DEPARTMENT OF REVENUE

Second Omnibus Tax Bill
Vetoed by the Governor

June 5, 2018

See Separate Analysis
For Property Tax Provisions

	Yes	No
DOR Administrative Costs/Savings	x	

Department of Revenue
Analysis of Laws 2018, Chapter 205 (H.F. 947, 1st Engrossment), Vetoed

	Fund Impact			
	F.Y. 2018	**F.Y. 2019**	**F.Y. 2020**	**F.Y. 2021**
	(000's)			
Federal Update				
Disaster Tax Relief Act (11/29/17)				
Individual Income Tax	($5,140)	$1,790	$610	$310
Corporate Franchise Tax	($400)	$200	$100	$0
Subtotal	($5,540)	$1,990	$710	$310
Tax Cuts and Jobs Act* with modifications (12/20/17)				
Individual Income Tax	($17,600)	$13,840	$101,520	$151,820
Property Tax Refund	$0	$0	$50	$50
Corporate Franchise Tax	($3,800)	$84,900	$97,700	$100,500
Subtotal	($21,400)	$98,740	$199,270	$252,370
Bipartisan Budget Act 2018 (2/9/18)				
Individual Income Tax	($18,480)	($225)	($50)	($145)
Corporate Franchise Tax	($2,310)	$410	$360	$270
Subtotal	($20,790)	$185	$310	$125
Consolidated Appropriations Act 2018 (3/23/18)	$0	$0	$0	$0
Individual Income Tax				
Reduce 1st Bracket Rate to 5.3% in TY18 & 19, 5.25% thereafter, and 2nd Bracket Rate to 6.95% In TY18 & 19, 6.85% thereafter (1/1/18)	$0	($136,700)	($141,900)	($198,600)
Angel Investment Credit (1/1/18)	$0	($5,000)	$0	$0
Cannabis Expense Subtraction (12/31/16)	$0	(Unknown)	(Unknown)	(Unknown)
Stillborn Credit Modification (1/1/16)	Negl.	Negl.	Negl.	Negl.
Corporate Franchise Tax				
Captive Insurance Company Definition (1/1/17)	$0	$0	$0	($300)
Rate reduction from 9.8% to 9.65% in TY 18-19 & 9.1% beginning in TY20 (1/1/18)	$0	($22,900)	($37,600)	($85,100)
Repeal Corporate AMT (1/1/18)	$0	($23,000)	($15,400)	($14,200)

**See the attached table for a more detailed estimate of the Tax Cuts and Jobs Act*

	Fund Impact			
	F.Y. 2018	F.Y. 2019	F.Y. 2020	F.Y. 2021
		(000's)		
Estate Tax				
Modify Business/Farm Subtraction (1/1/12-12/31/16)	$0	($400)	$0	$0
Qualified Property (1/1/18)	(Unknown)	(Unknown)	(Unknown)	(Unknown)
Sales and Use Tax				
Medical Facilities (7/1/18)	$0	($150)	($180)	($210)
Nonprofit Ice Arenas (7/1/18)	$0	($10)	($10)	($10)
Conservation Clubs (7/1/18)	$0	($10)	($10)	($10)
Inver Grove Heights Fire Station (DFE-12/31/20)	$0	($220)	$0	$0
Virginia Fire Station (DFE-12/31/20)	$0	($200)	($200)	$0
Minnetonka Facilities (DFE-12/31/20)	$0	($110)	($520)	($180)
Nonprofit Snowmobile Clubs (7/1/18)	$0	($15)	($15)	($15)
Mazeppa Fire (3/12/18-12/31/20)	$0	($10)	$0	$0
Melrose Fire (DFE-12/31/21)	$100	($100)	$0	$0
Elko New Market Facility (6/2/14-5/31/16)	$0	($240)	$0	$0
Occupation Tax				
Occupation Tax Refund	$0	$0	($1,900)	($1,800)
Department of Revenue Policy				
Deed Transfer Minimum Tax (1/1/19)	$0	(Negl.)	(Negl.)	(Negl.)
General Fund – All Provisions	($47,630)	($88,150)	$2,555	($47,620)
Natural Resources and Arts Funds				
Medical Facilities (7/1/18)	$0	($10)	($10)	($10)
Nonprofit Ice Arenas (7/1/18)	$0	(Negl.)	(Negl.)	(Negl.)
Conservation Clubs (7/1/18)	$0	(Negl.)	(Negl.)	(Negl.)
Inver Grove Heights Fire Station (DFE-12/31/20)	$0	($10)	$0	$0
Virginia Fire Station (DFE-12/31/20)	$0	($10)	($10)	$0
Minnetonka Facilities (DFE-12/31/20)	$0	($10)	($30)	($10)
Nonprofit Snowmobile Clubs (7/1/18)	$0	(Negl.)	(Negl.)	(Negl.)
Mazeppa Fire (3/12/18-12/31/20)	$0	(Negl.)	$0	$0
Melrose Fire (DFE-12/31/21)	$5	($5)	$0	$0
Elko New Market Facility (6/2/14-5/31/16)	$0	($10)	$0	$0
Natural Resources and Arts Fund – Total	$5	($55)	($50)	($20)
Total – All Funds	($47,625)	($88,205)	$2,505	($47,640)

DFE – Date of Final Enactment

	Fund Impact			
	F.Y. 2018	**F.Y. 2019**	**F.Y. 2020**	**F.Y. 2021**
	(000's)			
Local Sales and Use Tax				
Excise Tax and Fee Prohibition	$0	$0	$0	$0
City of St. Cloud	$0	$0	$0	$0
City of Minneapolis	$0	$0	$0	$0
City of St. Paul	$0	$0	$0	$0
City of Cloquet	$0	$0	$0	$0
City of Excelsior	$0	$0	$0	$0

EXPLANATION AND ANALYSIS OF THE BILL

Federal Update – Article 2

The bill would update reference to the Internal Revenue Code as amended through March 31, 2018, adopting the federal law changes made in the following Acts:

- The Disaster Tax Relief and Airport and Airway Extension Act of 2017, Public Law 115-63, enacted September 29, 2017.
- The Tax Cuts and Jobs Act of 2017, Public Law 115-97, enacted December 22, 2017.
- The Bipartisan Budget Act of 2018, Public Law 115-123, enacted February 9, 2018.
- The Consolidated Appropriations Act of 2018, Public Law 115-141, enacted March 23, 2018.

Disaster Tax Relief and Airport and Airway Extension Act
The Act establishes special rules for taxpayers taking an early distribution from a retirement plan due to damages sustained in Hurricanes Harvey, Irma, or Maria. An eligible taxpayer may take an early distribution of up to $100,000 without paying the 10% penalty and may either repay the amount or include the distribution in gross income over a three-year period, instead of in the year it was withdrawn.

The Act modifies the casualty loss deduction for hurricane-related losses. Generally, casualty losses may only be deducted to the extent that they exceed 10% of adjusted gross income, and the deduction is only available to taxpayers who itemize deductions. The law allows non-itemizers to claim the deduction for hurricane-related losses and removes the 10% threshold so that the entire loss may be deducted.

The Act also suspends the limits on charitable contributions made before December 31, 2017 for contributions related to hurricane disaster relief.

Disaster Tax Relief and Airport and Airway Extension Act (cont.)

- The estimate is based on the estimate for the federal legislation prepared by the staff of the Joint Committee on Taxation dated September 25, 2017.
- The federal estimates were apportioned to Minnesota and adjusted for differences in federal and state tax rates.
- The estimates were further adjusted to reflect the extent to which Minnesota taxpayers would likely be affected by the provision.

Tax Cuts and Jobs Act (TCJA)

The TCJA includes a number of provisions that affect Minnesota taxable income for individuals and businesses. A more detailed description of the TCJA is provided in a separate analysis. The bill generally conforms to the changes in the TCJA, with some modifications.

Under current law, federal taxable income is the starting point for determining Minnesota tax liability. The bill would use federal adjusted gross income instead, which is the amount on the federal return before applying the standard deduction, itemized deductions, and personal and dependent exemptions.

The bill allows state itemized deductions that are the same as the itemized deductions under the TCJA. State income or sales taxes would not be deductible, as under current Minnesota law. Itemized deductions would be phased out by income using the thresholds under current Minnesota law.

The bill creates a personal and dependent exemption of $4,150 for the taxpayer, spouse, and each dependent. The exemptions would be phased out by income using the same thresholds as under current Minnesota law.

All income tax brackets and other thresholds would be indexed using chained CPI-U beginning in tax year 2019.

The bill would fully conform to the federal limits on Section 179 expensing beginning in tax year 2019, eliminating the need for the Minnesota addback and subtractions.

The TCJA makes the federal historic rehabilitation credit payable over five years rather than in one year. The bill makes the Minnesota historic rehabilitation credit and grant payable over five years.

International Provisions
The TCJA requires a U.S. shareholder in a foreign corporation to recognize its share of the corporation's accumulated deferred foreign income since 1986, whether or not the income is actually brought back to the U.S. The provision applies to cash and non-cash holdings. The included amount is eligible for certain deductions, effectively reducing the federal tax rate.

Under the bill, deferred foreign income minus the amount of the federal deduction would be included in Minnesota net taxable income. The income also would qualify for the Minnesota dividends received deduction.

A domestic corporation is required to include in its federal gross income certain global intangible low-taxed income (GILTI), and is allowed a deduction for foreign derived intangible income (FDII). The bill would allow a subtraction for any GILTI income and would require FDII to be added back on the Minnesota return.

- The House Income Tax Simulation Model (HITS 6.6a) was used to estimate individual provisions where possible. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2018. The model uses a stratified sample of 2015 individual income tax returns compiled by the Minnesota Department of Revenue.
- For other provisions, the estimates are based on the estimates of the federal impacts prepared by the staff of the Joint Committee on Taxation, dated December 18, 2017. The estimates for each provision were apportioned to Minnesota based on information relevant to that provision. The estimates were adjusted for the difference between federal and state tax rates and federal and state fiscal years.
- For individual provisions, all of tax year 2018 is allocated to the following fiscal year. For most business- related provisions, one month of impact is allocated to fiscal year 2018, assuming that businesses would make changes to one estimated payment in the current fiscal year after enactment.

Bipartisan Budget Act (BBA) of 2018
The BBA extends certain expiring tax provisions through tax year 2017. It also expands the deduction for legal fees associated with whistleblower lawsuits to include certain whistleblower awards paid by the Securities and Exchange Commission, by the Commodities Futures Trading Commission, or under a State false claims act.

The BBA also expands the foreign earned income exclusion to include individuals working overseas in support of the armed forces in a combat zone. A qualifying taxpayer may exclude up to $104,100 of income in 2018, plus housing costs.

The BBA also modifies certain provisions in the Disaster Tax Relief and Airport and Airway Extension Act to include California wildfires and to include Hurricane Harvey and Hurricane Irma disaster areas declared between September 21, 2017 and October 17, 2017.

Bipartisan Budget Act (BBA) of 2018 (cont.)

- The House Income Tax Simulation Model (HITS 6.6a) was used to estimate the home mortgage insurance premiums deduction. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2018. The model uses a stratified sample of 2015 individual income tax returns compiled by the Minnesota Department of Revenue.
- For other provisions, the estimates are based on the estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated February 8, 2018.
- Where applicable, the estimates were divided between the individual income tax and corporate franchise tax. The estimates for each provision were apportioned to Minnesota based on information relevant to that provision. The estimates were adjusted for the difference between federal and state tax rates and federal and state fiscal years.

Consolidated Appropriations Act of 2018

The Consolidated Appropriations Act modifies the deduction for qualified business income in the Tax Cuts and Jobs Act.

- The Act includes a provision that changes the treatment of agricultural cooperatives and patrons of cooperatives when calculating the deduction for qualified business income. Because the bill does not conform to that federal deduction, the Act will have no impact on Minnesota tax revenue.

Other Individual and Corporate Provisions - Article 3

Reduce 1st and 2nd Bracket Rates

The provision would reduce the first and second income tax rates (currently 5.35% and 7.05%) as follows:

- 5.3% and 6.95% in tax year 2018
- 5.25% and 6.85% in tax year 2019 thereafter.

The income tax brackets would remain unchanged.

- The House Income Tax Simulation Model (HITS 6.6a) was used to estimate the rate reduction. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2018. The model uses a stratified sample of 2015 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of the impact from tax year 2018 was allocated to fiscal year 2019. Other tax years were allocated to fiscal years using a standard formula.

Angel Investment Credit

The angel investment tax credit is the commonly used name for a provision identified in statute as the small business investment tax credit. The refundable individual income tax credit is equal to 25% of the investment made in a qualified small business. The maximum credit for a tax year is $250,000 for a married couple filing a joint return and $125,000 for other filers. The investment can be made directly by a qualified taxpayer or through a qualified angel investment network fund that invests in a qualified small business. The law specifies the requirements for the investor, the investment fund, the investment, and the small business. The provision extends the sunset of this provision one year and allocates $5 million for tax year 2018.

Captive Insurance Company Definition

Insurance companies are generally exempt from the Minnesota corporate franchise tax and instead are subject to a gross premium tax. The basic qualification to determine whether a company qualifies as an insurance company is whether 50% or more of its income is from insurance. The 50% test affects situations where a unitary business sets up a self-funded insurance company that is more investment company than it is an insurance company. If a corporation fails to meet the definition of an insurance company, its income is subject to the corporate franchise tax. Such a corporation is called a captive insurance company.

The 2017 legislature further qualified what is an insurance company based on whether a company sells admitted insurance. Insurance sold by an admitted insurance company is subject to the gross premium tax. The gross premium tax may be based on either the retaliatory method or a reciprocal exemption from the retaliatory method.

The provision provides a new method to further qualify what is an insurance company and what is a taxable captive insurance company. The replacement of the method to define what is an insurance company would be on a retroactive basis. Under the provision, a company is an insurance company (which is tax-exempt) if it fails to be defined as a disqualified captive insurance company. The definition has two tests. Failure to meet one of the tests results in the failure to be defined as a disqualified captive insurance company.

The two conditions in the first test are: 1) it registers as a captive insurance company **or** 2) it receives more than 80% of premium income from related companies. The two conditions in the second test are: 1) it receives less than 50% of gross receipts from premiums **or** 2) it pays less than 0.25% in insurance gross premium taxes or comparable taxes.

If a corporation meets the definition of a disqualified captive insurance company, its income is included in the unitary income of the group, and its income is subject to the corporate franchise tax. Such a corporation is often called a captive insurance company.

Captive Insurance Company Definition (cont.)

- The provision will have no affect on traditional insurance companies who sell their policies to the general public. They are tax-exempt insurance companies. Under current law, the definition of an insurance company and, by its absence, what is a captive insurance company is a simple bright line test. The definition of an insurance company in the provision and, by its absence, what is a captive insurance company appears to have a result that is less certain than under current law.
- For instance, one of the conditions of the first test is based on a threshold of receiving more than 80% of its premiums from related companies. This condition could possibly reclassify companies as insurance companies that are now captive insurance companies.
- One of the conditions of the second test is based on a threshold of paying less than 0.25% in premium taxes. The condition appears very low when compared to the taxes paid by traditional insurance companies. This condition could possibly reclassify companies as insurance companies that are now captive insurance companies.
- The interaction between the four conditions used in the two tests is uncertain. Due to this uncertainty, the provision's language appears to offer some captive insurance companies under current law the ability to reclassify themselves as insurance companies as early as fiscal year 2021.

Cannabis Expense Subtraction

Federal law prohibits a business from claiming any expense as a deduction from federal taxable income, if the business consists of trafficking in controlled substances such as cannabis. Minnesota conforms to federal law.

The provision would allow the subtraction from Minnesota taxable income of expenses incurred in the business of providing medical cannabis, for entities registered in Minnesota to do so. The subtraction would also be allowed in determining alternative minimum taxable income.

- Entities registered to provide medical cannabis must file annual public audit reports, conducted by independent accounting firms, with the Minnesota Department of Health. This estimate is based on those public audit reports.
- At present, there are two entities registered to provide medical cannabis.
- The independent audits reveal that both entities experienced net losses in all years they have been in operation. It is not clear when, or if, the companies would have positive net incomes. Both companies do show positive gross revenue and therefore under current law have positive taxable income.
- Both companies are pass-through entities, so no estimate of the ultimate tax liability is possible without knowing the tax position of the ultimate owners or owning entities.
- Tax year impacts are allocated to the following fiscal year.

Stillborn Credit

A refundable individual income tax credit of $2,000 is allowed for an individual who is a parent of a stillborn child if the Minnesota Department of Health issued a Certificate of Birth Resulting in Stillbirth for that child, and the individual would have been eligible to claim the child as a dependent. For nonresidents or part-year residents, the credit must be allocated based on the percentage of their income that is attributable to Minnesota.

Under the provision, the individual who gave birth resulting in stillbirth would be eligible for the credit. The individual must also be listed as a parent on the Certificate of Birth Resulting in Stillbirth issued by the Minnesota Department of Health, or if the birth occurred in another state or country, a similar certificate under that state's or country's law. If no individual meets both those requirements, then the first parent listed on the certificate is eligible.

For stillbirths occurring outside Minnesota for which no certificate of birth was issued, the individual who gave birth resulting in stillbirth is eligible for the credit.

"Stillbirth" means a birth for which a fetal death report would be required if the birth occurred in Minnesota. A qualifying individual has to be 1) a resident, or 2) a nonresident spouse of a resident who is a member of armed forces of the United States or the United Nations. For part-year residents, the credit is allocated based on the percentage of income attributable to Minnesota.

- About 250 credits were claimed in tax year 2016, totaling about $500,000.
- The number of returns affected by the provision is unknown, but is assumed to be negligible. The provision extends the credit to residents who give birth in another state, but also restricts eligibility to the parent and residents. The net revenue impact is assumed to be slightly positive.

Modify Corporate Tax Rate

The provision would reduce the corporate franchise tax rate from 9.8% to 9.65% beginning in tax year 2018 and 9.1% in tax year 2020. The minimum fee would remain unchanged.

- Estimates are based on the February 2018 forecast.
- Due to a retroactive effective date, all of the tax year 2018 revenue loss is allocated to fiscal year 2019. Other tax year impacts were allocated 30/70 to fiscal years.
- The estimates include an adjustment for conformity to the Tax Cuts and Jobs Act (TCJA), which includes provisions that will expand the corporate tax base. The estimate was adjusted overall by about 7.27% to reflect the effect of conformity.

Repeal Corporate AMT
In addition to the regular corporate franchise tax with a 9.8% tax rate, taxpayers must also compute a calculation to see if they have any tax liability under the alternative minimum tax (AMT).

The calculation of the AMT begins with taxable income. The AMT tax base includes the disallowance of tax preferences that were used in the regular tax calculation and it includes amounts for adjustments. The adjustments may be positive or negative.

The AMT tax base is multiplied by a 5.8% tax rate. The product of this calculation is the tentative minimum tax. If the tentative minimum tax is larger than the regular tax, the taxpayer must pay the difference between the tentative minimum tax and the regular tax as AMT.
The amount of AMT paid generates an AMT credit, which can be taken to reduce the regular tax in future years.

Under the provision, for corporate taxpayers beginning with tax year 2018, the proposed law would eliminate the AMT. The provision allows taxpayers to use accumulated unused AMT credits against the regular tax until tax year 2021.

When compared to current law, the lack of a current-year AMT accelerates and increases the use of the AMT credit. Because the AMT credit is limited by the tentative minimum tax, under current law the AMT credit cannot be more than 42% of the regular tax. With the repeal of the AMT, there would be no current-year AMT/tentative minimum tax, and the AMT credit could be claimed against 100% of the regular tax.

- The estimate is based on an analysis of AMT and AMT credit amounts reported during tax years 2009-2015.
- The projection of the lost AMT revenue assumes AMT revenue of slightly more than 1% of current revenue projected during fiscal years 2018-2021, based on historic trends during tax years 2009-2015.
- The amount of projected corporate tax revenue is based on the February 2017 forecast prepared by MMB.
- Due to a retroactive effective date, all of the tax year 2018 revenue loss is allocated to FY 2019. Tax year revenue losses from other tax years are allocated 30/70 to fiscal years.
- The estimate assumes an accelerated use of the AMT credit as compared to current law. The bulk of the impact from this effect happens in fiscal years 2019 and 2020. Overall, the accelerated and increased use the AMT credit increases the total revenue loss by about 15%.

Estate Tax - Article 3

Modify Business/ Farm Subtraction, Definition Changes for Recapture Tax
If upon the death of a decedent, the estate and a qualified heir elect to treat certain small business or farm property of the decedent as qualified small business or farm property and agree to pay the estate tax recapture tax if applicable, then the value of such qualified property may be subtracted from the taxable estate. In the case of small business property, a family member must materially participate in the trade or business for three years after the death of the decedent, and the trade or business must not be a passive activity. Farm property must continue to be classified for property tax purposes as class 2a property for three years after of the death of the decedent. (At the time of death, the property must have been classified as property class 2a and classified as agricultural homestead, agricultural relative homestead, or special agricultural homestead.) If the property ceases to satisfy the conditions of the agreement, a recapture tax must be paid. The amount of the recapture tax is 16% of the value of the qualified property subtracted from the taxable estate.

In some situations, the value of the small business and farm property subtraction claimed by the estate exceeds the amount necessary to eliminate all tax liability on the estate tax return. If this situation were to occur, and if the property ceases to satisfy the conditions of the agreement during the required three-year period, the recapture tax that would need to be paid would be 16% of the small business and farm property subtraction even though that subtracted amount exceeded the amount necessary to eliminate the tax. This would be in accordance with the signed recapture tax agreement.

Under the provision, for estates of decedents who die in 2012 through 2016, for which there was no estate tax due, the amount of the small business and farm subtraction used to calculate any recapture tax that might be due would be redefined. The amount of the subtraction would be deemed to be the minimum amount necessary to reduce the tax on the final estate tax return to zero.

- Based on estate tax records maintained by the Department of Revenue, it was determined that there were five estate tax returns that were filed that met the following conditions:
  - The decedent died in one of the years 2012 through 2016.
  - The estate claimed the small business and farm subtraction and agreed to pay the recapture tax if required.
  - The estate owed zero estate tax when the estate tax return was filed.
  - The agreed upon conditions of the recapture tax agreement were not maintained for the required three-year period following the death of the deceased.
- The total small business and farm subtraction claimed on these five returns was about $4.87 million. The subtraction needed to reduce the estate tax to zero was about $2.44 million. The excess subtraction was estimated to be about $2.43 million.
- The excess recapture tax that would be refunded or not collected is 16% of $2.43 million or about $400,000.
- It is assumed that the refunds would occur or the collection activity would cease in fiscal year 2019.

Definition of Qualified Property

In order for small business or farm property owned by the decedent to be eligible for the small business and farm property subtraction on the estate tax return, several conditions must be met. One of the conditions that for both small business property and farm property is that the decedent must have owned the property for at least three years prior to the death of the decedent for the property to be eligible for the small business and farm subtraction.

Under the provision, if the small business or farm property is owned by the decedent or the spouse of the decedent for three years prior to the death of the decedent, then the property is eligible for the small business and farm subtraction. For the purpose of satisfying the three-year ownership requirement, any ownership by the spouse of the decedent, whether the spouse predeceases or survives the decedent, is attributed to the decedent. The provision also corrects a cross reference.

- Department of Revenue personnel have encountered situations where they have had to inform the executor of an estate that the small business or farm property of the deceased did not meet the three-year ownership requirement.
- While these types of situations do not occur frequently, it is not known how many estates would have been able to claim the small business and farm property subtraction if current statutes would allow the spousal ownership and decedent ownership to be counted as ownership for the decedent.

Sales Tax - Article 4

Medical Facilities

There is an exemption from the sales and use tax for hospitals, outpatient surgical centers, and critical access dental providers. The provision expands this exemption to additional qualifying medical facilities if the items are purchased or used in providing medical services. The provision also provides an exemption from the sales and use tax for purchases of materials and supplies used or consumed in, and equipment incorporated into, the construction or improvement of real property.

To qualify for the sales and use tax exemptions, the medical facility must: 1) be located in a medically underserved county, not in a metropolitan county, 2) have been subject to a resolution by a political subdivision stating that it fulfills an unmet need, and 3) have received an economic development abatement of the tax on the facility property from the political subdivision for at least 15 years.

A qualifying medical facility is: 1) an office, clinic, building, or portion of a building that is primarily used for the provision of primary or specialty health care services to patients on an outpatient basis, 2) birth center, 3) hospital, 4) urgent care clinic, or 5) an outpatient surgical center.

Medical Facilities (cont.)

- There are approximately 1,300 clinics in Minnesota located in medically underserved areas.
- The participation levels by political subdivisions in the local economic development abatement program for qualifying medical facilities, and the average costs per facility, are uncertain.
- It is estimated that fifteen additional medical facilities will qualify for the sales tax exemption each year. The annual sales tax exempted per medical facility is estimated to be $2,000.
- It is estimated that about five qualifying medical facilities will utilize the construction exemption each year. The sales tax exempted per construction project is estimated to be $14,000.
- A full year impact is assumed for fiscal year 2019.

Nonprofit Ice Arenas

Sales to a specific nonprofit organization whose primary purpose is the operation of ice arenas or rinks and are used for youth and high school programs are exempt from the sales and use tax. The provision would expand the exemption for a certain nonprofit ice facility to another facility.

- The estimates are based on information for Westonka Sports Association reported on federal Form 990 for nonprofit organizations in Minnesota and information for the David M. Thaler Sports Center received from a representative of the center.
- Total expenses for fiscal year 2017 are reported to be approximately $350,000.
- It is estimated that about 50% of expenses are for taxable sales.
- A growth rate of 2% is assumed.

Conservation Clubs

The provision would exempt sales to nonprofit conservation clubs from the sales and use tax. A conservation club is defined as an organization exempt under section 501(c)(3) by the Internal Revenue Service and that provides instruction, training, and facilities for shooting handguns or rifles.

- The estimates are based on information from Federal Form 990 filings of conservation clubs in Minnesota. There are approximately 34,500 nonprofits registered with the Internal Revenue Service in Minnesota.
- It is estimated that there are 100 conservation clubs in Minnesota registered as nonprofits.
- It is estimated that there are twenty conservation clubs registered with 501(c)(3) status.
- It is estimated that ten of the twenty nonprofit conservation clubs with 501(c)(3) status provide instruction, training, and facilities for shooting handguns or rifles.
- No adjustment is made for new nonprofit registrations or changes in registrations.
- January 2018 growth rates published by IHS Markit for consumer prices are used to estimate future purchases.

Inver Grove Heights Fire Station

The provision provides an exemption from the sales and use tax for materials and supplies used in, and equipment incorporated into, the construction of a new fire station in the city of Inver Grove Heights. The exemption includes construction materials for firefighting and public safety training facilities.

- Information for the estimates was provided by representatives of the city of Inver Grove Heights.
- Total construction costs of the building are estimated to be $6.7 million. It is estimated that $3.4 million will be spent on purchases that would normally be subject to sales and use tax.
- It is expected that construction will begin in the summer of 2018 and be completed by March 2019. It is assumed that purchases will occur in fiscal year 2019.

Virginia Fire Station

The provision would exempt materials and supplies used in and equipment incorporated into the construction of a new fire station, or the remodeling and expansion of an existing fire station in the city of Virginia. Materials, supplies, and equipment would be exempt at the time of purchase.

- Information for the estimates was provided by the city of Virginia.
- The total project is estimated to cost $14.6 million. It is estimated that $6 million will be spent on purchases that would normally be subject to sales and use tax.
- Construction on the project is planned to begin in 2019 and continue through early 2020.
- It is assumed that 50% of taxable purchases will be made in fiscal year 2019 and fiscal year 2020.

Minnetonka Facilities

The provision would exempt materials and supplies, and equipment incorporated into the construction of a new fire station and the remodeling and expansion of an existing police and fire station in a specific city.

- Information for the estimates was provided by a representative from the city of Minnetonka.
- The Minnetonka Police and Fire 2020 Facility Project is estimated to cost approximately $25 million. The fire station is projected to be completed first, and is estimated to cost $14 million. The remodeling project is expected to be completed second, and is estimated to cost $11 million.
- Total construction costs for materials, supplies, and equipment are estimated to be $12.5 million.
- It is estimated that $1.75 million will be spent on purchases that would normally be subject to sales and use tax in fiscal year 2019, $8 million in fiscal year 2020, and $2.75 million in fiscal year 2021.

Nonprofit Snowmobile Clubs

The provision would exempt building materials and supplies purchased by a nonprofit snowmobile club to construct, reconstruct, or maintain or improve state or grant-in-aid trails from the sales and use tax. A nonprofit snowmobile club would be eligible for the exemption if it received a state grant-in-aid grant from the Department of Natural Resources in the current year or in the previous three-year period.

- The Department of Natural Resources reports providing 178 grants totaling $7.2 million in FY 2016 for grooming and trail maintenance.
- The Department of Natural Resources estimates that 50% of the grant money is spent on grooming of trails and 50% on maintaining trails.
- Information from the Minnesota United Snowmobilers Association indicated that, for trail maintenance spending, 5% of the grant-in-aid money is spent on taxable building materials and supplies.
- The estimate is increased by 5% for spending on building materials and supplies from other snowmobile club revenues.
- It is assumed that expenditures will increase by 2% per year.

Mazeppa Fire

The provision provides an exemption from the sales and use tax for building materials and supplies used in, and equipment incorporated into, the construction or replacement of property located in the city of Mazeppa that was affected by a fire on March 11, 2018. Durable equipment used in a restaurant for food storage, preparation, and serving are included in the exemption. The tax must be paid at the time of purchase and a refund requested.

- Information for the estimates was provided by a representative from the city of Mazeppa.
- The total project cost is estimated to be $450,000. It is estimated that $190,000 will be spent on purchases that would normally be subject to sales and use tax.
- It is assumed that claims for refunds would be paid in fiscal year 2019.

Excise Tax and Fee Prohibition

Counties, cities, towns, or other taxing authorities are prohibited from imposing, or increasing, sales or income taxes. The provision would further prohibit local subdivisions from imposing, or increasing, an excise tax or fee on food or food containers, as defined.

Reasonable license fees lawfully imposed by a county, city, town, or other licensing authority in the exercise of its regulatory authority to license a trade, profession, or business are excluded from the prohibition.

Melrose Fire
A fire affected the city of Melrose on September 8, 2016. In 2017, a law was passed exempting materials, supplies, and equipment used in the construction or replacement of property affected by the fire. The effective date was retroactive for sales and purchases after September 30, 2016 and before January 1, 2019. The provision adjusts the effective date for the sales and use tax exemption for the city of Melrose. The sunset for the exemption is proposed to be changed from January 1, 2019 to January 1, 2022.

- A representative from the city of Melrose provided information for the estimates.
- The total construction costs on materials, supplies, and equipment are expected to be $2.4 million.
- It is expected that 50% of the costs will be spent in fiscal years 2020 and 2021.

Elko New Market Facility
The provision provides an exemption for materials and supplies used in, and equipment incorporated into, a water treatment facility owned and operated by the city of Elko New Market. The exemption would be administered as a tax refund to the city.

- The estimate is for sales tax paid during the two-year period.
- Exempt materials and installed equipment cost are reported to be $3.6 million.
- The estimate assumes that refunds would be paid in fiscal year 2019.

<u>Local Sales Tax- Article 7</u>

The following provisions have no impact on any state fund.

City of St. Cloud
The city of St. Cloud currently imposes a 1% tax on on-sale liquor and food and beverages. The city also has a 5% lodging tax. The provision allows the city of St. Cloud to increase the tax on on-sale liquor and food and beverages up to 0.5% and the lodging tax up to 1%, if approved by voters at a general election.

The proceeds of the increased taxes are to be used for remodeling, improvements, and expansion of the Municipal Athletic Center, including bond payments.

City of Minneapolis

The city of Minneapolis has imposed a local tax on lodging since 1969. In 1986, an additional local sales tax was enacted on lodging for businesses with more than 50 rooms. The maximum allowable tax rate on lodging establishments, including the state and local sales tax rates, has been 13% since 2001 (12% since 1986).

There were tax rate changes in 2009 and 2017 related to the 13% limit. The Minneapolis 3% lodging tax on businesses with more than 50 rooms (1986) was reduced to 2.625% with the 0.375% increase in the statewide sales tax rate in 2009. The 2.625% was reduced to 2.125% with the imposition of the 0.5% local transportation tax for Hennepin County in 2017.

Local sales tax rate changes were enacted for Hennepin County in 2006 and 2008 that could have impacted the maximum allowed tax rate for lodging in Minneapolis. However, both tax rate changes had provisions that excluded them from determining if the total tax on lodging in Minneapolis exceeded 13%.

The provision would remove the limitation that total state and local taxes on lodging in Minneapolis not exceed 13%. The 3% limit on the local lodging tax on businesses with more than 50 rooms (1986) would still apply.

City of St. Paul

The city of St. Paul has legislative authorization to impose a lodging tax of no greater than 3%. This tax does not apply to a business having less than 50 lodging rooms

The provision allows the city of St. Paul to increase this tax to 4%.

City of Cloquet

The city of Cloquet has imposed a 0.5% sales and use tax since 2013, to pay for various city projects. The projects include up to $4.5 million for the construction and completion of several city parks and recreation improvement projects, $5.8 million for extension of utilities and construction of improvements associated with the development of property adjacent to Highway 33 and Interstate Highway 35, and $6.2 million for engineering and construction of city infrastructure improvements. The total amount authorized is $16.5 million.

The provision would allow unused amounts from the $5.8 million authorization for the development of property adjacent to Highway 33 and Interstate Highway 35 to be used for the other projects. The total amount authorized remains capped at $16.5 million.

City of Excelsior
The provision authorizes the city of Excelsior to impose a local sales and use tax of up to 0.5%, subject to approval at a general election held before January 1, 2019. The revenues from the tax would be for improvements to the commons as reported in the November 2016 commons master planning work group. Authorized expenses would include accessibility improvements, beach area and facilities enhancements, shoreline erosion management, and port and bandshell redesign. The provision authorizes the city to issue bonds to pay for the improvements, not to exceed $7 million.

The tax would expire at the later of 25 years after the imposition or when the city council determines $7 million plus costs and interest has been received from the tax.

Department of Revenue Policy and Technical Changes - Articles 9, 10, 11, 12, 13, 15

The bill makes a number of policy and technical changes related to the Department of Revenue. Those provisions do not have a fiscal impact on state tax revenue with the following exceptions.

Minimum Deed Transfer Tax Calculation
The provision changes the threshold for the minimum consideration for real property for purposes of calculating the deed tax from $500 or less to $3,000 or less.

- The provision is expected to have a negligible impact on state revenues.

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

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Federal Update: Tax Cuts and Jobs Act
Laws 2018, Chapter 205 (H.F. 947), Vetoed
($000s)

	FY 2018	FY 2019	FY 2020	FY 2021
Tax Cuts and Jobs Act				
Standard Deduction and Exemptions				
Create MN standard deduction equal to prior federal deduction (beginning TY 18)	$0	$0	$0	$0
Create MN personal exemption equal to prior federal personal exemption (beginning TY 18)	$0	$0	$0	$0
Reverse forecast adjustment: taxpayers no longer bound by federal decision to itemize	$0	($26,500)	($27,100)	($27,900)
Subtotal: Standard Deduction and Exemptions	**$0**	**($26,500)**	**($27,100)**	**($27,900)**
Education-Related Provisions				
Allow exclusion of discharged student loan debt in case of death or disability (TY 18-25)	$0	(Negl.)	(Negl.)	(Negl.)
Require addback for Section 529 plan withdrawals used for K-12 tuition (beginning TY 18)	$0	$0	$0	$0
Subtotal: Education-Related Provisions	**$0**	**$0**	**$0**	**$0**
MN Itemized Deductions; Federal Deductions				
Switch to AGI starting point for calculating MN taxable income, allow itemized deductions generally equal to TCJA deductions (includes interaction with other income tax changes and impact of chained CPI indexing) (beginning TY 18)	$0	($23,200)	($2,700)	$13,000
Medical expense deduction: Reduce FAGI floor from 10% to 7.5% (TY17 & 18)	$0	($26,400)	$0	$0
Subtraction for qualified moving expenses (other than service members) (TY18-25)	$0	($5,000)	($3,700)	($3,900)
Suspend deduction for moving expenses (other than service members) (TY18-25)	$0	$5,000	$3,900	$4,000
Repeal deduction for alimony payments and corresponding inclusion of received alimony (for agreements beginning 2019)	$0	$500	$1,100	$2,300
Modify limit on wagering losses (TY18-25)	$0	$150	$90	$90
Charitable deduction not allowed for amounts paid for college athletic event seating rights (beginning TY18)	$0	$2,000	$1,200	$1,200
Subtotal: Federal Deductions	**$0**	**($46,950)**	**($110)**	**$16,690**

	FY 2018	FY 2019	FY 2020	FY 2021
Federal Exclusions				
Suspend exclusion for certain employer-provided bicycle commuter fringe benefits (TY18-25)	$0	$40	$30	$30
Subtotal: Federal Exclusions	**$0**	**$40**	**$30**	**$30**
Retirement, Savings, and Pensions				
Allow increased contributions to Able accounts (TY18-25)	$0	(Negl.)	(Negl.)	(Negl.)
Extend rollover period for certain retirement plan loan offsets (beginning TY18)	$0	(Negl.)	(Negl.)	(Negl.)
Repeal special rule permitting recharacterized IRA contributions (beginning TY18)	$0	$450	$300	$300
Subtotal: Retirement, Savings, and Pensions	**$0**	**$450**	**$300**	**$300**
Bonus Depreciation and Section 179 Expensing				
Bonus depreciation of 100%, with 80% addback and 5-year recovery; phased out beginning in TY 2023 (TY18-26)				
Individual Income Tax	($600)	$1,000	$8,700	$10,700
Corporate Franchise Tax	($1,300)	$2,100	$18,300	$22,600
	($1,900)	$3,100	$27,000	$33,300
Section 179 expensing: Full conformity to federal limits (beginning TY18)				
Individual Income Tax	($19,800)	($61,800)	($48,600)	($36,600)
Corporate Franchise Tax	($7,500)	($23,400)	($18,400)	($13,900)
	($27,300)	($85,200)	($67,000)	($50,500)
Bonus Depreciation and Section 179 Expensing				
Individual Income Tax	**($20,400)**	**($60,800)**	**($39,900)**	**($25,900)**
Corporate Franchise Tax	**($8,800)**	**($21,300)**	**($100)**	**$8,700**
Subtotal	**($29,200)**	**($82,100)**	**($40,000)**	**($17,200)**
Other Business and Investment Provisions				
Index minimum fee using chained CPI-U Corporate Franchise Tax	$0	$0	$100	$100
Require addback for certain pass-through income eligible for a federal deduction (beginning TY 18)				
Individual Income Tax	$0	$0	$0	$0
Disallow pass-through losses over $500,000 married joint, $250,000 for other filers (TY18-25)				
Individual Income Tax	$0	$58,000	$52,200	$46,300
Tax gain on the sale of partnership on a look-through basis (beginning TY18)				
Individual Income Tax	$0	$1,100	$1,800	$1,900
Expand the definition of built-in loss for purposes of partnership loss transfers (beginning TY18)				
Individual Income Tax	$0	$400	$300	$300

	FY 2018	FY 2019	FY 2020	FY 2021
Other Business and Investment Provisions (Cont.)				
Charitable contributions and foreign taxes taken into account in determining limit on partner's share of loss (beginning TY18)				
Individual Income Tax	$0	$700	$700	$800
Repeal rollover of publicly traded securities gain into specialized small business investment companies (beginning TY18)				
Individual Income Tax	$0	$300	$300	$300
Corporate Franchise Tax	$0	$700	$600	$600
Small business accounting method reform and simplification (beginning TY18)				
Individual Income Tax	($4,300)	($62,700)	($22,000)	($12,200)
Corporate Franchise Tax	($500)	($6,900)	($2,400)	($1,300)
Limit net interest deduction to 30% of income, with carryforward (beginning TY18)				
Individual Income Tax	$4,400	$97,700	$90,500	$92,500
Corporate Franchise Tax	$700	$16,600	$15,400	$15,700
Modification of net operating loss deduction (beginning TY18)				
Individual Income Tax	$2,100	$38,800	$31,900	$43,300
Repeal deferred gain on like-kind exchanges, except for real property (beginning TY18)				
Individual Income Tax	$100	$2,300	$2,500	$3,300
Corporate Franchise Tax	$100	$2,900	$3,100	$4,200
Reduce recovery period for certain real property (beginning TY18)				
Individual Income Tax	$0	($200)	($400)	($600)
Corporate Franchise Tax	$0	($500)	($800)	($1,100)
Repeal deduction for local lobbying expenses (DOE)				
Individual Income Tax	$0	$200	$100	$100
Corporate Franchise Tax	$0	$400	$300	$300
Limit deduction for employer-provided meals and entertainment expenses (beginning TY18)				
Individual Income Tax	$200	$3,600	$2,600	$2,700
Corporate Franchise Tax	$600	$9,800	$7,000	$7,300
Limit deduction for certain employer-provided transportation benefits (beginning TY18)				
Individual Income Tax	$200	$2,700	$2,000	$2,000
Corporate Franchise Tax	$400	$7,300	$5,400	$5,600

	FY 2018	FY 2019	FY 2020	FY 2021
Other Business and Investment Provisions (Cont.)				
Prohibit deduction for achievement awards of cash, gift cards and other nontangible personal property (beginning TY18)				
Individual Income Tax	Negl.	Negl.	Negl.	Negl.
Corporate Franchise Tax	Negl.	Negl.	Negl.	Negl.
Limit deduction for FDIC Premiums (beginning TY18)				
Individual Income Tax	$100	$1,900	$1,800	$1,800
Corporate Franchise Tax	$200	$5,000	$4,900	$4,900
Deny deduction for sexual harassment settlements paid subject to a nondisclosure agreement (DOE)				
Individual Income Tax	Negl.	Negl.	Negl.	Negl.
Corporate Franchise Tax	Negl.	Negl.	Negl.	Negl.
Revise treatment of contributions to capital (DOE)				
Individual Income Tax	$0	$300	$400	$700
Corporate Franchise Tax	$0	$800	$1,100	$2,000
Modify historic rehabilitation credit to provide 20% credit spread over 5 years (beginning TY18)				
Corporate Franchise Tax	$0	$14,900	$25,000	$12,700
Modify treatment of interest for producers of beer, wine, and distilled spirits (TY18 & 19)				
Individual Income Tax	($100)	($1,500)	($900)	$0
Corporate Franchise Tax	($100)	($1,900)	($1,100)	$0
Modify limit on excessive compensation (beginning TY18)				
Individual Income Tax	$0	$500	$600	$600
Corporate Franchise Tax	$0	$2,800	$3,600	$3,600
All Other Business and Investment Provisions				
Individual Income Tax	$2,700	$144,100	$164,400	$183,800
Corporate Franchise Tax	$1,400	$51,900	$62,200	$54,600
Subtotal	**$4,100**	**$196,000**	**$226,600**	**$238,400**
Unrelated Business Income				
Allow charitable organizations to aggregate losses for all unrelated business activities without regard to limitation under TCJA (beginning TY18)				
Unrelated Business Income Tax	$0	$0	$0	$0
Subtotal: Unrelated Business Income	**$0**	**$0**	**$0**	**$0**
Bond Interest				
Repeal exclusion of interest on advance refunding bonds (beginning TY18)				
Individual Income Tax	$100	$3,500	$3,900	$4,800
Corporate Franchise Tax	$100	$1,800	$2,100	$2,500
Subtotal: Bond Interest	**$200**	**$5,300**	**$6,000**	**$7,300**

	FY 2018	FY 2019	FY 2020	FY 2021
International Business Income				
Deferred foreign income included in MN taxable income after federal deduction (beginning TY18)				
Corporate Franchise Tax	$3,500	$52,500	$33,500	$34,700
Subtraction for global intangible low-taxed income (GILTI) (beginning TY18)				
Individual Income Tax	$0	$0	$0	$0
Corporate Franchise Tax	$0	$0	$0	$0
Addition for foreign-derived intangible income (FDII) derived from domestic trade or business (beginning TY18)				
Individual Income Tax	$0	$0	$0	$0
Corporate Franchise Tax	$0	$0	$0	$0
Other modifications to Subpart F provisions				
Corporate Franchise Tax	Negl.	Negl.	Negl.	Negl.
International Business Income				
Individual Income Tax	**$0**	**$0**	**$0**	**$0**
Corporate Franchise Tax	**$3,500**	**$52,500**	**$33,500**	**$34,700**
Subtotal	**$3,500**	**$52,500**	**$33,500**	**$34,700**
Property Tax Refund				
Modifications to federal adjusted gross income				
Homestead Credit Refund	$0	$0	$35	$35
Renter Property Tax Refund	$0	$0	$15	$15
Subtotal: Property Tax Refund	**$0**	**$0**	**$50**	**$50**
Tax Cuts and Jobs Act: All Provisions				
Individual Income Tax	**($17,600)**	**$13,840**	**$101,520**	**$151,820**
Property Tax Refund	**$0**	**$0**	**$50**	**$50**
Unrelated Business Income Tax	**$0**	**$0**	**$0**	**$0**
Corporate Franchise Tax	**($3,800)**	**$84,900**	**$97,700**	**$100,500**
General Fund Total	**($21,400)**	**$98,740**	**$199,270**	**$252,370**