

MINNESOTA • REVENUE

SALES TAX Up-Front Capital Equipment Exemption for Small Businesses

March 2, 2012

	Yes	No
DOR Administrative Costs/Savings		X

Department of Revenue

Analysis of H.F. 1842 (Fabian) / S.F. 1670 (Koch), **Revised for February Forecast**

	Fund Impact			
	<u>F.Y. 2012</u>	<u>F.Y. 2013</u>	<u>F.Y. 2014</u>	<u>F.Y. 2015</u>
		(000's)		
General Fund	\$0	(\$7,800)	(\$4,800)	(\$2,900)
Natural Resources and Arts Funds	<u>\$0</u>	<u>(\$500)</u>	<u>(\$300)</u>	<u>(\$200)</u>
Total – All Funds	\$0	(\$8,300)	(\$5,100)	(\$3,100)

Effective for purchases made after June 30, 2012.

EXPLANATION OF THE BILL

Current Law: Capital equipment, as defined, is exempt from the sales and use tax when used by production industries. 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 claims in a calendar year, but the claims can be for multiple transactions.

The items must be acquired by the user in order to be exempt. Machinery and equipment purchased by a contractor under a lump-sum contract do not qualify.

Proposed Law: The bill would allow small businesses to obtain a sales tax exemption on qualifying capital equipment at the time of purchase or lease, without going through the refund process required under current law. A small business is defined as a business meeting the qualifications in Minnesota Statutes, Section 645.445. To qualify as a small business, the business must have 20 or fewer full time employees and not more than \$1 million in gross revenues. The business cannot be an affiliate or subsidiary of an entity that does not meet the employment and revenue thresholds.

REVENUE ANALYSIS DETAIL

- The estimate was based on capital equipment expenditures for calendar years 2010 and 2009 from the U.S. Census report *Annual Capital Expenditures*. National expenditures were apportioned to Minnesota based on the state's share of the U.S. manufacturing, mining, and electric utility sectors.
- 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.

REVENUE ANALYSIS DETAIL (Cont.)

- Data from the Census of Business (2008) shows that manufacturing business with 20 or fewer employees, employed 8.2% of total manufacturing employees. The portion was increased to 8.5% to account for other qualifying small businesses outside the manufacturing sector. This percentage was used to break out the amount of total capital equipment expenditures covered by this bill.
- Total adjusted expenditures were multiplied by the 6.875% tax rate and increased annually by growth in industrial equipment expenditures based on data published in February 2012 by Global Insight, Inc.
- Capital equipment refunds from the February 2012 state revenue forecast were subtracted from total estimated qualifying expenditures to arrive at the core revenue impacts.
- The estimates were further adjusted to account for tax refunds on purchases made before June 30, 2012, 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 3 ½ years from the date of purchase or lease to file refund claims.
- The estimate for fiscal year 2013 was adjusted for the June 30, 2012, effective date (eleven months of impact in the first year).

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