DEPARTMENT OF REVENUE

Senate Omnibus Tax Bill

May 3, 2019

	Yes	No
DOR Administrative Costs/Savings	X	

State Taxes Only –
See Separate Analysis for Property Tax Provisions

Department of Revenue
Analysis of H.F. 2125, First Unofficial Engrossment (Senate Omnibus Tax Bill)

	Fund Impact				
	F.Y. 2019	**F.Y. 2020**	**F.Y. 2021**	**F.Y. 2022**	**F.Y. 2023**
			(000's)		
Federal Update					
Disaster Tax Relief Act					
Individual Income Tax	$0	($2,740)	$310	$200	$100
Corporate Franchise Tax	$0	($100)	$40	$30	$10
Subtotal	$0	($2,840)	$350	$230	$110
Tax Cuts and Jobs Act* with Modifications					
Individual Income Tax	$12,230	$204,510	$245,620	$307,270	$391,320
Property Tax Refund	$0	$0	$1,100	$2,000	$3,300
Corporate Franchise Tax	$2,700	$117,240	$67,000	$69,900	$38,300
Subtotal	$14,930	$321,750	$313,720	$379,170	$432,920
Bipartisan Budget Act					
Individual Income Tax	$0	($18,455)	($145)	($225)	($290)
Corporate Franchise Tax	$0	($1,440)	$270	$245	$190
Subtotal	$0	($19,895)	$125	$20	($100)
Individual Income Tax					
Angel Investment Credit	$0	($5,000)	$0	$0	$0
Business Entity Election to File as a C Corporation	(Unknown)	(Unknown)	(Unknown)	(Unknown)	(Unknown)
K-12 Scholarship Donation Credit	$0	$0	($19,300)	($19,300)	($19,300)
Addition	$0	$1,400	$1,400	$1,400	$1,400
Increase Social Security Subtraction	$0	($20,400)	($22,500)	($23,800)	($25,300)
Medical Cannabis Subtraction	$0	($200)	($200)	($200)	($200)
Reduce 2nd Bracket Rate	$0	($227,800)	($151,000)	($206,500)	($256,900)
Increase K-12 Credit; Expand Eligibility to Pre-K expenses	$0	$0	($8,100)	($8,300)	($8,500)
Housing Contribution Credit	$0	$0	$0	$0	$0
Partnership Audit Rules	$0	($600)	($1,400)	($1,500)	($1,600)

*See attached table for estimates of the provisions in the Tax Cuts and Jobs Act.

	Fund Impact				
	F.Y. 2019	F.Y. 2020	F.Y. 2021	F.Y. 2022	F.Y. 2023
			(000's)		
Corporate Franchise Tax					
Limit DRD from Debt-Financed Stock	$0	$130	$100	$100	$100
Interest Expense Limitation	($200)	($2,300)	($2,400)	($2,800)	($3,500)
Captive Insurance Definition Modified	$0	$0	$0	($400)	($400)
K-12 Scholarships Donation Credit	$0	($2,200)	($7,200)	($7,200)	($7,200)
Addition	$0	$0	$100	$100	$100
Sales and Use Tax					
County Agricultural Societies	$0	($1,200)	($1,500)	($1,500)	($1,500)
June Accelerated Repeal – Construction	$0	($7,800)	($200)	($200)	($200)
Collegiate Preferred Seating	$0	($790)	($800)	($800)	($810)
Invasive Aquatic Species – Herbicides	$0	($130)	($140)	($140)	($140)
Nonprofit Agricultural Heritage Orgs.	$0	($10)	($10)	($10)	($10)
Nonprofit Ice Arena	$0	($10)	($10)	($10)	($10)
City of Mazeppa Construction	$0	$0	($15)	$0	$0
Monticello Fire Station	$0	($170)	$0	$0	$0
Inver Grove Heights Fire Station	$0	($280)	$0	$0	$0
Minnetonka Public Safety Facility	$0	$0	($800)	$0	$0
ISD 414 School Building	$0	($140)	$0	$0	$0
Vendor Allowance	$0	($8,700)	($9,900)	($10,400)	($10,600)
City of Melrose Construction	$0	($80)	($80)	($20)	$0
Special Taxes					
Gambling Combined Net Receipts Rate	$0	($9,100)	($10,900)	($11,600)	($12,500)
Vapor Products					
Surcharge	$0	$2,100	$5,200	$5,500	$5,700
Excise Tax	$0	$690	$1,740	$1,830	$1,920
Sales Tax – Tobacco Products	$0	$50	$140	$140	$150
Tobacco Products Definition	$0	Negl.	Negl.	Negl.	Negl.
General Fund Total	**$14,730**	**$16,475**	**$86,420**	**$93,810**	**$93,630**
Natural Resources and Arts Funds					
County Agricultural Societies	$0	($60)	($90)	($90)	($90)
June Accelerated Repeal – Construction	$0	($400)	(Negl.)	(Negl.)	(Negl.)
Collegiate Preferred Seating	$0	($40)	($40)	($50)	($50)
Invasive Aquatic Species – Herbicides	$0	($10)	($10)	($10)	($10)
Nonprofit Agricultural Heritage Orgs.	$0	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Nonprofit Ice Arena	$0	(Negl.)	(Negl.)	(Negl.)	(Negl.)
City of Mazeppa Construction	$0	$0	(Negl.)	$0	$0
Monticello Fire Station	$0	($10)	$0	$0	$0

	Fund Impact				
	F.Y. 2019	**F.Y. 2020**	**F.Y. 2021**	**F.Y. 2022**	**F.Y. 2023**
			(000's)		
Natural Resources and Arts Funds cont.					
Inver Grove Heights Fire Station	$0	($20)	$0	$0	$0
Minnetonka Public Safety Facility	$0	$0	($50)	$0	$0
ISD 414 School Building	$0	($10)	$0	$0	$0
City of Melrose Construction	$0	($5)	($5)	(Negl.)	$0
Sales Tax – Tobacco Products	$0	Negl.	$10	$10	$10
Tobacco Products Definition	$0	Negl.	Negl.	Negl.	Negl.
Natural Resources and Arts Funds Total	**$0**	**($555)**	**($185)**	**($140)**	**($140)**
Total – All Funds	**$14,730**	**$15,920**	**$86,235**	**$93,670**	**$93,490**
Local Sales and Use Tax					
Local Sales Tax Provisions	$0	$0	$0	$0	$0

EXPLANATION AND ANALYSIS OF THE BILL

Federal Update – Article 1

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
Effective retroactively beginning with tax year 2017.

The proposal would update reference to the Internal Revenue Code to adopt the federal law changes made in the Disaster Tax Relief and Airport and Airway Extension Act of 2017, Public Law 115-63, enacted September 29, 2017.

The law established 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 law also modified 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 law also suspended the limits on charitable contributions made before December 31, 2017 for contributions related to hurricane disaster relief.

- This 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.
- Because of the retroactive effective date, tax year 2017 returns would have to be amended or adjusted. Those impacts were allocated to fiscal year 2020.

Tax Cuts and Jobs Act (TCJA)
Most provisions effective beginning tax year 2019; select provisions effective retroactively to 2018.

The TCJA includes a number of provisions that affect Minnesota taxable income for individuals and businesses. The bill generally conforms to the changes in the TCJA, with some modifications.

Switch to Adjusted Gross Income. 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.

Maintain Current Standard Deduction. The bill creates a state standard deduction equal to the amount under prior federal law ($13,300 for married joint returns, $6,650 for single returns, and $9,750 for head of household returns.)

Create MN Itemized Deductions. The bill adopts state itemized deductions that are the same as under prior federal law, with some exceptions. The bill limits state and local tax deductions to $15,000 ($7,500 for married separate filers) and raises the floor for miscellaneous deductions from 2% to 5% of adjusted gross income. The bill limit mortgage interest deductions to acquisition debt of up to $750,000, mirroring a provision in the TCJA. State income or sales taxes are not deductible, as under current Minnesota law. Itemized deductions are phased out by income using the thresholds under current Minnesota law.

Create Personal and Dependent Exemptions. The bill creates a personal and dependent exemption of $4,250 in 2019 for the taxpayer, spouse, and each dependent. The exemptions are phased out by income using the same thresholds as under current Minnesota law.

Adopt Chained CPI-U. All amounts in Minnesota law that are indexed for inflation would be adjusted using the chained Consumer Price Index for all urban consumers (Chained CPI-U) beginning in tax year 2020, including income tax brackets, the corporate minimum fee and property tax refund thresholds.
Section 179 Expensing. For tax year 2018, the bill conforms to the federal limits on Section 179 expensing with the 80% addback and five-year cost recovery. Beginning with tax year 2019, the bill fully conforms to the federal limits on Section 179, eliminating the need for the Minnesota addback and subtractions.

International Provisions
The bill does not adopt any of the changes in the treatment of international income, except for several minor changes in the definition of subpart F income.

- The House Income Tax Simulation Model (HITS 6.7) was used to estimate the impact of switching to adjusted gross income as the starting point for calculating Minnesota taxable income. 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 2016 individual income tax returns compiled by the Minnesota Department of Revenue.
- For most 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 2019 is allocated to the following fiscal year. For most business- related provisions, one month of impact is allocated to fiscal year 2019, assuming that businesses would make changes to one estimated payment in the current fiscal year after enactment.

Bipartisan Budget Act of 2018
Effective retroactively beginning with tax year 2017.

The Bipartisan Budget Act (BBA) of 2018, Public Law 115-123, was enacted on February 9, 2018. This estimate shows the fiscal impact of updating reference to the Internal Revenue Code to include the Act, retroactive to tax year 2017.

The BBA extends certain expiring tax provisions through tax year 2017. It also includes a number of new provisions, as described below.

The BBA 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 the following provisions in the Disaster Tax Relief and Airport and Airway Extension Act:

- Special rules for taxpayers taking an early distribution from a retirement plan due to damages sustained in Hurricanes Harvey, Irma, or Maria.
- Expanded casualty loss deduction for hurricane-related losses.
- Suspended limits on charitable contributions for hurricane-related contributions.

The BBA expands those provisions to include California wildfires and to include Hurricane Harvey and Hurricane Irma disaster areas declared between September 21, 2017 and October 17, 2017.

- The House Income Tax Simulation Model (HITS 6.7) was used to estimate the home mortgage insurance premiums deduction.
- 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 are divided between the individual income tax and corporate franchise tax. The estimates for each provision are apportioned to Minnesota based on information relevant to that provision. The estimates are adjusted for the difference between federal and state tax rates and federal and state fiscal years.
- Retroactive impacts are allocated to fiscal year 2020.

Individual Income Tax – Articles 2 & 10

Angel Investment Credit (Article 2, Sections 1-3 & 32)
Effective beginning with tax year 2019.

The provision allocates $5 million for tax year 2019.

- It is assumed that the maximum of $5 million in credits would be allocated for tax year 2019.
- Tax year impacts are allocated to the following fiscal year.
- For tax year 2020 and beyond, there would be no allocations.

Business Entity Election to File as a C Corporation (Article 2, Sections 4, 12, 18, 26 & 27)
Effective beginning with tax year 2019.

The provision creates an option that allows a partnership, S corporation, or limited liability company to elect to file and pay their tax liability as a C corporation (termed a C-option corporation) and to be taxed at the highest individual rate, 9.85%. The corporate franchise tax rate is a flat 9.8%.

If the election is made by the majority owner of the qualifying entity (having more than 50% ownership interest), the election is binding all of the owners of the entity. The election is binding for the next four years. The election must be made by the date the return is due or the extended due date. A shareholder's basis in the entity is not affected by the election to file as an C-Option corporation.

Shareholders of the qualifying entity may claim a subtraction on their individual income tax return equal to the amount of net income received from the entity. Net income cannot be less than zero.

If an entity filing as a C-option corporation files a composite return with another state on behalf of its Minnesota shareholders, the entity may claim a credit for taxes paid to the other state.

- The number of qualifying entities that would elect to file as a C-option corporation is unknown.
- In tax year 2016, about 179,400 returns reported income from an S Corporation, partnership, or limited liability corporation.
- Of those, about 80,300 returns had state and local taxes over the federal deduction limit ($10,000 or $5,000 for married separate filers).
- About 29,900 of those returns had at least some income in the highest income tax bracket. Those are considered to be most likely to file as a C-option corporation, which would have all of its income taxed at the highest income tax rate.
- It is unknown how many of those taxpayers have more than 50% ownership in the qualifying entities.
- It is assumed that an entity would only file as a C-option corporation if the majority shareholders benefit from the election with a reduced federal and state tax liability.
- The effect on state tax revenue depends on the tax situation of the underlying shareholders. The entity is taxed at the highest rate of 9.85%. If all of the income would have been taxed at the highest rate on the shareholders' returns, then the election to file as a C-option corporation should be revenue neutral. However, if some of the income would have been taxed at a lower rate, the election could increase state tax revenue.
- The election is binding on all shareholders, so minority shareholders could be hurt by the election even if the majority shareholders benefit.
- The election is binding for the next four tax years. Taxpayers may not benefit from the election in the following years if their financial situation changes.

K-12 Scholarship Donations Equity and Opportunity Credit (Article 2, Sections 8, 9, 13 & 23)
Effective day following final enactment for donations made and effective beginning with tax year 2020 for credits allowed.

The provision allows taxpayers to claim a nonrefundable credit against the individual income tax or corporate franchise tax equal to 70% of the amount donated to either a "qualified public school foundation" or a "qualified foundation." A qualified public school foundation is a foundation formed for the purpose of supporting public schools or school districts in Minnesota where at least 30% of students qualify for reduced price lunches. A qualified foundation is a 501(c)(3) charitable organization formed for the primary purpose of providing scholarships for tuition or transportation to qualified nonpublic schools, among other requirements. In either case, the foundation may allocate no more than 5% of its annual revenue for administrative purposes.
The provision caps the total credits at $26.5 million per year. To receive the credit, a taxpayer must apply to the Commissioner of Revenue for a tax credit certificate. The certificates are to be made available on a first-come, first served basis.

The maximum credit per tax year is:
- $21,000 for married joint filers for a donation of $30,000
- $10,500 for other individual filers for a donation of $15,000
- $105,000 for corporate filers for a donation of $150,000.

A qualified foundation may award scholarships to eligible students to pay tuition or transportation to a qualified school. An eligible student must be in a household whose annual income is not more than twice the income standard for reduced lunches under the National School Lunch Program ($92,870 for a family of four in the 2018-19 school year).

Alternatively, a student with a disability is eligible if the student also meets one of the following criteria: attended a school in the semester preceding receipt of a qualified scholarship, is younger than seven years of age and not enrolled in kindergarten or first grade in the preceding semester, has previously received a qualified scholarship, or has lived in Minnesota for less than a year.

Since a taxpayer may claim a federal deduction for contributions to a qualified foundation or qualified public school foundation, the amount of the donation must be added back to the taxpayer's federal taxable income on the taxpayer's Minnesota income or corporate franchise tax return.

- Arizona allows a similar credit against its individual income tax, corporate income tax, and insurance premium tax. The credit is equal to 100% of the amount of the donation up to a maximum amount. For calendar years 2014 through 2016, the Arizona Department of Revenue reported an average of $63.4 million in donations from 88,400 individuals and $25.6 million in donations from 71 corporations.
- Based on the number of credits in Arizona, after adjusting for population size, per capita income, and other factors, it is expected that the demand for the proposed credit will exceed the maximum of $26.5 million per year.
- The amount deducted federally for the donation must be added back to Minnesota taxable income. For the corporate tax, an average apportionment factor of 20% is assumed before application of the 9.8% tax rate. For individuals, a marginal rate of 7.5% is assumed.
- Growth in personal income from the February 2019 IHS Markit forecast is used to calculate the yearly change in donations.
- For individual income tax credits, tax year impact was allocated to the following fiscal year. For corporate franchise tax credits, tax year impact was allocated 30/70 to fiscal years.

Increase Social Security Subtraction (Article 2, Section 10)
Effective beginning with tax year 2019.

This provision increases the maximum social security subtraction from $4,700 to $6,150 for married joint filers, $2,350 to $3,075 for married separate filers, and $3,660 to $4,800 for single and head-of-household filers. The amounts are indexed for inflation using Chained CPI-U starting in tax year 2020. Phase-out thresholds remain as in current law.

- The House Income Tax Simulation Model (HITS 6.7) 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 2019. The model uses a stratified random sample of tax year 2016 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts were allocated to the following fiscal year.
- About 255,200 returns would be affected in tax year 2019. The average reduction in tax would be about $80.

Medical Cannabis Subtraction (Article 2, Section 11, 14 & 24)
Effective beginning with tax year 2019.

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 independent audit reports with the Minnesota Department of Health. Only two such entities are allowed and there are currently two. Both are registered as limited liability corporations.
- The public audits filed with the Department of Health show that one of the entities experienced net losses in all years it has been in operation. The other entity had positive net income for 2017 only. Both companies do show positive gross revenue and therefore under current law have positive taxable income.
- Using average expenses reported on the public audits over the past three years, their projected operating expenses are expected to be about $2,400,000 per year. The impact of the subtraction could vary depending on the amount of future expenses and on the tax situation of the underlying shareholders.
- Tax year impacts are allocated to the following fiscal year.
- Two taxpayers would be affected in tax year 2019.

Reduce 2nd Bracket Rate (Article 2, Section 17)
Effective beginning with tax year 2019.

The provision would reduce the 2nd bracket rate from 7.05% to 6.8% in tax year 2019 and to 6.67% in tax year 2022. The brackets would be indexed for inflation using Chained CPI-U beginning in tax year 2020.

- The House Income Tax Simulation (HITS 6.7) 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 2019. The model uses a stratified sample of 2016 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of tax year 2019 was allocated to fiscal year 2020. Other tax years were allocated to fiscal years using a standard formula.
- About 1,403,300 tax returns would be affected in tax year 2019. The average reduction in tax would be $104.

Increase K-12 Credit; Expand Eligibility to PreK Expenses (Article 2, Section 19, 20)
Effective beginning with tax year 2020.

The provision would increase the credit phase-out threshold to $39,000 in 2020. The threshold would be indexed for inflation using Chained CPI-U beginning in tax year 2021. In addition, the provision would allow expenses incurred in pre-kindergarten educational programs, including fees charged for enrollment, to qualify for the education subtraction or credit.

Such programs include (1) those run by school districts, (2) preschools, nursery schools and early childhood development programs licensed by the Department of Human Services and holding current accreditation, (3) Montessori programs, and (4) child care programs provided by family day care providers as long as the provider holds a current early childhood development credential approved by the Commissioner of Human Services. Expenses used to claim the dependent care credit could not be used to claim the education subtraction or credit.

Increase Credit Phase-Out Threshold
- The estimate is based on a sample of Minnesota income tax returns for tax year 2016.
- About 42,600 returns claimed $10.2 million in K-12 education credits in 2016. The average credit was $240.
- With the increased phase-out threshold, the credit is expected to increase by about $3.8 million in tax year 2019. About 16,700 returns would become eligible or receive an increased credit.
- A growth rate of 1.5% is assumed beginning in tax year 2020, due to the inflation adjustment.
- Since the same expenses cannot be used to claim the credit and subtraction, as taxpayers switch to the credit, there will be fewer subtractions. A marginal rate of 7% was used to estimate the foregone subtractions.

Pre-kindergarten Expenses
- Data from Minnesota tax returns and the U.S. Census Bureau is the basis for this analysis.
- It was assumed that filers with dependents aged 3 to 4 would have eligible prekindergarten expenses.
- There are about 69,500 children between the ages of 3 and 4 enrolled in school of some kind in Minnesota, based on 2017 estimates from the Census Bureau. There are about 916,100 children age 5 to 17 enrolled in school.
- The proposal would increase the number of children eligible for the credit and subtraction by about 8%.
- The cost of pre-kindergarten programs varies widely, but most eligible taxpayers are assumed to receive the maximum subtraction or credit. Assuming that most taxpayers have one eligible child of pre-kindergarten age, the average subtraction would be $1,625 and the average credit would be $1,000. Taxpayers in the income phase-out range would receive an average credit of $500.
- A marginal tax rate of 7% was used to estimate the fiscal impact of the subtraction.
- The credit is assumed to grow at 1.5% beginning in tax year 2020.
- No growth is assumed for the subtraction since there has been no clear trend in growth over the past five years.

Interaction

- The increased income phase-out thresholds will increase the credits for pre-kindergarten expenses by an additional $800,000 in tax year 2019.
- The higher credits would be offset by a decrease in the education subtraction. A marginal rate of 7% was used to estimate the impact of the subtraction.
- Tax year impacts were allocated to the following fiscal year.

Housing Contribution Credit (Article 2, Sections 22 & 30)
Effective beginning with tax year 2020.

The provision establishes a Minnesota Housing Tax Credit Contribution Fund to receive contributions for low and moderate income housing, if a Minnesota housing tax credit is established.

The Fund is to be used for grants and loans for low and moderate income housing developments. The provision specifies that grants and loans should approximately fund the metropolitan area and greater Minnesota equally, among other requirements.

By January 15, 2021, the Commissioners of Management and Budget, Housing Finance, and Revenue must report on whether a tax credit would stimulate the development and preservation of affordable housing, including housing for households below 50% of median income, additional economic activity generated by the credit, and a recommendation on the value of the credit.

- There is no revenue impact associated with the provision.

Partnership Audit Rules (Article 10, Sections 1-16)
Effective for federal adjustments that have a final determination after June 30, 2019.

The provision is a response to a 2015 federal law change (PL 114-74) otherwise known as the "Bipartisan Budget Act of 2015." Under the federal law, with an election the payment of tax associated with federal audits may be shifted from the partners to the partnership itself. The ability to have partnerships pay tax does not automatically flow through to Minnesota from the federal law change. The bill allows Minnesota tax to be paid by the partnerships themselves. The reporting and payment requirements do not apply if the amount falls below a *de minimus* threshold set by the Department of Revenue.

The provision includes rules for calculating the tax payable by the partnership.
Under the provision, both residents and non-residents apportion their income. The ability of non-residents to apportion income is the same as under current law. The ability of residents to apportion income is a change from our current law, and it reduces taxes paid when compared to current law.

- The provision creates a revenue loss because resident taxpayers who elect to have the partnership pay their tax will pay less tax than the sum of the tax owed by each partner. The revenue loss over the next two biennium is estimated to be -$5.1 million.
- Non-resident taxpayers pay the same amount of tax with and without the new partnership pays rules, and it is assumed they account for 2/3 of the revenue associated with partnership audits.

- The estimate assumes 1/3 of the revenue from the partnership audits is from resident taxpayers. On average with the proposal, the ability of residents to apportion income is reduced by 57% as compared to current law. The 57% reduction is based on the current law approach of assigning income 100% to Minnesota with a credit for taxes paid to other states. The credit for taxes paid to other states assumes a tax rate of 5.5%.
- The revenue loss estimate is the reduction of estimated audit collections under the bill from the baseline amount, which assumes no change in tax paid by resident taxpayers.
- The baseline amount of estimated audit collections was calculated from estimates made by the Joint Committee on Taxation.
- The bill assumes about a 20% reduction in audit collections from those estimated by the Joint Committee on Taxation.

Corporate Franchise Tax – Articles 1 & 2

Limit Dividend Received Deduction from Debt-Financed Stock (Article 1, Section 49)
Effective beginning with tax year 2019.

The provision would put into Minnesota law a federal tax law provision that reduces the dividend received deduction if the purchase of the stock is debt financed. The debt-financed provision applies to stock defined as portfolio stock.

Under the provision, the dividend received deduction percentage is reduced by the average indebtedness percentage. If 100% of the stock is debt financed (i.e., the average indebtedness percentage is 100%), the dividend received deduction percentage is reduced to 0%. If the dividend received deduction percentage is 80% and 50% of the stock is debt-financed, the dividend received deduction percentage is reduced to 40%.

There is also a dollar limitation on the reduction of the dividend received deduction. The dividend received deduction cannot be reduced by more than the dollar value of the interest deduction associated with the purchase of the stock.

- The reduction of the dividend received deduction affects only domestic dividends.
- Data published by the federal government shows less than 2% of domestic dividends are from debt-financed stock. The estimate apportions these dividends to Minnesota. The estimate assumes a 50% reduction in the dividend received deduction.
- Thirty percent of tax year 2019 revenue gain is allocated to fiscal year 2020. Other tax years were allocated 30/70 to fiscal years.

Interest Expense Limitation (Article 1, Section 50)
Effective beginning with tax year 2019.

The TCJA placed a limitation on the amount of interest expense that may be claimed in a single tax year. In essence, the limitation is limited to 30% of income. The limitation does not apply to any business with less than $25 million of gross receipts. Any interest disallowed in a year may be carried forward and used against income in future years.

The provision revises the interest limitation calculation for affiliated groups that have insurance companies which are taxed under the gross premiums tax. In order to be eligible for the revised calculation, the insurance company must be exempt from the corporate franchise tax.

The revised calculation produces a much higher limitation than the amount that would be permitted without this provision. Any such limitation under current law would include in the calculation only the income of the group currently subject to corporate franchise tax. Companies subject to the gross premiums tax are exempt from the corporate franchise tax. Under the proposal, the calculation would include all the income of the group regardless of whether it is currently subject to tax. A larger interest limitation means a smaller chance that the interest deduction would be limited.

- The amount of revenue loss associated with this provision is uncertain.
- The total corporate revenue gain without this provision is about $74 million over the forecast period.
- With this provision, the total revenue gain is assumed to be reduced by 15%, or about $11 million.

Captive Insurance Definition Modified (Article 2, Sections 6, 7, 15 & 25)
Effective retroactively beginning with tax year 2017.

The proposal uses an entirely new method to define what is a taxable insurance company. This new definition would be applied on a retroactive basis.

Under the bill, an insurance company is tax-exempt if it fails to be defined as a disqualified captive insurance company. A company is a disqualified captive insurance company if it meets the definition of two tests.

First, a company must be defined as a captive insurance company. A captive insurance company is 1) is a registered captive insurance company **or** 2) *as amended*, it receives less than 80% of premium income from sources outside of its unitary business.

Second, a company must be defined as a disqualified captive insurance company. A disqualified captive insurance company is defined as a company that 1) receives less than 50% of gross receipts from premiums **or** 2) pays less than 0.50% 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.

- One of the conditions for being classified as disqualified captive insurance company is paying less than 0.50% in premium taxes. This amount of premium taxes is low when compared to the same taxes paid by traditional insurance companies.
- The provision has a less inclusive definition of what is a taxable insurance company than under current law. Due to this less inclusive definition, the bill’s language appears to offer some companies selling non-admitted insurance companies that are subject to the corporate franchise tax will be exempt from tax as early as fiscal year 2022.
- The conditions defining a disqualified captive insurance company introduce a great amount of uncertainty as compared to current law.

K-12 Scholarship Donations Equity and Opportunity Credit (Article 2, Sections 8, 9, 13 & 23)
See Individual Income – Articles 2, Sections 8, 9, 13 & 23.

<u>Sales and Use Tax – Article 3</u>

County Agricultural Societies (Article 3, Sections 1&7)
Effective for sales and purchases made after June 30, 2019.

The provision exempts sales by a county agricultural society, including admissions, parking, admissions to separately ticketed events, concessions sales, and other sales made by employees or volunteers of the county agricultural society. The provision limits the sales and use tax exemption to sales or events by a county agricultural society at a scheduled county fair and on the county fairgrounds.
The sales tax savings are required to be used to maintain, improve, or expand the buildings and facilities on the fairground.

- Attendance at the 93 county fairs in Minnesota was approximately 2.6 million in 2018.
- The Minnesota Department of Agriculture reports $22.1 million of income for county agricultural societies in calendar year 2018. The total sales tax collected by Minnesota county agricultural societies is estimated to be $1.5 million.
- A growth rate of 2% is assumed based on the consumer price index for urban consumers.
- The fiscal year 2020 estimates are adjusted for the effective date.

June Accelerated Repeal – Construction Materials Vendors (Article 3, Section 2)
Effective for sales and purchases made after June 30, 2019.

The provision would exclude certain vendors of construction materials from the requirement to make a June accelerated payment. The excluded vendors would be businesses in the following North American Industrial Classification System (NAICS) classifications: saw mills and wood preservation (NAICS 3211); veneer, plywood, and wood products manufacturing (NAICS 3212); millwork manufacturing (NAICS 32191); cement and concrete product manufacturing (NAICS 3273); and lumber and other construction materials merchant wholesalers (NAICS 4233).

- The estimates are based on accelerated payments received in June 2018.
- The June accelerated payment exclusion creates a shift in revenue collections. The main impact occurs in the initial fiscal year as the accelerated payments normally received in the last month of the fiscal year are shifted to the following fiscal year. The impacts for subsequent years reflect the annual growth in payments shifted by the proposal.
- For payments in 2018, there were approximately 70 businesses that would have been excluded from June accelerated payments.

Collegiate Preferred Seating (Article 3, Section 3)
Effective for sales and purchases made after June 30, 2019.

The provision would exempt the right to purchase a ticket to a collegiate athletic event in a preferred area if three criteria are met: 1) the amount paid for the right to purchase a ticket is used entirely to support student scholarship costs, 2) the amount paid for the right to purchase a ticket is separately stated from the admission price, and 3) the admission price is equal to or greater than the highest priced general admission ticket for the closest seat not in the preferred area.

- It is assumed that the exemption would apply to the scholarship gift or donation that is included as part of the season ticket price. It is assumed that all scholarship donations are separately stated from the ticket price.
- It is assumed that parking is not included in the exemption.
- The University of Minnesota reported the portion of season ticket prices collected as scholarship seating donations. Scholarship seating donations totaled $11 million for the 2018-2019 school year.
- The donation amounts for the University of Minnesota were increased 10% to include other colleges and universities that would qualify for the exemption.
- It is assumed that revenues from seating donations will increase 1% per year.
- The first full year impact is assumed to be fiscal year 2020.
- The estimates are based on ten sports programs at five colleges, including football, men's and women's basketball, men's hockey, and volleyball at the University of Minnesota. No adjustment is included for possible additional programs that would qualify.

Invasive Aquatic Species – Herbicides (Article 3, Section 4)
Effective for sales and purchases made after June 30, 2019.

The provision would exempt from the sales and use tax the purchase of herbicides authorized for use pursuant to an invasive aquatic plant management permit if purchased by a lakeshore property owner or an association of lakeshore property owners.

- In calendar year 2018, there were 390 invasive aquatic plant management permits issued by the Minnesota Department of Natural Resources (DNR). Most of the permits were issued to lakeshore property owners or associations representing lakeshore property owners. Local government units, including lake improvement districts, watershed districts, and local city governments, were also issued permits but in most cases used contractors. It is assumed the contractors paid the sales tax when purchasing herbicide on behalf of a local government unit.
- The DNR provided a report detailing the types and amounts of herbicides used to combat invasive aquatic species in Minnesota during 2015. A recommended price list for herbicides was provided by the DNR.
- It is assumed the growth of herbicide use will remain constant through the forecast period.
- The fiscal year 2020 estimates are adjusted for eleven months of impact.

Nonprofit Agricultural Heritage Organizations (Article 3, Section 5)
Effective day following final enactment.

The provision creates a sales and use tax exemption for the sale of tickets or admissions to certain performances or events on the premises of specific rural agricultural heritage organizations that are tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

A nonprofit organization would qualify for the exemption if it meets four requirements. First, the organization must have been established to preserve Minnesota's rural agricultural heritage and educate the public about rural history and how farms in Minnesota helped provide food to the nation and the world. Second, the premises of the nonprofit organization must be at least 115 acres. Third, the performance or event must be sponsored and conducted exclusively by volunteers, employees of the organization, or members of the board of directors of the organization. Fourth, the performance or event must be consistent with the nonprofit purpose of the organization.

- The exemption is expected to apply to a limited number of organizations.
- The estimates are based on information reported on federal Form 990 for nonprofit organizations in Minnesota.

Nonprofit Ice Arenas (Article 3, Section 6)
Effective for sales and purchases made after June 30, 2019.

Nonprofit organizations whose primary purpose is the operation of ice arenas or rinks are not generally considered to be operated exclusively for a charitable, religious, or educational purpose. There is a sales and use tax exemption for a specific nonprofit ice arena used for youth and high school programs.

The provision would expand the exemption for one nonprofit ice arena to the David M. Thaler Sports Center.

- 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.
- It is assumed that the current organizational structure for the David M. Thaler Sports Center would qualify for the exemption.
- Total expenses for the most recent fiscal year were approximately $350,000.
- It is estimated that about 50% of expenses were for taxable sales.
- A growth rate of 2% is assumed.

City of Mazeppa Construction (Article 3, Section 8)
Effective the day following final enactment and applies retroactively from March 11, 2018.

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 is included in the exemption.

The tax must be paid at the time of purchase and a refund requested. The exemption would expire for purchases made after January 1, 2022.

- This estimate is based on project information provided by the city administrator.
- The total project cost is estimated to be $450,000. It is assumed the cost of materials is $225,000.
- It is assumed that claims for refunds would be paid in fiscal year 2021.

Monticello Fire Station Construction (Article 3, Section 9)
Effective for sales and purchases made after January 31, 2019, and before January 1, 2022.

The provision would provide a sales and use tax exemption for materials, supplies, and equipment used in the construction of a new fire station, which includes firefighting, emergency management, public safety training, and other public safety facilities, in the city of Monticello. The exemption would be administered as a refund.

- Information for the estimates was provided by a representative from the city of Monticello.
- The Monticello fire station is estimated to cost approximately $5.1 million.
- The total construction cost for materials, supplies, and equipment is estimated to be $2.6 million. Construction is expected to be completed in February 2020.
- It is assumed that all refunds will be paid in fiscal year 2020.

Inver Grove Heights Fire Station Construction (Article 3, Section 9)
Effective for sales and purchases made after June 30, 2018, and before January 1, 2021.

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

- The estimates are based on project information provided by the city administrator and fire chief.
- Total construction costs of the building are estimated to be $8.7 million. It is assumed the cost of materials that would be exempt is $4.3 million.

- Construction on the project began in October of 2018, and is expected to be completed by fall of 2019.
- It is assumed that one refund will be applied for in fiscal year 2020.

Minnetonka Public Safety Facility Construction (Article 3, Section 9)
Effective for sales and purchases made after May 23, 2019, and before January 1, 2021.

The provision would exempt materials, supplies, and equipment incorporated into the construction, remodeling, expansion, or improvement of a fire station and police station, and related public safety facilities owned and operated by the city of Minnetonka. As proposed to be amended, related facilities include access roads, lighting, sidewalks, and utility components.

The provision is limited to sales and purchases made after the date following final enactment and before January 1, 2021. The exemption would be administered as a refund. Refunds would be limited to no more than $850,000.

- Information for the estimates was provided by a representative of the city of Minnetonka. Additional information is available on the city website and the city Capital Improvement Plan 2019-2023.
- 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 assumed that the maximum amount of $850,000 will be claimed in fiscal year 2021.

Minneota School Building ISD #414 (Article 3, Section 9)
Effective for purchases made after January 1, 2018, and before January 1, 2021.

The provision creates an exemption from the sales and use tax for materials and supplies used in and equipment incorporated in the remodeling, upgrading, and expansion of the Minneota Independent School District No. 414 school building. The exemption would be administered as a refund.

- The estimates are based on project information provided by a representative of the Minneota Independent School District.
- The total construction costs for materials, supplies, and equipment are estimated to be $2.1 million.
- Based on the construction timeline, it is expected that refund claims will be filed and paid in fiscal year 2020.

Vendor Allowance (Article 3, Section 13-14)
Effective for sales tax remitted after June 30, 2019.

The provision would allow a qualified retailer to retain a portion of the sales tax collected as a vendor allowance for the costs of collecting and administering the sales tax. Qualified retailers would be limited to sales tax filers not subject to the June accelerated payment.

The vendor allowance for each reporting period would be the greater of $5 or one-half of one percent of the tax collected, excluding use tax paid by the seller and local sales and use taxes collected by the retailer. The allowance must not reduce the tax owed in the reporting period to less than zero. The vendor allowance applies only if the tax minus the allowance is reported and remitted timely.

- The estimate of the vendor allowance is based on recent sales tax liabilities.
- Annual growth is estimated based on the November 2018 state forecast of sales and use tax revenue.
- It is assumed the amounts retained by the seller will only impact the General Fund.
- The fiscal year 2020 estimate is adjusted for eleven months of impact.

City of Melrose Construction (Article 3, Section 15)
Effective retroactively for sales and purchases made after December 31, 2018.

A fire affected the city of Melrose on September 8, 2016. A sales and use tax exemption was enacted in 2017 for 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 bill would change the end date for the sales and use tax exemption from January 1, 2019 to January 1, 2023.

- A representative from the city of Melrose provided information for the estimates.
- The construction costs for materials, supplies, and equipment are estimated to be $2.7 million.
- It is expected that 45% of the costs will be spent in fiscal years 2020 and 2021, and 10% of the costs will be spent in fiscal year 2022.

<u>Local Taxes – Article 6</u>

The following provisions have no impact on state taxes. The following provisions are effective the day after the governing body of the local government comply with certain regulations, unless otherwise noted.

Special Authorization Modification (Article 6, Sections 1-4)

Political subdivisions may impose a local general sales and use tax subject to voter approval and special law authorization.

The uses of local sales taxes are limited to the construction of capital projects with a regional benefit. To impose a local sales tax, a political subdivision would need a population of at least 1,000. The provisions provide additional specifications for local resolutions including a detailed description of no more than five capital projects, documentation of the share of economic benefit attributable to individuals and businesses outside the taxing jurisdiction, and the amount of local sales tax revenue used for each project and the time needed to raise the revenue.

The imposition of the tax would be subject voter approval. The question to voters must include a variety of information, including the specific projects to be funded, the amount of revenue used for each project and the total amount of revenue raised for all projects, and the estimated length of time the tax will be in effect.

Excise/Fee Prohibition (Article 6, Section 5)

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.

City of Duluth (Article 6, Section 6)

The city of Duluth has a local general sales tax of 1%. The provision would authorize the city to impose an additional local general sales and use tax of up to 0.5%, as approved by the voters at the November 2017 election. The proceeds of the tax additional 0.5% tax would be used to finance capital and administrative costs related to street, curb, gutter, sidewalk, and bridge improvements including related lighting and signals as outlined in the Duluth Street Improvement Program 2017. The provsion authorizes the city to issue bonds to pay capital and administrative expenses related to the projects.

The tax would terminate at the earlier of 25 years after it is first imposed, or when the city council determines that sufficient funds have been raised to finance the projects listed above.
The tax may expire earlier if the city so determines by ordinance.

Minneapolis Cap Removal (Article 6, Section 7)

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 raise the limitation of total state and local taxes on lodging in Minneapolis from 13% to 13.875%. The 3% limit on the local lodging tax on businesses with more than 50 rooms (1986) would still apply.

City of St. Paul Lodging Tax (Article 6, Section 8)

The city of Saint Paul has a local lodging tax of 3% that applies to all lodging. Additionally, the city was authorized to impose a lodging tax of 3% on businesses with 50 rooms or more. Ninety-five percent of the revenues generated from the tax are used to fund a convention bureau to market and promote the city as a tourist or convention center.

The provision would increase the additional rate on businesses with 50 rooms or more from 3% to 4%. The total lodging tax rate on businesses with 50 rooms or more would increase from 6% to 7%.

City of Two Harbors (Article 6, Section 9-13)

The city of Two Harbors has sales and use tax of 0.5%. The proceeds are used for sanitary sewer separation, wastewater treatment, water system improvements, and harbor refuge development projects.

The provision authorizes the city to impose an additional sales and use tax of 0.5%, as approved by the voters at the 2018 general election. The proceeds would be used to finance capital and administrative costs of water and sewer infrastructure projects including gravity-fed sewer mains, water mains, drain tile, service lines, street patching, acquiring property, related engineering, and construction expenses. The provision authorizes a $30 million bond issuance.
The additional 0.5% sales and use tax would terminate 25 years after first imposition or when the city council determines that enough has been received from the tax to pay for project costs. The tax may expire earlier if the city so determines by ordinance.

City of Cloquet (Article 6, Section 14)

The provision of Cloquet imposes a 0.5% sales and use tax and a $20 motor vehicle excise tax to pay for city projects. The total amount authorized is $16.5 million including $4.5 million for the construction and completion of park improvement projects, $5.8 million for the 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 the engineering and construction of infrastructure improvements.

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

City of Avon (Article 6, Section 15)

The provision authorizes the city of Avon, as approved by the voters at the 2018 general election, to impose a sales and use tax of up to 0.5%.

The proceeds would be used to finance capital and administrative costs of transportation improvement projects as adopted in the city's street priority improvement plan. The provision authorizes the issuance of up to $1.5 million in bonds.

The tax would terminate the earlier of Dec 31, 2045 or when the city council determines that $1.5 million has been received from the tax to pay for the cost of the projects. The tax could expire earlier if the city so determines by ordinance.

City of Blue Earth (Article 6, Section 16)

The provision authorizes the city of Blue Earth as approved by the voters at the 2018 general election, to impose a sales and use tax of up to 0.5%.

The proceeds would be used to finance sewer plant improvements, street reconstruction projects and recreational amenities. The provision authorizes the issuance of up to $5 million in bonds.

The tax would terminate the earlier of 25 years after it was first imposed or when the city council determines that $5m has been received from the tax to pay for the cost of the projects. The tax could expire earlier if the city so determines by ordinance.

City of Cambridge (Article 6, Section 17)

The provision authorizes the city of Cambridge to impose a sales and use tax of 0.5%, as approved by the voters at the 2018 general election. The proceeds would be used to finance $8 million of construction costs for library facilities and $14 million for street improvement and outdoor park improvements.

The provision authorizes $22 million of bond issuances. The tax would terminate the earlier of December 31, 2043, or when the city council determines that sufficient funds have been received to pay for the cost of the projects. The tax may expire earlier if the city so determines by ordinance.

City of Detroit Lakes (Article 6, Section 18)

The provision authorizes the city of Detroit Lakes to impose a sales and use tax of 0.5%, as approved by the voters at the 2018 general election. The proceeds would be used to finance construction of a new police department facility. The provision authorizes a bond issuance of up to $6.7 million plus bond costs.

The tax would terminate the earlier of ten years after it was first imposed or when the city council determines that $6.7 million plus bond costs has been received from the tax to pay for the cost of the projects. The tax may expire earlier if the city so determines by ordinance.

City of Elk River (Article 6, Section 19)

The provision authorizes the city of Elk River to impose a sales and use tax of up to 0.5%, as approved by the voters at the 2018 general election. The proceeds would be used to finance capital and administrative costs for recreational facilities and park improvements. The provision authorizes a bond issuance of up to $35 million plus bond costs.

The tax would terminate at the earlier of 25 years after it is first imposed or when the city council determines that $35 million plus bond costs has been received from the tax. The tax may expire earlier if the city so determines by ordinance.

City of Excelsior (Article 6, Section 20)

The provision authorizes the city of Excelsior, as approved by the voters at the 2014 general election, to impose a sales and use tax of up to 0.5%.

The proceeds would be used to finance capital and administrative costs of improvements to the commons as indicated in the Commons Master Plan projects in the city. Authorized expenses would include accessibility improvements, beach area and facilities enhancements, shoreline erosion management, and port and band shell redesign and improvement of playground equipment. The provision authorizes the issuance of up to $7 million in bonds.

The tax would terminate the later of 25 years after it was first imposed, or when the city council determines that $7 million has been received from the tax to pay for the cost of the projects. The tax could expire earlier if the city so determines by ordinance.

City of Glenwood (Article 6, Section 21)

The provision authorizes the city of Glenwood, as approved by the voters at the 2018 general election, to impose a sales and use tax of up to 0.5%.

The proceeds would be used to finance capital costs of the Phases II and Phase III improvements in the city's capital improvement plan, the development and expansion of and improvements to city parks, trails and recreational facilities and improvements to Glenwood City Hall and Police station. The provision authorizes the issuance of up to $2.8 million in bonds.

The tax would terminate the earlier of 20 years after it was first imposed, or when the city council determines that $2.8 million has been received from the tax to pay for the cost of the projects. The tax could expire earlier if the city so determines by ordinance.

City of International Falls (Article 6, Section 22)

The provision authorizes the city of International Falls to impose a sales and use tax of up to 1%, as approved by the voters at the 2018 general election. The proceeds would be used to finance transportation and other public infrastructure projects in the city. The provision authorizes a bond issuance of up to $30 million plus bond costs.

The tax would terminate the earlier of 30 years after it is first imposed or when the city council determines that $30 million plus costs has been received from the tax to pay for the cost of the bonds. The tax may expire earlier if the city so determines by ordinance.

City of La Crescent (Article 6, Section 23)

Cities and towns are authorized to impose a tax on lodging of up to 3%.

The provision authorizes city of La Crescent to impose a lodging tax of up to 2%. The tax would be in addition to any general authorization lodging tax.

The proceeds would be split evenly between the city chamber of commerce to promote tourism in southeastern Minnesota and the La Crescent Area Event Center to promote local tourism.

Lake County (Article 6, Section 24)

The provision authorizes Lake County to impose a lodging tax of up to 4%. The proceeds of the tax would be used to finance a new Lake County Event and Visitors Bureau. Seventy-five percent of the tax revenue would be used for the Lake County Event and Visitors Bureau and 25 percent would be used to fund and promote events and festivals in Fall Lake, Beaver Bay, Silver Bay, Two Harbors, Knife River, Larsmont, Finland, and Isabella.

The tax would be in addition to the statewide general authorization for cities and towns for a local lodging tax of up to 3%. The city of Two Harbors has a 3% local lodging tax, of which 2% is from the general authorization and 1% is a legislative authorization. For cities and towns in Lake County, the total lodging tax must not exceed 5%.

City of North Mankato (Article 6, Section 25)

The provision authorizes the city of North Mankato to impose a sales and use tax of up to 1% on the gross receipts of all sales of food and beverages by a restaurant or place of refreshment, as defined by a resolution of the city. Food and beverages would include on-sale intoxicating liquor and fermented malt beverages.

The proceeds would be used to finance the operation, maintenance, and capital expenses for the Caswell Park Regional Sporting Complex and costs related to regional tourism events.

City of Perham (Article 6, Section 26)

The provision authorizes the city of Perham to impose a sales and use tax of up to 0.5%, as approved by the voters at the 2018 general election. The proceeds would be used to finance the capital and administrative costs of site preparation, redevelopment, renovation, design, construction, furnishing, and equipping of buildings, land, and infrastructure at the Perham Area Community Center. The provision authorizes a bond issuance of up to $5.2 million plus bond costs.

The tax would terminate the later of 20 years after it was first imposed or when the city council determines that $5.2 million plus bond costs has been received from the tax to pay for the cost of the projects. The tax may expire earlier if the city so determines by ordinance.

City of Rogers (Article 6, Section 27)

The provision authorizes the city of Rogers to impose a sales and use tax of 0.25% and a motor vehicle excise tax of up to $20, as approved by the voters at the 2018 general election.

The proceeds would be used to finance trail and pedestrian facilities, aquatic facilities and community athletic facilities. The bill authorizes the issuance of up to $16.5 million in bonds.

The tax would terminate the later of 20 years after it was first imposed, or when the city council determines that $16.5 million has been received from the tax to pay for the cost of the projects. The tax may expire earlier if the city so determines by ordinance.

City of Sartell (Article 6, Section 28)

The provision authorizes the city of Sartell to impose a sales and use tax of up to 1.5% on the gross receipts of all food and beverages sold by a restaurant or place of refreshment, as defined by an ordinance of the city. Food and beverages would include on-sale intoxicating liquor and fermented malt beverages.

The proceeds would be used to finance capital and operational costs for new and existing recreational facilities and amenities in the city.

City of Sauk Centre (Article 6, Section 29)

The provision authorizes the city of Sauk Centre to impose a sales and use tax of up to 0.5% and a motor vehicle excise tax of $20, as approved by the voters at the 2018 general election. The proceeds would be used to finance capital and administrative costs of transportation projects, including the reconstruction of Trunk Highway 71 and projects in the city of Sauk Centre capital improvement plan. The provision authorizes a bond issuance of up to $10 million plus bond costs.

The tax would terminate the earlier of December 31, 2045, or when the city council determines that $10 million plus bond costs has been raised by the taxes to pay for the projects. The tax may expire earlier if the city so determines by ordinance.

City of Scanlon (Article 6, Section 30)

The provision authorizes the city of Scanlon as approved by the voters at the 2018 general election, to impose a sales and use tax of up to 0.5%.

The proceeds would be used to finance capital costs of street improvements and utility infrastructure, including storm sewer and sanitary sewer improvements. The bill authorizes the issuance of up to $400,000 in bonds.

The tax would terminate the earlier of 10 years after it was first imposed, or when the city council determines that $400,000 has been received from the tax to pay for the cost of the projects. The tax could expire earlier if the city so determines by ordinance.

City of Virginia (Article 6, Section 31)

The provision authorizes the city of Virginia to impose a sales and use tax of up to 1%, as approved by the voters at the 2018 general election. The proceeds would be used to finance the costs of renovation, reconstruction, expansion, and improvements of the Miner's Memorial recreation complex and convention center. The provision authorizes a bond issuance of up to $30 million plus bond costs.

The tax would terminate the earlier of 20 years after it was first imposed, or when the city council determines that $30 million plus bond costs has been received from the tax to pay for the cost of the projects. The tax may expire earlier if the city so determines by ordinance.

City of West St. Paul (Article 6, Section 32)

The provision authorizes the city of West St. Paul, as approved by the voters at the 2018 general election, to impose a sales and use tax of up to 0.5%.

The proceeds would be used to finance capital and administrative costs of priority 1 and priority 2 street project identified in the city's pavement management plan. The bill authorizes the issuance of up to $28 million in bonds.
The tax would terminate the earlier of 20 years after it was first imposed or when the city council determines that $1.5 million has been received from the tax to pay for the cost of the projects. The tax could expire earlier if the city so determines by ordinance.

City of Willmar (Article 6, Section 33)

The provision authorizes the city of Willmar to impose a sales and use tax of up to 0.5% and a motor vehicle excise tax of up to $20, as approved by the voters at the 2018 general election. The proceeds would be used to finance various city projects: $2 million for community center replacement, $6 million for new athletic fields, $3 million for infrastructure improvements at Robins Island Regional Park, $2 million for a new playground and spectator amenities at Swansson Field Regional Park, $7 million for stormwater management infrastructure improvements, and $10 million for a new recreation and event center. There is a provision to reallocate up to 10% from any of the projects to the other projects.

The provision authorizes a $30 million bond issuance. The tax would terminate 13 years after first imposition or when the city council determines that enough has been received from the tax to pay for the cost of the project. The tax may expire earlier if the city so determines by ordinance.

City of Worthington (Article 6, Section 34)

The city of Worthington had a local sales and use tax of 0.5% that expired October 2018. The provision authorizes the city to impose a sales and use tax of 0.5% and a motor vehicle excise tax of up to $20, as approved by the voters at the 2018 general election.

The proceeds would be used to finance the following projects: improvements to the aquatic center, the field house, the ice arena, park and recreation capital projects, lake quality, and the 10th street plaza. The provision authorizes a bond issuance of $25 million. The tax would terminate 15 years after it is first imposed or when the city council determines that enough has been received from the tax to pay for the cost of the projects. The tax may expire earlier if the city so determines by ordinance.

<u>Special Taxes – Articles 9 & 14</u>

Gambling Combined Net Receipts Rate Reduction (Article 9, Section 11-15)
Effective 7/1/2019.

The provision would reduce the combined net receipts tax as shown in the following table.

Combined Net Receipts Tax

Net Receipts			Current Rate	Proposed Rate
$0	to	$87,500	9%	8%
$87,501	to	$122,500	18%	16%
$122,501	to	$157,500	27%	24%
$157,501		or more	36%	32%

In addition, the fiscal year gambling tax revenue baseline for the stadium reserve fund calculation would be reduced from $36.9 million to a baseline of $26,900,000 in fiscal year 2020; $26,100,000 in fiscal year 2021; $25,400,000 in fiscal year 2022; and $24,500,000 in fiscal year 2023 and thereafter.

The provision also alters the requirements regarding up to $20 million being included in the available resources for the stadium reserve fund.

- The estimates are based on data from 2017 gambling tax returns.
- Over the four fiscal years, the proposal would reduce gambling revenues by $45 million. In addition, over the four fiscal years, the appropriation for problem gambling would be reduced by $450,000 and the amount available for the stadium reserve fund would be $610,000 higher.
- Changes to the addition of $20 million to available resources for the stadium reserve fund has no revenue impact.
- About 1,100 charitable organizations pay combined net receipts tax including fraternal and veterans organizations, religious institutions, and other charities including youth hockey leagues.

Vapor Products Surcharge (Article 9, Sections 16-18)
Effective for closed-system cartridges bought or sold after December 31, 2019.

The provision would impose, in addition to the excise and sales taxes, a $2 surcharge on the retail sale of each closed-system cartridge in the state. The surcharge is not included in the retail sales price when calculating sales tax due.

Closed-system cartridges are defined as a disposable cartridge, tank, pod, or other package that is prefilled with any liquid nicotine solution or other material containing nicotine that is consumed or meant to be consumed through the use of a heating element, electronic circuit, or other electronic, chemical, or mechanical means and is not intended to be reused, refilled, or opened. Closed-system cartridges are also included in the definition of a tobacco product.

- It is estimated that excise tax collections for vapor products were $11.5 million for fiscal year 2018.
- It is assumed that sales of closed-system products account for 70% of the Minnesota vapor market.
- An elasticity factor of -0.9 was applied and an annual growth rate of 5% is assumed.
- Expected impacts of recent FDA deeming regulations on tobacco products, for future years, are uncertain and are not included in the estimates.
- The fiscal year 2020 estimates are adjusted for five months of collections.

Vapor Products – Excise Tax (Article 9, Section 19)
Effective January 1, 2020.

The provision would impose a 5¢ per milliliter tax on consumable material for vapor products. The tax would be in addition to the tobacco products excise tax and sales tax. Consumable material is defined as any liquid solution or similar material that is depleted as a vapor product is used.

- It is assumed that the new tax will apply to both open-system and closed-system vapor products.
- It is assumed consumable material includes only liquid solutions containing nicotine.
- It is assumed the tax will apply to final products, intended to be purchased and consumed by consumers.
- It is estimated that excise tax collections for vapor products were $11.5 million for FY 2018.
- The estimates are based on per capita vapor products tax revenues in other states.
- An annual growth rate of 5% is assumed.
- Expected impacts of recent FDA deeming regulations on tobacco products, for future years, are uncertain and are not included in the estimates.
- The fiscal year 2020 estimates are adjusted for five months of collections.

Tobacco Products Definition Update (Article 14, Section 2)
Effective the Day Following Final Enactment.

The provision would expand the definition of tobacco products to include vapor products and separately define vapor products. The vapor products definition would include products containing nicotine derived from something other than tobacco. Vapor products containing tobacco-free nicotine would be subject to the tobacco products excise tax.

- One out-of-state company is known to be producing tobacco-free nicotine.
- The Special Taxes Division at the Department of Revenue reports some limited availability of vapor products containing tobacco-free nicotine at retail in Minnesota. It is uncertain how the market share of vapor products containing tobacco-free nicotine might develop.

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

hf2125_4 (Senate OTB) / crc trc sd dkd hjg nrg awh cej wkm mjr rrs js ct cw

H.F. 2125, 1st Unofficial Engrossment, As Passed by the Senate
Senate Omnibus Tax Bill
($000s)

*Retroactive items

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Tax Cuts and Jobs Act					
Maintain prior federal standard deduction and exemptions; modify itemized deductions (1/1/19)	$0	$60,000	$49,500	$51,000	$54,400
Index individual income tax provisions using Chained CPI-U (1/1/20)	$0	$12,800	$31,200	$40,200	$57,500
Switch Minnesota starting point to AGI (1/1/19)	$0	($1,800)	($1,800)	($1,800)	($1,800)
Subtotal: Standard Deduction and Exemptions	**$0**	**$71,000**	**$78,900**	**$89,400**	**$110,100**
Education-Related Provisions					
Allow exclusion of discharged student loan debt in case of death or disability (TY19-25)	$0	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Allow deduction for Section 529 plan withdrawals used for K-12 tuition (1/1/19)	$0	($800)	($900)	($1,000)	($1,000)
Subtotal: Education-Related Provisions	**$0**	**($800)**	**($900)**	**($1,000)**	**($1,000)**
Federal Deductions					
Repeal deduction for alimony payments and corresponding inclusion of received alimony (for agreements beginning 2019)	$0	$1,600	$2,300	$3,100	$4,300
Modify limit on wagering losses (TY19-25)	$0	$150	$90	$90	$90
Charitable deduction not allowed for amounts paid for college athletic event seating rights (1/1/19)	$0	$1,900	$1,200	$1,200	$1,200
Subtotal: Federal Deductions	**$0**	**$3,650**	**$3,590**	**$4,390**	**$5,590**
Federal Exclusions					
Suspend exclusion for qualified moving expense reimbursement (TY19-25)	$0	$5,600	$3,900	$3,900	$3,900
Suspend exclusion for certain employer-provided bicycle commuter fringe benefits (TY19-25)	$0	$40	$30	$30	$30
Subtotal: Federal Exclusions	**$0**	**$5,640**	**$3,930**	**$3,930**	**$3,930**
Retirement, Savings, and Pensions					
Allow increased contributions to ABLE accounts (TY19-25)	$0	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Extend rollover period for certain retirement plan loan offsets (1/1/19)	$0	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Repeal special rule permitting recharacterization of IRA contributions (1/1/19)	$0	$450	$300	$350	$400
Subtotal: Retirement, Savings, and Pensions	**$0**	**$450**	**$300**	**$350**	**$400**
Bonus Depreciation and Section 179 Expensing					
*Bonus depreciation of 100% with 80% addback; phased out beginning in TY23 (TY18-26)					
Individual Income Tax	$400	$8,700	$10,700	$10,500	$3,700
Corporate Franchise Tax	$800	$18,300	$22,600	$22,100	$7,800
	$1,200	$27,000	$33,300	$32,600	$11,500
*Section 179 expensing with 80% addback in TY18; full conformity in TY19 (1/1/18)					
Individual Income Tax	($5,200)	($76,200)	($49,900)	($38,900)	($25,100)
Corporate Franchise Tax	($2,000)	($28,900)	($18,900)	($14,700)	($9,500)
	($7,200)	($105,100)	($68,800)	($53,600)	($34,600)
Bonus Depreciation and Section 179 Expensing					
Individual Income Tax	**($4,800)**	**($67,500)**	**($39,200)**	**($28,400)**	**($21,400)**
Corporate Franchise Tax	**($1,200)**	**($10,600)**	**$3,700**	**$7,400**	**($1,700)**
Subtotal	**($6,000)**	**($78,100)**	**($35,500)**	**($21,000)**	**($23,100)**

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Other Business and Investment Provisions					
Index corporate minimum fee using Chained CPI-U (1/1/20)					
Individual Income Tax	$0	$0	$100	$100	$100
Disallow pass-through losses over $500,000 married joint, $250,000 for other filers (TY19-25)					
Individual Income Tax	$4,400	$47,800	$46,300	$40,400	$41,600
Tax gain on the sale of partnership on a look-through basis (1/1/19)					
Individual Income Tax	$200	$1,600	$1,900	$2,400	$3,100
*Expand the definition of built-in loss for purposes of partnership loss transfers (1/1/18)					
Individual Income Tax	$30	$670	$300	$300	$400
*Charitable contributions and foreign taxes taken into account in determining limit on partner's share of loss (1/1/18)					
Individual Income Tax	$100	$1,300	$800	$800	$900
*Repeal rollover of publicly traded securities gain into specialized small business investment companies (1/1/18)					
Individual Income Tax	$30	$570	$300	$300	$200
Corporate Franchise Tax	$50	$1,250	$600	$500	$400
Limit net interest deduction to 30% of income, with carryforward					
Individual Income Tax (1/1/19)	$8,100	$89,600	$92,500	$111,100	$136,000
*Corporate Franchise Tax (1/1/18)	$1,400	$31,300	$15,700	$18,900	$23,100
Modification of net operating loss deduction (1/1/19)					
Individual Income Tax	$3,200	$35,600	$43,300	$67,400	$93,900
*Repeal deferred gain on like-kind exchanges, except for real property (1/1/18)					
Individual Income Tax	$200	$4,700	$3,300	$4,300	$5,600
Corporate Franchise Tax	$200	$5,900	$4,200	$5,400	$7,100
*Reduce recovery period for certain real property (1/1/18)					
Individual Income Tax	($30)	($570)	($600)	($700)	($1,000)
Corporate Franchise Tax	($70)	($1,230)	($1,100)	($1,400)	($2,000)
Repeal deduction for local lobbying expenses					
Individual Income Tax (1/1/19)	$20	$180	$100	$100	$100
*Corporate Franchise Tax (1/1/18)	$30	$670	$300	$300	$300
Limit deduction for employer-provided meals and entertainment expenses					
Individual Income Tax (1/1/19)	$300	$6,100	$2,700	$2,700	$2,800
*Corporate Franchise Tax (1/1/18)	$800	$16,600	$7,300	$7,400	$7,600
Limit deduction for certain employer-provided transportation benefits					
Individual Income Tax (1/1/19)	$200	$2,700	$2,000	$2,100	$2,200
*Corporate Franchise Tax (1/1/18)	$600	$12,500	$5,600	$5,700	$5,900
Prohibit deduction for achievement awards of cash, gift cards and other nontangible personal property					
Individual Income Tax (1/1/19)	Negl.	Negl.	Negl.	Negl.	Negl.
*Corporate Franchise Tax (1/1/18)	Negl.	Negl.	Negl.	Negl.	Negl.
Limit deduction for FDIC Premiums					
*Corporate Franchise Tax (1/1/18)	$500	$12,100	$6,100	$6,200	$6,300

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Other Business and Investment Provisions (Cont.)					
Deny deduction for sexual harassment settlements paid subject to a nondisclosure agreement					
Individual Income Tax (1/1/19)	Negl.	Negl.	Negl.	Negl.	Negl.
*Corporate Franchise Tax (1/1/18)	Negl.	Negl.	Negl.	Negl.	Negl.
Revise treatment of contributions to capital					
Individual Income Tax (1/1/19)	$30	$370	$700	$1,100	$1,200
*Corporate Franchise Tax (1/1/18)	$90	$1,850	$2,000	$3,000	$3,200
*Modify historic rehabilitation credit to provide 20% credit spread over 5 years (beginning TY18)					
Corporate Franchise Tax	$0	$39,900	$16,400	$9,800	($18,800)
*Modify treatment of interest for producers of beer, wine, and distilled spirits (TY18 & TY19)					
Individual Income Tax	($100)	($2,400)	$0	$0	$0
Corporate Franchise Tax	($200)	($2,900)	$0	$0	$0
Modify limit on excessive compensation					
Individual Income Tax (1/1/19)	$50	$550	$600	$600	$600
*Corporate Franchise Tax (1/1/18)	$300	$6,100	$3,600	$3,600	$3,600
All Other Business and Investment Provisions					
Individual Income Tax	$16,730	$188,770	$194,200	$232,900	$287,600
Corporate Franchise Tax	$3,700	$124,040	$60,800	$59,500	$36,800
Subtotal	**$20,430**	**$312,810**	**$255,000**	**$292,400**	**$324,400**
Bond Interest					
Repeal exclusion of interest on advance refunding bonds					
Individual Income Tax (1/1/19)	$300	$3,300	$4,800	$5,700	$6,100
*Corporate Franchise Tax (1/1/18)	$200	$3,800	$2,500	$3,000	$3,200
Subtotal: Bond Interest	**$500**	**$7,100**	**$7,300**	**$8,700**	**$9,300**
International Business Income					
*Deemed repatriation of certain deferred foreign income (1/1/17)2					
Corporate Franchise Tax	$0	$0	$0	$0	$0
Include income of controlled foreign corporations (CFCs) that generate global intangible low-taxed income (GILTI) (1/1/19)					
Corporate Franchise Tax	$0	$0	$0	$0	$0
*Other modifications to Subpart F provisions (1/1/18)					
Corporate Franchise Tax	Negl.	Negl.	Negl.	Negl.	Negl.
International Business Income					
Individual Income Tax	**$0**	**$0**	**$0**	**$0**	**$0**
Corporate Franchise Tax	**$0**	**$0**	**$0**	**$0**	**$0**
Subtotal	**$0**	**$0**	**$0**	**$0**	**$0**
Property Tax Refund					
Homestead Credit Refund Indexed by CCPI-U	$0	$0	$800	$1,500	$2,500
Renter Property Tax Refund Indexed by CCPI-U	$0	$0	$300	$500	$800
Subtotal: Property Tax Refund	**$0**	**$0**	**$1,100**	**$2,000**	**$3,300**
All TCJA-Related Provisions					
Individual Pass-Through Income	**$12,230**	**$124,570**	**$159,800**	**$210,200**	**$272,300**
Other Individual Income Tax	**$0**	**$79,940**	**$85,820**	**$97,070**	**$119,020**
Property Tax Refund	**$0**	**$0**	**$1,100**	**$2,000**	**$3,300**
Corporate Franchise Tax	**$2,700**	**$117,240**	**$67,000**	**$69,900**	**$38,300**
General Fund Total	**$14,930**	**$321,750**	**$313,720**	**$379,170**	**$432,920**