPDATE

Overview

Minnesota income and franchise tax is based on "federal taxable income" (FTI) for regular Minnesota tax purposes; "federal alternative minimum taxable income" (AMTI) for Minnesota alternative minimum taxable income; "federal adjusted gross income" (FAGI) for household income used for the Minnesota dependent care credit, education credit, and property tax refund; and "earned income" for the Working Family Credit. Present Minnesota law references these federal concepts through May 18, 2006.

Since May 18, 2006, the federal government has enacted three laws that modified the definitions of FTI, AMTI, AGI, and earned income.

The Heroes Earned Retirement Opportunities Act, Public Law 109-227, enacted May 29, 2006, which allows military personnel who have tax exempt combat pay to use the exempt pay as earned income for the purpose of qualifying to make tax favored individual retirement account contributions is effective retroactively to 2004.

The Pension Protection Act of 2006, Public Law 109-280, enacted August 17, 2006 which made a large number of changes to federal provisions on employer-provided defined benefit or contribution plans, IRAs and Keogh plans. The most significant change was removing the 2010 sunset of a number of pension and IRA liberalizations which were enacted federally in 2001 (higher employee contribution limits, high IRA limits and more liberal catch-up contributions for those over 50). This Act also included a number of provisions dealing with deductible charitable contributions.

The Tax Relief and Health Care Act of 2006, Public Law 109-432, enacted on December 20, 2006, extended a number of tax deductions which expired at the end of 2005 for an additional two years, a number of new provisions dealing with health savings accounts and a new itemized deduction for mortgage insurance premiums for 2007.

Section 1. Federal Update of Minnesota Administrative Provisions. Amends Minn. Stat. § 289A.02, subd. 7, to incorporate certain federal administrative provisions as defined in the Internal Revenue Code as amended through December 31, 2006. Because none of the three federal acts enacted since the last Minnesota update affect Minnesota administrative provisions, this change has no substantive effect.

Section 2. Federal Update to Minnesota Taxable Income. Amends Minn. Stat. § 290.01, subd. 19, to adopt all of the federal changes to federal taxable income made by the above three mentioned federal acts. The main federal changes in this area were:

1. For taxpayers who are 70½ or older and who transfer money from an IRA to a 501(c)(3) charity, the IRA distribution of up to $100,000 will not be part of federal adjusted gross income. Effective for transfers in 2006 and 2007.

2. For donations of used household items and clothes after August 17, 2006, a charitable deduction is not allowed if the value of the items is less than $500 and not in good used condition. If the donated item is valued at over $500, the taxpayer must submit an appraisal of the item by a qualified appraiser to claim a deduction.

3. For donations of stuffed or mounted animals to a charity, the charitable deduction is limited to the cost of stuffing or mounting the animal. Effective for donations after July 25, 2006.

4. For donations of fractional interests in personal property, no charitable deduction is allowed if the donor and donee charity do not own the total interest after gift. Further, if the donor makes fraction interest gifts of the property in a later year the deductible contribution is limited to the pro-rata fair market value of the property at the time of the first gift of a fractional interest after August 17, 2006. Effective for gifts after August 17, 2006.

5. The ability of a noncorporate taxpayer to deduct the cost plus 50% of market value over cost, of food held as inventory was extended to 2006 and 2007.

6. Corporations' ability to claim an enhanced charitable deduction for donations of book inventory or computers and computer technology to schools was extended to 2006 and 2007.

7. The federal adjusted gross income limitation on charitable deductions for donations of qualified conservation easements is increased to 50% from the old 20% or 30% limit. The 50% limit is raised to 100% for farmers and ranchers (50% of taxpayer's gross income is from farming) for tax years 2006 and 2007.

8. The restrictions necessary for claiming a charitable deduction for a facade easement of a historic building were tightened on donations made after July 25, 2006.

9. In the case where an "S" corporation donates appreciated property to a charity the shareholder's basis in their "S" stock is only decreased by the tax basis of the property instead of the fair market value of the property. Effective for tax years 2006 and 2007.

10. The ability to deduct up to $4000 per taxpayer of college expenses by taxpayers with federal adjusted gross income of less than $65,000 and $2000 per taxpayer for federal adjusted

gross income between $65,000 and $80,000 (federal adjusted gross income limits double for married filing joint) was extended for 2006 and 2007.

11. The ability of teachers to take a deduction against federal adjusted gross income (rather than as itemized deductions) of up to $250 of expenses they spent for classroom supplies was extended for 2006 and 2007.

12. The ability to elect to deduct sales taxes on personal purchases rather than deducting state income taxes was extended to 2006 and 2007 (this has little impact for Minnesota due to the required current Minnesota add-back of these deductions).

13. The ability to depreciate over 15 years rather than 39 years restaurant buildings and leasehold improvements was extended to 2006 and 2007.

14. The ability to deduct amounts placed in Archer medical savings accounts was extended to 2006 and 2007.

15. The ability to expense the cost of Brownfield clean ups was extended to 2006 and 2007.

16. Advanced mine safety equipment can be expensed up to 50% of its cost (remainder of cost depreciated) for equipment purchased after December 20, 2006 and before December 31, 2008.

17. A nonspousal beneficiary of an employer-sponsored retirement plan is allowed to roll over the proceeds into an IRA. However, amounts in the IRA must be distributed within 5 years of the decedent's death or starting within one year of decedent's death over the life expectancy of the new beneficiary. Prior law required a lump sum distribution at death for employer-sponsored plans going to a nonspouse. Effective for distributions after December 31, 2006.

18. Starting in 2007 the phase out, based on federal adjusted gross income, of an individual's ability to make an IRA contribution when the individual is already an active participant in another IRA will be adjusted for inflation rounded to the nearest $1000.

19. The higher deductible contribution limits for pension plans and IRAs which were enacted in 2001 and set to expire in 2011 were extended indefinitely.

20. The tax favored status of qualified tuition savings programs (529 plans) which would have expired starting in 2011 was extended indefinitely.

21. The square footage based deduction for building energy efficient commercial buildings was extended one year through 2008.

22. Taxpayers can make a one time tax free roll over from an IRA to health savings account (HSA) starting in 2007.

23. One of the limits on the deductible amount put in an HSA (amount of medical cost not covered by high deductible insurance coverage) was removed. Limits of $2250 for a single taxpayer and $4500 for a family still apply. Effective for tax years beginning after December 31, 2006.

24. For taxpayers with federal adjusted gross income of less than $100,000, premiums for mortgage insurance on a personal residence will be allowed as an itemized deduction for 2007 only. The 2007 deduction phases out by 10% for each $1000 of FAGI over $100,000.

Section 3. Clarification of Military Pay Subtraction and Limit on Nonitemizer Subtraction for Charitable Contributions. Amends Minn. Stat. § 290.01, subd. 19b, to clarify that the Minnesota military pay subtraction is limited to pay that is included in the taxpayer's federal adjusted gross income. Also provides that taxpayers who exclude IRA distributions going to charity under the new federal law are not allowed to claim the nonitemizer charitable subtraction for the amount of the IRA distribution going to charity. Effective for tax years beginning after December 31, 2005.

Section 4. Federal Update of Credits and Individual Alternative Minimum Tax. Amends Minn. Stat. § 290.01, subd. 31, to incorporate the federal changes from the three federal acts which impact Minnesota income and franchise tax provisions that are not part of the computation of the regular tax. For the Minnesota alternative minimum tax on individuals, trusts, estates and C corporations, the new changes to federal adjusted gross income listed in section 8 will apply to the computation of Minnesota alternative minimum taxable income. Similarly, the definition of "household income" used in computing the Minnesota Dependent Care Credit and Education Credit will adopt the same federal changes. The federal earned income credit which Minnesota uses in part in computing the Working Family Credit, was changed for the 2007 tax year to continue to allow tax exempt combat pay as earned income needed to qualify for the federal credit. All of these federal changes would be effective for Minnesota at the same time they became effective federally.

Section 5. Federal Update of Property Tax Refund. Amends Minn. Stat. § 290A.03, subd. 15, to incorporate the new federal changes to federal adjusted gross income into the definition of "household income" used to determine the Minnesota Property Tax refund available to homeowners and renters. Effective retroactively for property tax refunds based on property taxes payable on or after December 31, 2005, and rent paid on or after December 31, 2004.

Section 6. Federal Update of Estate Tax. Amends Minn. Stat. § 291.005, subd. 1, to move the date through which Minnesota incorporates the federal estate tax to December 31, 2006. Since there has not been a federal change in the estate tax since the last update, this change does not have any substantive effect.