

MINNESOTA · REVENUE

SALES AND USE TAX INDIVIDUAL INCOME TAX Repeal Sales Tax Exemption for Clothing Clothing Sales Tax Credit

January 15, 2013

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue

Analysis of S.F. 11 (Rest), As Proposed to be Amended (SCS011A-1)

	Fund Impact			
	<u>F.Y. 2014</u>	<u>F.Y. 2015</u>	<u>F.Y. 2016</u>	<u>F.Y. 2017</u>
	(000's)			
Tax Clothing (6.5%)	\$289,300	\$325,300	\$335,900	\$346,600
Clothing Income Tax Credit	(\$41,600)	(\$42,100)	(\$42,500)	(\$42,900)
Sales Tax Rate Reduction to 6.158%	<u>(\$249,000)</u>	<u>(\$281,000)</u>	<u>(\$289,100)</u>	<u>(\$296,600)</u>
General Fund Total	(\$1,300)	\$2,200	\$4,300	\$7,100
Tax Clothing (0.375%)	\$16,700	\$18,800	\$19,400	\$20,000
Sales Tax Rate Reduction to 0.352%	<u>(\$16,900)</u>	<u>(\$19,000)</u>	<u>(\$19,600)</u>	<u>(\$21,000)</u>
Natural Resources and Arts Funds	(\$200)	(\$200)	(\$200)	(\$1,000)
Total – All Funds	(\$1,500)	\$2,000	\$4,100	\$6,100

Effective beginning in tax year 2013 for the income tax credit.

Effective for clothing sales made after June 30, 2013.

The sales tax rate is reduced effective for sales made after June 30, 2012.

EXPLANATION OF THE BILL

This bill would repeal the sales and use tax exemption for clothing and sewing materials. As proposed to be amended, the bill would reduce the total state sales tax rate from 6.875% to 6.51%. The general fund sales tax rate is reduced from 6.5% to 6.158%, and the legacy funds rate is reduced from 0.375% to 0.352%.

The bill would create a refundable credit against the individual income tax. The credit would equal \$60 for married joint filers and \$30 for all other filers, plus an amount for each dependent claimed on the return: \$30 for the first dependent, \$15 each for the second and third dependents, \$10 for the fourth dependent, and \$5 for each additional dependent.

The credit would be reduced by \$10 for every \$1,000 of income above 200% of the poverty guidelines. As an example, a family of four would be eligible for a credit of \$105 (\$60+\$30+\$15). Using the 2012 poverty guidelines, the credit would be reduced beginning at household income of \$46,100, and would be phased out completely at \$57,100. Income would include all taxable and nontaxable income, using the definition of household income that is used for the dependent care credit.

REVENUE ANALYSIS DETAIL

Repeal Exemption for Clothing

- The base for this estimate is consumer spending on clothing from the current version of the Department's consumption tax model.
- The consumption tax model is based on national input/output and personal consumption tables scaled to Minnesota. The model was updated to complete the 2013 Tax Incidence Study.
- An analysis of the Top 500 Internet retailers as published by Internet Retailer indicates that Internet clothing retailers with a physical presence in Minnesota are already collecting sales tax on their non-clothing Internet sales. This estimate assumes retailers with a physical presence would collect sales tax on their online clothing sales.
- Retailers that ship clothing to Minnesota, but do not have a physical presence in Minnesota, would not be required to collect Minnesota sales tax on their clothing sales.
- Consumers who purchase clothing on which the sales tax was not collected would be responsible for remitting use tax if they purchased more than \$770 in items subject to use tax per calendar year. Consumers who purchase less than \$770 per year would be eligible for the *de minimis* exemption.
- Data from the U.S. Census Bureau's Annual Retail Trade Survey and Internet Retailer indicate that about 6% of clothing sales are being made by retailers who would not be required to collect sales tax. Use tax would likely not be collected on the majority of these purchases because of the *de minimis* exemption or noncompliance by consumers with Minnesota use tax provisions. Therefore, the estimates have been reduced by 6%.
- The estimate for fiscal year 2014 reflects eleven months of impact.

Sales Tax Rate Reduction

- The sales tax rate reductions are based on the November 2012 sales tax forecast.

Income Tax Credit for Clothing Purchases

- Estimates of the clothing sales tax credit are based on a database constructed for the 2011 Tax Incidence Study. It was assumed that all households filing income tax returns would claim the credit. Of nonfiler households, it was assumed that the 20% entitled to the greatest credit amount would claim the credit.
- The five-year average growth in the total number of income tax returns was used as a growth factor in this analysis.
- Credit amounts for each tax year were allocated to the following fiscal year.
- It is estimated that about 801,000 taxpayers would claim the credit in tax year 2013. The average credit would be \$52.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.revenue.state.mn.us/research_stats/Pages/Revenue-Analyses.aspx