INDIVIDUAL INCOME TAX
CORPORATE FRANCHISE TAX
Various Provisions

April 2, 2013

See Separate Analysis for Property Tax and Mining Tax Provisions

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 1493 (Lenczewski), As Proposed to be Amended (H1493A1)

	Fund Impact			
	F.Y. 2014	**F.Y. 2015**	**F.Y. 2016**	**F.Y. 2017**
	(000's)			
Individual Income Tax				
Limit Real Estate Tax Deduction to Tax on Principal Residence	$24,900	$25,200	$25,900	$27,500
Limit Mortgage Interest Deduction to Acquisition Debt on Principal Residence	$42,400	$41,200	$42,200	$44,900
Limit Personal Property Tax Deduction to Tax on Principal Residence	$11,000	$11,500	$12,100	$12,900
Repeal Charitable Contribution Deduction	$187,900	$198,100	$208,100	$220,500
Repeal Exemption for Minnesota State & Local Bond Interest	$1,500	$9,200	$12,800	$21,300
Repeal K-12 Education Subtraction	$17,900	$18,300	$18,800	$19,700
Repeal Charitable Contribution Subtraction for Nonitemizers	$8,000	$8,600	$9,200	$9,700
Repeal Subnational Foreign Taxes Subtraction	$40	$40	$40	$40
Repeal Subtraction for AmeriCorps National Service Program	$100	$100	$100	$100
Charitable Contribution Credit	($167,600)	($178,400)	($188,200)	($197,900)
Repeal Long Term Care Insurance Credit	$8,500	$8,700	$8,800	$9,000
Repeal Employer Transit Pass Credit	$100	$100	$100	$100
Repeal K-12 Credit	$15,100	$14,700	$14,200	$14,000
Repeal Nonresident Partner Credit	Negl.	Negl.	Negl.	Negl.
Make Research & Development Credit Nonrefundable	$2,500	$2,300	$2,200	$2,000
Interaction Among All Provisions	$22,200	$14,000	$10,100	$3,000
Subtotal: Individual Income Tax	$174,540	$173,640	$176,440	$186,840

	Fund Impact			
	F.Y. 2014	**F.Y. 2015**	**F.Y. 2016**	**F.Y. 2017**
	(000's)			
Corporate Franchise Tax				
Repeal Foreign Source Royalty Subtraction	$111,600	$77,600	$77,300	$78,400
Repeal FOC Provisions	$25,800	$18,200	$18,200	$18,500
Interaction	$2,000	$2,000	$2,000	$2,000
Subtotal: FOC and Foreign Royalty	$139,400	$97,800	$97,500	$98,900
Index Minimum Fee and Bracket Amounts	$9,300	$9,400	$9,600	$9,800
Make Research & Development Credit Nonrefundable	$48,700	$35,100	$32,700	$30,200
Foreign Partnership Income	$6,000	$6,000	$6,000	$6,000
Definition of Minnesota Sales	$26,000	$20,000	$20,000	$20,000
Eliminate Dividend Received Deduction for REIT Dividends	$1,000	$1,000	$1,000	$1,000
Repeal Employer Transit Pass Credit	$1,100	$1,100	$1,100	$1,100
Repeal Corporate Credit for Taxes Paid to Another State	$0	$0	$0	$0
Subtotal: Corporate Franchise Tax	$231,500	$170,400	$167,900	$167,000
Extend Suspension of Political Contribution Refund Program	$5,500	$6,500	$0	$0
General Fund Net Impact*	$411,540	$350,540	$344,340	$353,840

* Does not include an estimate for the definition of a domestic corporation. An estimate for the provision has not yet been determined.

EXPLANATION OF THE BILL

Individual Income Tax

Limit Real Estate Tax Deduction to Tax on Principal Residence
The proposal would limit the itemized deduction for real estate taxes to the tax on the taxpayer's primary residence. Amounts deducted for real estate taxes on other non-income-producing property would be added back in calculating Minnesota taxable income, but total itemized deductions could not be reduced below the amount of the Minnesota standard deduction.

Limit Mortgage Interest Deduction to Acquisition Debt on Principal Residence
The proposal would limit the itemized deduction for mortgage interest to interest on debt secured by the principal residence that qualifies as acquisition debt. Acquisition debt includes the total mortgage amount at the time of initial home purchase (up to the home's market value) along with refinanced mortgages up to the amount of outstanding acquisition debt at the time of refinance.

It also includes amounts borrowed for certain home improvements. It does not include equity extracted during refinancing, home equity loans, or outstanding balances on a home equity line of credit unless the funds are used for certain home improvements.

Limit Personal Property Tax Deduction to Tax on Principal Residence
Under current law, personal property taxes are allowed to be deducted as a federal itemized deduction. The proposal is to add back the itemized deduction for personal property taxes, other than taxes on a principal residence, when calculating Minnesota taxable income. The total amount added back for personal property taxes and state income and sales taxes cannot reduce total itemized deductions to below the standard deduction. Personal property taxes allowed as an itemized deduction, other than those on a principal residence, would primarily be for the ad valorem portion of the motor vehicle registration tax.

Repeal Charitable Contribution Deduction
Under current law taxpayers are allowed the federal itemized deduction for charitable contributions when calculating Minnesota taxable income. The proposal disallows this deduction.

Repeal Exemption for Minnesota State & Local Bond Interest
Current law requires that federally exempt interest income from debt obligations of any state or its political subdivisions must be added to federal taxable income when calculating Minnesota taxable income. Interest on Minnesota obligations is exempt from this requirement. The bill would remove this exemption for bonds issued after June 30, 2013, thus requiring that interest income from Minnesota debt also be added to federal taxable income when calculating Minnesota taxable income.

Repeal K-12 Education Subtraction
This proposal repeals the K-12 education subtraction. A subtraction from federal taxable income is allowed for certain education expenses paid for a qualifying child in kindergarten through twelfth grade. The maximum subtraction is $1,625 per child in kindergarten through sixth grade and $2,500 per child in seventh through twelfth grade. Qualifying expenses include amounts paid to others for tuition, transportation, nonreligious textbooks, and instructional materials and equipment required for regular school classes. Fees or tuition for instruction outside the regular school day and school year also qualify, such as tutoring and educational summer camps. Amounts paid for computer hardware and educational software can be subtracted, subject to a limit of $200 per family. The amount that can be subtracted is reduced by any expenses used to claim the K-12 education credit.

Repeal Charitable Contribution Subtraction for Nonitemizers
Under current law taxpayers are allowed a subtraction for charitable contributions for nonitemizers from federal taxable income when calculating Minnesota taxable income. The subtraction is equal to 50% of the contributions that exceed $500. The proposal disallows this subtraction.

Repeal Subnational Foreign Taxes Subtraction
Income taxes paid to a subnational government in a country other than Canada may be subtracted from Minnesota taxable income. The subtraction applies only to the amount not used for the federal foreign tax credit. The proposal would repeal the subtraction.

Repeal Subtraction for AmeriCorps National Service Program
A subtraction from federal taxable income is allowed for the amount of a national service education award received from the National Service Trust for service in the AmeriCorps National Service program. The award can be used to pay college tuition or repay student loans. The proposal is to repeal the subtraction.

Allow Charitable Contribution Credit
The proposal allows a nonrefundable credit against tax equal to 8% of the amount by which eligible charitable contributions exceed the greater of: (1) 2% of adjusted gross income or (2) $800 for married joint filers and $400 for all other filers. Eligible charitable contributions are charitable contributions allowed to be deducted as an itemized deduction even if the taxpayer took the standard deduction. The credit is available to taxpayers who itemize or take the standard deduction. The credit is apportioned for nonresidents.

Repeal Long Term Care Insurance Credit
A taxpayer is allowed a nonrefundable credit against the individual income tax equal to 25% of long term care insurance premiums paid during the tax year, to the extent that the premiums are not deducted in determining federal taxable income. The maximum credit is $100 for each qualified beneficiary. The maximum credit is $200 for married-joint returns and $100 for all other filers. The proposal would repeal the credit.

Repeal Employer Transit Pass Credit – Individual and Corporate
An employer may take a nonrefundable credit against the corporate franchise tax or individual income tax equal to 30% of the expense incurred to provide to its employees transit passes that are for use in Minnesota. If the employer purchases the transit passes from a transit system operator and then resells them to its employees at a discount, the credit is based on the difference between the price paid by the employer and the price paid by employees. The proposal would repeal this credit.

Repeal K-12 Credit
Taxpayers may claim a refundable credit against the individual income tax equal to 75% of educational expenses for a qualifying child in kindergarten through 12th grade. Qualifying expenses include amounts paid to others for transportation, nonreligious textbooks, and instructional equipment for regular school classes. Fees or tuition for instruction outside the regular school day and school year also qualify, such as driver education, tutoring, and educational summer camps. Amounts paid for computer hardware and educational software are qualifying expenses, subject to a limit of $200 per family. The maximum credit is $1,000 per qualifying child. The credit is reduced for taxpayers with household income over $33,500, and

for taxpayers with one or two children is phased out completely at household income of $37,500. The income thresholds and maximum credit amounts are not indexed for inflation. The proposal is to repeal the K-12 education credit.

Repeal Nonresident Partner Credit
A nonresident who is subject to Minnesota income tax on the gain from the sale of a partnership interest and also paid tax on the same income to the state of domicile may claim a credit equal to the tax paid on the gain to the individual's state of domicile. The credit is allowed only if the other state does not allow a credit for the tax paid to Minnesota on the gain from the sale. The proposal would repeal the nonresident partner credit.

Corporate Franchise Tax

Repeal Foreign Source Royalty Subtraction and Foreign Operating Corporation Provisions
The proposal would repeal the subtraction for foreign royalty income. The subtraction is 80% of royalties received from foreign corporations. The proposal would also repeal the foreign operating corporation (FOC) provisions. Under current law, 80% of FOC income can be claimed as a dividend received deduction.

Index Minimum Fee and Bracket Amounts
C corporations, S corporations, and partnerships pay a minimum fee based on the sum of their Minnesota property, payroll, and sales, the Minnesota factors. The fee varies from $0 in the first bracket to $5,000 in the top bracket. The minimum fee amounts and brackets have not been changed since enactment in 1990.

Under the proposal, the current law fee and brackets amounts are changed for tax year 2013. Tax year 2013 fee and the factor brackets would be changed to reflect the effects of inflation since the minimum fee was first imposed in tax year 1990. The 2013 fee and factor brackets were computed using the same method used to index the tax brackets for the individual income tax.

Starting with tax year 2014, the proposal requires the fee and brackets to be indexed to reflect the effects of inflation based on the Consumer Price Index, with tax year 2013 as the base year. The indexing method used to compute the fee and factor brackets is the same method used to index tax brackets for the individual income tax.

Total MN Property, Payroll, and Sales	Minimum Fee	Total MN Property, Payroll, and Sales	Minimum Fee
Less than $500,000	$0	Less than $930,000	$0
$500,000 - $999,999	$100	$930,000 - $1,869,999	$190
$1,000,000 - $4,999,999	$300	$1,870,000 - $9,339,999	$560
$5,000,000 - $9,999,999	$1,000	$9,340,000 - $18,679,999	$1,870
$10,000,000 - $19,999,999	$2,000	$18,680,000 - $37,359,999	$3,740
$20,000,000 or more	$5,000	$37,360,000 or more	$9,340

Make Research and Development Credit Nonrefundable – Corporate and Individual
The research and development (R & D) tax credit is a refundable credit allowed against the franchise tax for C corporations and against the individual income tax for partners in a partnership and shareholders in an S corporation. If the credit exceeds the tax liability under Chapter 290, the difference is refunded to the taxpayer.

Under the proposal, the R & D credit would be a nonrefundable credit. If an R & D tax credit exceeds the tax, the excess credit would not be refunded but could be carried forward to reduce tax in future years. The revenue gain is expected to decline in future years due to the increased use of carryover credits.

Foreign Partnership Income
The proposal covers the flow through of income from entities subject to the federal check-the-box rules. Under the proposal, as long as the income is taxable income for federal tax purposes it would also be taxable income for Minnesota.

Entities subject to the check-the-box rules are business entities, such as an LLC, that have nearly all the attributes of a corporation. With these attributes it is not clear whether such an entity should be taxed as a partnership or as a corporation. In response to the difficulty of determining whether an LLC-like entity is a partnership or a corporation, the federal government developed the check-the-box regulations.

Under these regulations, the taxpayer with an LLC-like entity makes a choice to have the entity taxed as a corporation or as a partnership. A taxpayer can choose to have an entity be a disregarded entity. This choice permits the income of the entity to flow to the owner of the entity as if the entity were a partnership.

The proposal would reverse the ruling in the Manpower case. The case covered the flow through of income from a foreign partnership. Under the proposal, this flow through of income would be subject to tax.

Although the Manpower case covered a narrow set of foreign entities using the check-the-box regulations, the court decision has been broadly interpreted to prohibit the flow through of income and losses from foreign entities to domestic corporations.

Under the proposal, the flow through of income from entities due to choices under the check-the-box regulations would be the same under federal and Minnesota law.

Definition of Minnesota Sales
Multiple related corporations that operate as a single economic unit are called a unitary group. Beginning in tax year 2014 the apportionment percentage is the ratio of Minnesota sales to total sales. Only those corporations that compute an apportionment percentage are subject to tax in Minnesota.

Corporations with nexus are required to compute an apportionment percentage. Under current law, the determination of whether nexus is established is made on a corporation-by-corporations basis for each corporation in a unitary group. Nexus is generally created by the presence of Minnesota property and payroll.

Under current law, the Minnesota sales and the Minnesota property and payroll may be placed into two separate corporations. In this circumstance the apportionment percentage would be zero even though on a unitary basis the unitary group has Minnesota property, payroll, and sales.

Under the proposal, the determination of nexus would be made on a unitary basis. When nexus is determined on a unitary basis, once nexus is established for one corporation in a unitary group then all corporations in the unitary group have nexus, and all Minnesota sales would be used to compute an apportionment percentage.

Eliminate Dividend Received Deduction for REIT Dividends
As a general rule, a corporation is allowed to take a dividend received deduction on dividends it receives from another corporation. There are exceptions to this general rule. For example, under both federal and state law a corporation that receives dividends from a regulated investment company cannot take the dividend received deduction.

Minnesota differs from federal law on whether dividends from a real estate investment trust (REIT) are eligible for the dividend received deduction. Under federal law a corporation that receives REIT dividends cannot take the dividend received deduction. Unlike federal law, Minnesota law contains no prohibition from using the dividend received deduction for REIT dividends.

Under both federal and state law, the taxable income of a REIT is computed in the same manner. Provided that a corporation distributes 90% of its income, its taxable income is computed using a dividend paid deduction. In most cases the dividend paid deduction reduces the taxable income of a REIT to zero.

Under the proposal, the dividend received deduction would not be allowed for REIT dividends. If the proposal were enacted, both state and federal law would prohibit the use of the dividend received deduction for REIT dividends.

Repeal Corporate Credit for Taxes Paid to Another State
A corporate taxpayer may, under limited circumstances, claim a tax credit equal to the paid to another state. This credit can be claimed if an item of income is both assigned to another state and the same item is taxable under Minnesota law. The proposal would repeal the credit for taxes paid to another state.

Definition of a Domestic Corporation
Under current law only corporations organized in the United States are included in the unitary group. Corporations organized in foreign countries are excluded from the unitary group.
The proposed law has two sets of conditions where corporations organized in a foreign country could be part of a unitary group.

Under the first set of conditions, a foreign corporation could be part of a unitary group if the average of its U.S. property, payroll, and sales is 20% or more, or if it derives less than 80% of its income from foreign sources. The definition of what is foreign source income relies on definitions in the Internal Revenue Code. The code determines by class of income such as interest, dividends, and other types of income what is foreign source income Data to determine what part of foreign corporation's income is foreign source income may not be readily available. Unitary groups report the income and expenses for their U.S. corporations. Under current law, income from a related foreign corporation is reported when it is repatriated to the United States. Repatriated income may not necessarily be the current year income of a foreign corporation. The repatriated income reported contains no data on the current year income and expenses of such corporations.

Under the second set of conditions, a foreign corporation could be part of a unitary group if the corporation is incorporated in or has its principal place of business in a jurisdiction that does not impose an income or imposes an income tax of 10% or less of the United States income tax rate provided that either of two conditions are met. The first condition is if 50% or more of the sales, purchases, or payments of income or expenses are made directly or indirectly with other members of a Minnesota unitary group. The second condition is if the corporation does not conduct significant economic activity. The term significant economic activity may need to be defined more precisely.

Extend Suspension of Political Contribution Refund Program
The political contribution refund provides a refund to individuals for contributions made to qualifying political parties and candidates. The maximum refund is $50 for an individual and $100 for a married couple filing jointly. The political contribution refund program has not been in effect since July 1, 2009, and is scheduled in current law to be re-implemented July 1, 2013. The proposal is to extend the period of suspension of the program to July 1, 2015.

Local Lodging Taxes
Minnesota law authorizes cities and townships to impose a tax on transient lodging of up to 3%. Ninety-five percent of the revenue must be used to fund a local convention or tourism bureau. The provision specifies that if the local lodging tax is not state administered and is collected by an "accommodations intermediary", as defined in the state sales tax statute, the local government imposing the tax may only require the accommodations intermediary to file and remit the tax once in every calendar year. The local government must inform the tax intermediary of the date when the return and remittance is due.

REVENUE ANALYSIS DETAIL

Individual Income Taxes

Limit Real Estate Tax Deduction to Tax on Principal Residence

- The Tax Incidence Study database for 2010 was used to compare each taxpayer's itemized deduction for real estate taxes with the property tax on that taxpayer's homesteaded property. The database is limited to full-year residents.
- Only taxes on non-income-producing property can be claimed as itemized deductions. Deducted amounts should be net of property tax refunds, and special assessments are generally not deductible.
- For taxpayers with a Minnesota homestead, the difference between the amount claimed as an itemized deduction and the tax on the taxpayer's homestead property was assumed to be tax on another home or property under the following conditions:
  - The difference was at least $500.
  - The difference could not be identified as due only to the failure to adjust for a property tax refund.
- The differences accounted for 14.6% of all real estate taxes claimed by Minnesota full-year residents in 2010.
- The same proportion was assumed to apply to nonresident and part-year resident returns claimed itemized deductions for real estate taxes.
- The House Income Tax Simulation Model was used to estimate the impact by assuming that 14.6% of real estate tax deductions would be added back when calculating Minnesota taxable income.
- Tax year impact was allocated to the following fiscal year.
- From the database of 2010 full-year resident returns, an estimated 181,500 returns would be affected by the proposal.

Limit Mortgage Interest Deduction to Acquisition Debt on Principal Residence
Principal Residence

- According to national data obtained from the Federal Reserve Board's *Survey of Consumer Finances*, in 2010 national debt on non-income-producing residential property that was not the primary residence accounted for about 6.5% of all national residential property debt. A program from the Federal Reserve Bank was modified to run against the Survey of Consumer Finances detailed public dataset to separate out income-producing debt from other residential debt to obtain the 6.5%. Properties included in this category include seasonal or vacation houses, ownership in time shares, and cooperatives and condominiums. Because Census data for the year 2000 shows that the percentage of seasonal, recreational or occasional use homes in Minnesota is higher than the national average, the 6.5% was scaled upward to 7.8%.
- Simulation results are obtained using the House Income Tax Simulation (HITS 6.1) model. The simulations assume the same economic conditions used by Minnesota Management and

Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- The HITS model contains a variable allowing the user to add back all or part of itemized mortgage interest when calculating Minnesota taxable income. This variable was used to add back 7.8% of mortgage interest in that calculation. (This approach should give the correct amount of extra revenue obtained by the proposal but will greatly overstate the number of taxpayers affected.)

Acquisition Debt Only
- The Federal Reserve Board's 2010 *Survey of Consumer Finances* shows that 17.2% of those with a first-lien mortgage extracted an average of $30,000 in equity in their most recent refinanced first-lien mortgage, and half of that amount was used for purposes other than home improvements. That half ($15,000) represented 13.7% of the average debt secured by a primary residence.
- Applying that 13.7% to the 17.2% who extracted equity for purposes other than home improvements, equity extracted in the most recent refinancing accounts for 2.4% of outstanding debt on principal residences. Since many homeowners may have refinanced multiple times, that percentage was increased by 50% to account for equity extracted previously.
- It is estimated that equity extracted by refinancing first-lien mortgages accounts for 3.6% of total mortgage interest paid on principal homes. That percentage would be added back under the proposal.
- In addition to first-lien mortgages, 8.7% of homeowners have home equity loans on the principal residence, and 16.1% have outstanding balances on home equity lines of credit on that home.
- Calculations from the public use datasets for the Consumer Expenditure Survey from the US Bureau of Labor Statistics show that interest on home equity loans accounted for 2.9% of the total interest paid on debt secured by principal homes.
- From the *Survey of Consumer Finances*, about 31% of home equity loans secured by the principal residence were used for home purchase. It is assumed that the remaining 69% (1.9% of total interest on debt secured by the principal home) would be added back under the proposal.
- Including equity extracted from first-lien mortgage refinancing and home equity loans and lines of credit, the total percentage of interest attributed to non-acquisition debt on primary residences is estimated at 5.5%.
- That percentage was reduced by 30% to account for IRS rules requiring principal payments to be counted against non-acquisition debt before acquisition debt.
- The disallowed interest on non-acquisition debt is assumed to reduce the deduction for interest on principal residences by 3.9%.
- Since interest on debt secured by principal residence accounts for 92.2% of total deductions, the proposal is expected to reduce allowed interest deductions by 3.6%.

- Together with the 7.8% of interest deductions attributed to second homes, it is estimated that the proposal would reduce mortgage interest deductions by 11.4%. That percentage was added back when calculating Minnesota taxable income.
- Simulation results are obtained using the House Income Tax Simulation (HITS 6.1) model. The simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts were allocated to the following fiscal year.

Limit Personal Property Tax Deduction to Tax on Principal Residence

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- It is assumed that the motor vehicle registration tax accounts for 90% of the deduction for personal property taxes.
- Tax year revenue is allocated to the following fiscal year.
- For tax year 2013 an estimated 545,300 returns would be affected.

Repeal Charitable Contribution Deduction

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by the Minnesota Department of Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impact was allocated to the following fiscal year.

Repeal Exemption for Minnesota State & Local Bond Interest

- The House Income Tax Simulation Model (HITS 6.1) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2013. The model uses a stratified random sample of tax year 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- It is estimated that new issues will rise from about 3% of total interest income from Minnesota state and local debt in tax year 2013 to about 42% by 2016.
- Tax year impacts were allocated to fiscal years in accordance with predicted bond interest payment dates and estimated tax due dates.

Repeal K-12 Education Subtraction

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by the Minnesota Department of Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impact was allocated to the following fiscal year.
- For tax year 2013 an estimated 209,200 returns would have an average increase in tax of $86 per return.

Repeal Charitable Contribution Subtraction for Nonitemizers

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by the Minnesota Department of Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impact was allocated to the following fiscal year.

Repeal Subnational Foreign Taxes Subtraction

- Data from Minnesota income tax returns is the basis for this analysis.
- The most recent three-year average for subnational tax subtractions is $513,000. Because the amount of subtractions varies from year to year, that amount was used for this estimate.
- A tax rate of 6.5% was applied to the subtractions.
- An annual growth rate of 5% was applied to the estimate.
- Tax year revenue was allocated to the following fiscal year.

Repeal Subtraction for AmeriCorps National Service Program

- Data from Minnesota income tax returns indicate that, on average, about 700 taxpayers claimed $2 million in AmeriCorps subtractions for the three most recent years.
- A marginal tax rate of 5.35% was assumed.
- Tax year impact was allocated to the following fiscal year.

Allow Charitable Contribution Credit

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by the Minnesota Department of Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impact was allocated to the following fiscal year.

Repeal Long Term Care Insurance Credit

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year revenue was allocated to the following fiscal year.
- For tax year 2013 an estimated 59,600 returns would have an average increase in tax of $143 per return.

Repeal Employer Transit Pass Credit – Individual and Corporate

- The estimates are based on the amount of credit claimed in recent years.

Repeal K-12 Credit

- The House Income Tax Simulation (HITS 6.1) Model was used to estimate the tax year revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2013. The model uses a stratified sample of 2010 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year revenue is allocated to the following fiscal year.

Repeal Nonresident Partner Credit

- For the three most recent years, the average nonresident partner credit claimed was less than $5,000. For this estimate, the total amount of credits was assumed to be less than $5,000, or negligible. However, for any given year, the amount could be substantial due to a specific transaction.

Make Research and Development Credit Nonrefundable

- The total R & D credit for tax year 2011 is projected to be $14.0 million.
- Analysis of the data for tax year 2011 shows that 16% of the total amount of the credit was refunded to taxpayers.
- The R & D credit amounts are assumed to grow at 4% per year.
- Tax year revenue loss is allocated to the following fiscal year.

Corporate Franchise Tax

Repeal Foreign Royalty Subtraction and Foreign Operating Corporation Provisions

- The estimates are based on corporate income tax data for returns received in calendar year 2012. This is the latest available data.
- The revenue estimate is adjusted downward to reflect the effect of the phase-in to 100% sales weighting in tax year 2014.

- The revenue gain is assumed to match the growth of corporate franchise tax collections in the February 2013 revenue forecast.
- The estimates include the interaction that reflects the combined effect of repealing the foreign royalty subtraction and the FOC provisions.
- All of tax year 2013 was allocated to fiscal year 2014. Other tax years were allocated 30/70 to fiscal years.

Index Minimum Fee and Bracket Amounts

- Tax year 2013 fee and the factor brackets would be changed to reflect the effects of inflation since the minimum fee was first imposed in tax year 1990. The 2013 fee and factor brackets were computed using the same method used to index the tax brackets for the individual income tax.
- Starting with tax year 2014, the proposal requires the fee and brackets to be indexed to reflect the effects of inflation based on the Consumer Price Index, with tax year 2013 as the base year. The indexing method used to compute the fee and factor brackets is the same method used to index tax brackets for the individual income tax.
- Currently about 85,000 entities pay the minimum fee. Under the proposal, about 43,000 entities would have an increase in the fee, and about 42,000 would have a decrease in the fee, including about 17,000 business entities whose minimum fee would be reduced to zero.
- Revenue gain estimate is based on tax year 2009 data, projected to tax year 2013.
- Growth is estimated at 80% of inflation, as projected in the February 2013 forecast.
- Tax year impact was allocated to the following fiscal year.

Make Research and Development Credit Nonrefundable

- The total R & D credit for tax year 2010 was $63.5 million.
- Analysis of the data for tax year 2010 shows that 53% of the total amount of the credit was refunded to taxpayers.
- The R & D credit amounts are assumed to grow at 4% per year.
- All of tax year 2013 is allocated to FY 2014. Other tax years are allocated 30/70 to fiscal years.

Foreign Partnership Income

- The revenue impact from the proposal is difficult to predict. If the foreign entities in question have large amounts of income, the law change could generate a revenue gain. However, if the foreign entities have large amounts of losses, the law change could generate a revenue loss. It is assumed that the foreign entities in question are very profitable.
- The revenue gain estimate is based on estimates made in response to the Manpower case and increased to reflect all foreign partnership income.

Definition of Minnesota Sales

- Estimates are based on analysis of data from returns filed in 2007 and in 2010. The tax was recomputed on unitary groups likely to be affected by the proposal.
- All of tax year 2013 was allocated to fiscal year 2014. Other tax years were allocated 30/70 to fiscal years.

Eliminate Dividend Received Deduction for REIT Dividends

- The revenue impact from the proposal is based on an analysis of statistics from the IRS on the amount of dividends earned by corporations. REIT dividends are reported as other dividends on Form 1120, Schedule C. The difference between total dividend income and the sum of dividends reported by various categories represents an estimate of the other dividend income.
- It is assumed that most of the other dividend income is dividends from REITs and Regulated Investment Companies (RICs). IRS statistics indicate that about 25% of the combined income from RICs and REITs is earned by REITs. As such, it is assumed that 25% of the estimated other dividends income is earned by REITs.
- The nationwide total of REIT dividends received by corporations was apportioned to Minnesota.
- The dividend received deduction is 80% of the total dividends received by corporations.
- The revenue gain from the proposal was reduced by 10% to reflect that corporations with an overall loss do not fully benefit from the dividend received deduction.

Repeal Corporate Credit for Taxes Paid to another State

- It is extremely rare that an item of income is both assigned to another state and is taxable under Minnesota law.
- No corporation has claimed this credit in recent years.

Definition of a Domestic Corporation

- There is a great deal of uncertainty on the scope operations of foreign chartered corporations in unitary groups.
- Information to prove which foreign corporations should be part of unitary group may be difficult to determine in many cases.

Extend Suspension of Political Contribution Refund Program

- The annual estimates correspond to the February 2013 forecast by Minnesota Management and Budget.

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