## OMNIBUS TAX BILL

April 19, 2010

**State Taxes Only – See Separate Analysis for Property Tax Provisions**

| | Yes | No |
|---|---|---|
| **DOR Administrative Costs/Savings** | X | |

Department of Revenue
Analysis of H.F. 3729 (Lenczewski) / S.F. 3327 (Bakk) **Revised Analysis**

| | Fund Impact | | | |
|---|---|---|---|---|
| | **F.Y. 2010** | **F.Y. 2011** | **F.Y. 2012** | **F.Y. 2013** |
| | | (000's) | | |
| Estate Tax for Pass-Through Entities (1/1/10) | $0 | $4,700 | $6,500 | $6,700 |
| Sales and Use Tax | | | | |
| Online Travel Companies (7/1/10) | $0 | $3,400 | $3,700 | $3,800 |
| Exemption for Ring Tones (7/1/10) | $0 | ($175) | ($190) | ($190) |
| Eliminate Special Timing Account* | $0 | $0 | $0 | $0 |
| **General Fund Net Impact** | $0 | $7,925 | $10,010 | $10,310 |
| | | | | |
| Sales and Use Tax | | | | |
| Online Travel Companies | $0 | $200 | $200 | $200 |
| Exemption for Ring Tones | $0 | ($10) | ($10) | ($10) |
| Manufactured Homes, 0.375% Rate (7/1/10) | $0 | $50 | $40 | $30 |
| **Natural Resources and Arts Funds Net Impact** | $0 | $240 | $230 | $220 |
| | | | | |
| **Total – All Funds** | $0 | $8,165 | $10,240 | $10,530 |

*The analysis was revised to reflect that this account was previously repealed in Laws 2010, Chapter 215.

**EXPLANATION OF THE BILL –** Provisions that have a revenue impact

*Estate Tax for Pass-Through Entities*
Under current law, if a decedent was a nonresident of Minnesota, and if the decedent had an ownership interest in a pass-through entity containing real or tangible Minnesota property, the property would not be subject to the Minnesota estate tax since the property would be considered intangible personal property and hence located in the decedent's state or country of domicile at the time of the decedent's death.

Under the provisions of the bill, if a decedent was a nonresident of Minnesota, and if the decedent had an ownership interest in a pass-through entity containing real or tangible Minnesota property, the proposal states that such real or tangible property will be considered to be located in Minnesota in spite of the existence of the pass-through entity as long as the property was personally owned by the decedent. The proposal states that a pass-through entity includes: entities taxed as S corporations; entities taxed as partnerships; single-member limited liability companies or similar entities, including those disregarded for federal income tax purposes; and trusts.

**EXPLANATION OF THE BILL (Cont.)**

*Sales and Use Tax – Online Travel Companies*
Lodging and related services are subject to the sales and use tax. The final price charged to the consumer of the room rental is generally considered the price subject to sales tax. For national online reservation services which are not located in Minnesota, the industry practice has been to pay sales tax to the hotel/motel companies on their purchase price and not based on the price they charge to the consumer. These businesses are also referred to as online travel companies (OTC's).

The bill provides definitions for "accommodations intermediary" and "accommodations provider" and specifies that the accommodations intermediary is required to collect and remit sales and use tax for services connected with lodging in Minnesota. The accommodations provider is deemed to be the agent of the accommodations intermediary for purposes of establishing the intermediary's obligation to collect.

*Sales and Use Tax – Exemption for Ring Tones*
Ring tones are customized sounds to alert telecommunications users of an incoming call. Ring tones are currently taxable in Minnesota.

The bill would exempt ring tones from the sales and use tax in order to be in conformity with the Streamlined Sales and Use Tax Agreement, which Minnesota has been a party to since 2001.

*Sales and Use Tax – Manufactured Homes Subject to 0.375% Rate*
The sale of a manufactured home for the first time in Minnesota is taxed at 6.5% of 65% of the dealer's cost. There is an exemption in current law for the sale of used manufactured homes. Also, trade-in allowances are no longer allowed on the sale of a new home.

The bill would increase the tax rate on the sale of a manufactured home from 6.5% to 6.875% of 65% of the dealer's cost, to be consistent with the current general statewide sales tax rate in Minnesota.

**REVENUE ANALYSIS DETAIL**

*Estate Tax for Pass-Through Entities*
- The estimate is based on the February 2010 forecast.
- For 2006 and 2007, the portion of the estate tax paid from the estates of nonresidents was about 2.4%.
- From Department of Revenue data it is estimated that the ratio of non-homestead property not subject to estate taxation for nonresidents to non-homestead property currently subject to estate taxation for nonresidents is about 3.9.

**REVENUE ANALYSIS DETAIL (Cont.)**

- From other department data it is estimated that pass-through entities comprise about 45% of the business property in the state. Therefore, the ratio of pass-through property to non-homestead property currently subject to estate taxation for nonresidents would be about 1.8.
- Using the above ratios, the impact of the proposal for business related pass-through entities, which historically have been exempt from the estate tax, was estimated to be $4,600,000, $6,300,000 and $6,500,000 for fiscal years 2011, 2012 and 2013 respectively.
- The impact on non-business related pass-through entities is estimated to be $200,000 per year, based on estimates developed during the 2009 session.
- It is assumed that the returns are filed and the tax is paid nine months after the death of the decedent.

*Sales and Use Tax – Online Travel Companies*

- Sales and use tax return data from the 2008 Minnesota Sales Tax Statistics report that $113.7 million in sales and use tax was remitted statewide from the accommodations sector. It is estimated that 83% of this total, or $94.3 million, was attributable to room rentals.
- Global Insight, Inc., reports growth in recreation spending of -6.0% for 2009. Forecast growth rates for the subsequent years are 5.2%, 2.0%, 0.4%, and 0.7%.
- Information from Hospitality eBusiness Strategies (HeBS) reports that approximately 41% of all bookings in calendar year 2009 were generated from the Internet. This percentage is forecast to grow about two percentage points per year.
- Additionally, for calendar year 2009, HeBS reports that 63% of the online sales were attributable to hotel-branded websites and 37% accounted for the intermediary websites. The percentage attributable to the intermediary websites is forecast to decline about one percentage point per year.
- It is estimated that the portion of the room price that is being held by the intermediary as a reservation service is 25% of the final price to the consumer.
- It is assumed that travel agencies in Minnesota are correctly paying tax on room rental prices.
- It is assumed that the bill will not affect the taxes paid by in-state travel service companies.
- Calendar year data was converted to fiscal year data. Fiscal year 2011 was adjusted for eleven months of collections.
- There is a transition provision related to sales and purchases prior to July 1, 2010. The estimates do not include amounts for sales and purchases prior to July 1, 2010.
- The estimates reflect implementation and compliance with the provisions of the bill on the effective date. However, if the out-of state entities challenge the provisions with litigation, as has been the case in other jurisdictions, it is uncertain as to when and to what extent tax revenues would be realized.
- Several national on-line travel companies located outside Minnesota would be affected.

**REVENUE ANALYSIS DETAIL (Cont.)**

*Sales and Use Tax – Exemption for Ring Tones*

- The business magazine *B&T Weekly* estimated the U.S. ring tone market in 2006 at $600 million. This figure was reduced by 15% to account for possible over-estimation.
- The adjusted national number ($510 million) was multiplied by 1.73%, Minnesota's share of U.S. population in 2006 according to Census Bureau estimates.
- The apportioned Minnesota amount was then reduced by 65% to account for ring tone providers that lack enforceable nexus with Minnesota and for the $770 annual *de minimis* use tax exemption on consumer purchases.
- Recent telecom industry publications indicate that ring tone sales peaked in 2006 and declined in 2007 and 2008. This updated analysis reduces the 2006 base year estimate by 2% each year for 2007 and 2008, and then assumes no growth through 2013.
- The estimate for fiscal year 2011 was adjusted for the effective date of July 1, 2010, with 11 months of impact in the first year.

*Sales and Use Tax – Manufactured Homes Subject to the 0.375% Rate*

- Information on the number of manufactured homes, the average sales price, and growth rates is from the U.S. Census. It is expected that the number will continue to decline, as it has in recent years.
- Fiscal year 2011 is adjusted for 11 months of collections.
- It is estimated that there will be 300 new manufactured homes placed in Minnesota in fiscal year 2011.

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

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