DEPARTMENT OF REVENUE

Governor's Tax Bill

February 17, 2021

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 991 (Marquart) / S.F. 961 (Nelson)

	Fund Impact			
	F.Y. 2022	**F.Y. 2023**	**F.Y. 2024**	**F.Y. 2025**
	(000's)			
Individual Income Tax				
Angel Investment Credit	$0	($7,000)	$0	$0
Definition of Casualty Losses	($1,000)	($1,000)	($1,000)	($1,000)
GILTI Addition	$2,200	$1,700	$1,700	$1,700
Capital Gains Tax Surcharge	$256,500	$229,600	$218,200	$224,600
Expand 5.35% Bracket; Lower 3rd Bracket	($58,800)	($36,400)	($46,600)	($48,400)
Create 5th Bracket at 10.85%	$214,700	$188,000	$178,600	$185,400
Interactions with other Provisions	$60	$150	$150	$150
Working Family Credit: Taxpayers with ITINs	($9,800)	($9,800)	($9,900)	($9,900)
Working Family Credit: Increase Rates	($50,300)	($50,700)	($51,400)	($51,800)
Interaction: WFC Provisions	($1,800)	($1,800)	($1,800)	($1,800)
Subtotal	$351,760	$312,750	$287,950	$298,950
Corporate Franchise Tax				
Definiton of Resident Trust	$3,100	$3,100	$3,100	$3,100
Section 965 Repatriation	$261,100	$23,300	$23,300	$23,300
GILTI Addition	$20,400	$16,000	$16,100	$16,400
Addition for Cooperatives	Unknown	Unknown	Unknown	Unknown
Increase Corporate Rate to 11.25%	$236,500	$187,300	$200,500	$206,200
Interactions with other Provisions	$5,800	$6,100	$6,100	$6,100
Subtotal*	$526,900	$235,800	$249,100	$255,100
Estate Tax				
Reinstate $2.7 Million Exclusion	$11,600	$16,500	$17,500	$18,500
Gross Premiums Tax				
Directly Purchased Nonadmitted Insurance	$0	$800	$800	$800
Cigarette and Vapor Taxes				
Cigarette Excise Tax	$50,500	$55,800	$56,400	$56,900
Cigarette In-Lieu Sales Tax	($4,100)	($4,400)	($4,300)	($4,300)
Moist Snuff Excise Tax	$13,300	$15,000	$15,400	$15,900
Sales Tax – Tobacco Products	$550	$620	$640	$660
Floor Stocks Tax	$11,500	$0	$0	$0
Tobacco Products Excise Tax				
Nicotine Solution Products	($2,700)	($6,800)	($7,200)	($7,500)
Electronic Vaping Devices	$300	$900	$900	$900

	Fund Impact			
	F.Y. 2022	**F.Y. 2023**	**F.Y. 2024**	**F.Y. 2025**
	(000's)			
Gross Receipts Tax				
Nicotine Solution Products	$5,100	$12,800	$13,400	$14,100
Electronic Vaping Devices	$300	$700	$800	$800
Remote Sellers – Nicotine Solution	$700	$1,700	$1,700	$1,700
Remote Sellers – Vaping Devices	$110	$260	$260	$260
Sales Tax				
Nicotine Solution Products	($420)	($1,100)	($1,100)	($1,200)
Electronic Vaping Devices	($70)	($170)	($180)	($190)
Subtotal	$75,070	$75,310	$76,720	$78,030
Sales and Use Tax				
Qualified Data Center Software	$10,200	$20,500	$30,000	$40,000
Fundraising Sales for School Organizations	($640)	($670)	($690)	($720)
Subtotal	$9,560	$19,830	$29,310	$39,280
Solid Waste Management Tax				
Weight-to-Volume Conversion	Unknown	Unknown	Unknown	Unknown
General Reserve Account Appropriation	($50,300)	($79,300)	($89,500)	($99,500)
General Fund	$50,300	$79,300	$89,500	$99,500
Appropriation to Department of Revenue	($2,209)	($1,860)	($1,860)	($1,860)
General Fund Total*	**$972,681**	**$659,130**	**$659,520**	**$688,800**
Natural Resources and Arts Funds				
Tobacco Products	$30	$40	$40	$40
Nicotine Solution Products	($30)	($60)	($70)	($70)
Electronic Vaping Devices	(negl.)	($10)	($10)	($10)
Qualified Data Center Software	$600	$1,200	$1,700	$2,300
Fundraising Sales for School Organizations	($40)	($40)	($40)	($40)
Natural Resources and Arts Funds Total	**$560**	**$1,130**	**$1,620**	**$2,220**
Environmental Fund				
Weight-to-Volume Conversion	Unknown	Unknown	Unknown	Unknown
Total* – All Funds	**$973,241**	**$660,260**	**$661,140**	**$691,020**

*Totals do not include the impacts of the addition for cooperatives or the weight-to-volume conversion rates, which are unknown.

EXPLANATION AND ANALYSIS OF THE BILL
Individual Income and Corporate Franchise Taxes – Article 1

Angel Credit (Article 1, Sections 1, 2)
Effective for tax year 2022 only.

A refundable credit is allowed to investors for qualifying investments in a small business. The credit is equal to 25% of the qualifying investment. The maximum credit is $250,000 for a married joint return and $125,000 for all other filers. In 2019, the credits was extended for tax years 2019 and 2021 only, with a limit of $10 million each year.

The bill extends the credit for tax year 2022, with a maximum of $7 million.

- It is assumed that the maximum of $7 million in credits will be claimed in tax year 2022.
- Tax year impacts were allocated to the following fiscal year.

Casualty Losses (Article 1, Section 6)
Effective beginning with tax year 2019.

Casualty and Theft Losses. Under federal law, an itemized deduction is allowed for unreimbursed casualty and theft losses, including losses caused by theft, vandalism, storms, or other accidents. The deduction is allowed to the extent that each loss exceeds $100 and the total of all losses exceeds 10% of adjusted gross income. Losses are only deductible if they are uncompensated by insurance or otherwise.

The Tax Cuts and Jobs Act suspended the deduction for tax years 2018 through 2025, with certain exceptions.

In 2019, Minnesota created an itemized deduction for casualty and theft losses. The deduction is based on the definition of losses eligible for the federal deduction, disregarding the temporary suspension. The bill clarifies that only unreimbursed expenses qualify for the subtraction, and also clarifies references to the Internal Revenue Code to include all losses that were temporarily suspended under the TCJA.

Ponzi Losses. Federal law allows an itemized deduction for losses from transactions entered into for profit that are not connected with a trade or business, including losses that are a result of Ponzi schemes or other fraudulent/criminal activity.

Minnesota's itemized deduction for casualty and theft losses does not specifically include these losses. The bill amends the statute to make these losses eligible for the Minnesota itemized deduction.

- The revised deduction for casualty and theft losses will have no revenue impact. The language clarifies the definition of losses to match the prior federal deduction and is consistent with the way the subtraction is currently being administered.
- Expanding the deduction to include Ponzi losses will have a revenue impact. The estimate is based on Ponzi losses reported on Form 4684 for Minnesotan electronic filers over the years 2012-2018.
- Over that time period, total deductions for Ponzi losses averaged about $12.6 million per year.
- The estimate was increased by 10% to account for paper filers.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- A marginal rate of 7% is assumed.
- No growth is assumed since losses are unpredictable from year to year, although in some years the revenue impact could be significantly higher or lower than the amounts shown.

Capital Gains Tax (Article 1, Section 3, 14, 21)
Effective beginning with tax year 2021.

The bill creates an additional tax (or surcharge) on net capital gains and dividend income of individuals, estates, and trusts over $500,000. Income that is subject to this tax includes net long-term capital gains and qualified dividend income. The tax rate is 1.5% on income over $500,000 up to $1 million and 4% on income over $1 million.

For nonresidents and part-year residents, the tax would be apportioned to Minnesota based on the percentage of the taxpayer's preferential income that is allocable to Minnesota.

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in November 2020. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts were allocated to fiscal years using a standard formula.
- For tax year 2021, an estimated 6,800 returns would have an average increase in tax of $29,688 per return.
- Since capital gains and dividends can vary considerably from year to year, the tax could be volatile.

Expand 5.35% Bracket; Lower 3rd Bracket (Article 1, Section 16, 17)
Effective beginning with tax year 2021.

The bill expands the 5.35% bracket and lowers the threshold for the 7.85% bracket, as shown in the following table.

Income Tax Brackets: Tax Year 2021

	2nd Bracket Threshold		3rd Bracket Threshold	
	Current	Proposed	Current	Proposed
Single	$27,230	$29,270	$89,440	$86,620
Married Joint	$39,810	$42,800	$158,140	$154,010
Married Separate	$19,905	$21,400	$79,070	$77,005
Head of Household	$33,520	$36,030	$134,700	$131,230

Returns with their last dollar of taxable income in the 2nd bracket will have a tax decrease, with more income taxed at 5.35% rather than 6.8%. Returns with some income in the 3rd bracket or higher will have no change in tax, other than minor changes in the alternative minimum tax or marriage credit. The brackets are set so that the tax reduction from expanding the 5.35% bracket is offset by the reduction in the third bracket threshold.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Beginning in tax year 2022, the thresholds would be adjusted for inflation in the same manner as existing brackets. The tax year impact is as follows:

Tax Year Impact ($000s)	
TY 2021	($42,400)
TY 2022	($44,400)
TY 2023	($46,200)
TY 2024	($48,000)
TY 2025	($49,900)

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in November 2020. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of tax year 2021 was allocated to fiscal year 2022. In allocating other tax years to fiscal years, a standard formula was applied.
- For tax year 2021 an estimated 1,189,400 returns would have an average decrease in tax of $36 per return.

Fifth Tier 10.85% Rate (Article 1, Section 16, 17)
Effective beginning with tax year 2021.

The bill adds a new top bracket at a rate of 10.85% starting in tax year 2021. The 10.85% bracket is set at $1,000,000 for married joint filers, $500,000 for married separate and single filers, and $750,000 for head of household filers. Beginning in tax year 2022, the thresholds would be adjusted for inflation in the same manner as existing brackets. The tax year impact is as follows:

Tax Year Impact ($000s)	
TY 2021	$169,900
TY 2022	$177,200
TY 2023	$176,600
TY 2024	$182,600
TY 2025	$191,800

- The House Income Tax Simulation Model (HITS 7.0) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the budget forecast published in November 2020. The model uses a stratified random sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of tax year 2021 was allocated to fiscal year 2022. In allocating other tax years to fiscal years, a standard formula was applied.
- For tax year 2021 an estimated 21,050 returns would have an average increase in tax of $8,072 per return.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

WFC for Taxpayers with ITINs (Article 1, Section 18, 19)
Assumed effective beginning tax year 2021.

Under current law, a taxpayer generally must be eligible for the federal earned income credit to receive the working family credit. Taxpayers filing an income tax return with an Individual Taxpayer Identification Number (ITIN) are not eligible for the federal credit, and therefore cannot receive the working family credit. The bill would expand the working family credit to include taxpayers who file using an ITIN as opposed to a social security number. ITINs are issued by the Internal Revenue Service to individuals who are not eligible for a social security number but are required to file taxes. They are used exclusively for the purpose of filing taxes. Examples of individuals who require an ITIN include non-resident alien individuals who are required to file with their resident spouse or international students who have not received permission to work outside of their educational department.

- Minnesota state income tax information from 2018 was used in this estimate.
- In 2018, there were 22,600 returns filed using an ITIN for the taxpayer and/or the spouse. Of those, approximately 10,800 returns would qualify for the working family credit.
- The average credit for tax year 2018 would have been about $885 per return.
- The number of taxpayers with an ITIN has declined slightly each year since 2015, while the average credit per return is expected to grow slightly. An annual growth rate of 0.6% is assumed.
- Tax year impacts were allocated to the following fiscal year.

WFC Increase Rates (Article 1, Section 18)
Effective beginning with tax year 2021.

The bill would increase the working family credit rates and phase-out rates as shown in the table below.

Tax Year 2021 Working Family Credit Rates and Thresholds

	Eligible Earned Income	Credit Rate	Phase-out Begins*	Phase-out Rate
No children				
Current law	$7,340	3.90%	$8,960	2.00%
Proposal		**4.60%**		**2.30%**
One child				
Current law	$12,270	9.35%	$23,380	6.00%
Proposal		**11.00%**		**7.00%**
Two children				
Current law	$20,120	11.00%	$27,720	10.50%
Proposal		**13.00%**		**12.30%**
Three or more children				
Current law	$20,530	12.50%	$28,030	10.50%
Proposal		**14.80%**		**12.30%**

*Phase-out threshold is $6,000 higher for married taxpayers filing a joint tax return.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The House Income Tax Simulation (HITS 7.0) 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 November 2020. The model uses a stratified sample of 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts are allocated to the following fiscal year.
- About 313,400 tax returns would be affected in tax year 2021. The average reduction in tax would be about $160.

Definition of Resident Trust (Article 1, Section 5, 26(a))
Effective beginning in tax year 2021.

This bill is a response to the Minnesota Supreme Court's ruling in *Fielding v. Commissioner of Revenue,* ("*Fielding*") and the U.S. Supreme Court's decision in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust,* ("*Kaestner*"). The bill updates the factors to be considered when determining whether a trust has sufficient minimum connections with Minnesota to be taxed as a resident trust.

Under current Minnesota law, the definition of a resident trust differs depending on the date—before or after December 31, 1995—the trust becomes irrevocable or is first administered in Minnesota.

The U.S. Supreme Court addressed the Due Process Clause requirements for a state's ability to tax a trust in *Kaestner*. In that case, the Court applied a two-step analysis to determine whether a state tax abides by the Due Process Clause. The first test requires a minimum connection between a state and the person, property or transaction it seeks to tax. The second test requires the income attributed to the state for tax purposes to be rationally related to the taxing state. The Minnesota Supreme Court applied the same two-step analysis in *Fielding*.

The trusts at issue in *Fielding* and *Kaestner* were both *inter vivos* (i.e., during the life of the grantor) trusts. In each case, the Court held that the trust – which met the state's statutory definition of a "resident trust" – did not have sufficient minimum connections with the state to be taxed as a resident trust for purposes of due process. In both cases, the Court noted that its holding was limited to the facts presented in the case. Specifically, the holding in *Fielding* only applies to (1) irrevocable *inter vivos* trusts; and (2) that have the same "connections" to Minnesota that were at issue in *Fielding*.

As a result of the *Fielding* and *Kaestner* decisions, there is a lack of clarity in the constitutional application of the current Minnesota resident trust statute. For that reason, the bill changes the definition of resident trust to conform to the "minimum connections" standard set out in both decisions. The bill identifies relevant connections between Minnesota and the trust that are to be considered when determining whether the trust qualifies as a resident trust.

- The bill could change the amount of tax paid by trusts that were classified as resident trusts before the Supreme Court decision but as nonresident trusts after the decision.
- Only intangible income is affected by the bill, since it is assigned 100% to the trust's state of residence. Other income is apportioned to Minnesota, for resident and nonresident trusts.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate assumes that about 11.5% of total intangible income is earned by trusts that have been classified as nonresidents since the Supreme Court decision but would be reclassified as resident trusts under the bill.
- The revenue gains would begin with tax year 2021. The tax year revenue gains are reflected in the collections for following fiscal year.

Section 965 Repatriation and GILTI (Article 1, Sec. 7, 9-11, 13, 22, 23, 26(b))
Effective retroactively to tax year 2016.

Prior to the federal law change in the Tax Cuts and Jobs Act (TCJA), the income earned by foreign chartered corporations owned by domestic corporations could be deferred from taxation. Under federal law, these corporations are called controlled foreign corporations (CFCs). The past or current year income earned by CFCs could be taxed if any of its income was received by the domestic corporation that owned it. The term used to describe the transfer of income from a CFC subsidiary to its domestic parent corporation is repatriation.

Under the TCJA, the deferral of income earned by CFCs since 1986 is deemed to be repatriated and taxable under Internal Revenue Code Section 965, regardless whether it is actually repatriated (transferred) to the United States. The TCJA also imposes a tax on certain foreign income designated as global intangible low-taxed income (GILTI) under IRC Section 951A. This income is taxed regardless of whether it is repatriated to the United States.

The response to the federal law by the 2019 legislature was to exempt from taxation any Section 965 repatriation income or GILTI reported on the federal return.

The bill creates an addition for any income of a C corporation, resident, or part-year resident that is transferred to the United States but is excluded from federal income because it was previously taxed by the federal government as Section 965 repatriated income or GILTI. Any amount reported as an addition would be eligible for the dividends received deduction.

Section 965 Repatriation

- The revenue estimate is based on estimates of dividends and withdrawals by the U.S. Bureau of Economic Analysis (BEA) published in September 2020. Of this BEA data, about 80% is assumed to be Section 965 repatriated income. The BEA estimates show a spike of repatriated income in calendar years 2018 and 2019 equaling about $1.3 trillion, and preliminary data indicates a higher than normal flow of repatriated income in 2020. Projections for calendar years 2020 through 2025 assume about an additional $1 trillion of repatriated income.
- The pool of potentially repatriated income will flow to United States as repatriated income until the pool is depleted. It is assumed that the level of repatriated income will stabilize at levels slightly higher than historic norms beginning in 2021.
- Due to the retroactive effective date, all of the revenue gain associated with tax years 2017 through 2021 is allocated to FY 2022. The fiscal year 2021 estimate includes about $254 million in revenue associated with tax years 2018 through 2021.
- All other tax years are allocated 30%/70% to fiscal years.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

GILTI

- The estimate is based on the estimates of the federal legislation prepared by the staff of the Joint Committee on Taxation, dated December 18, 2017, and estimates of dividends and withdrawals from the Bureau of Economic Analysis.
- These estimates were adjusted to reflect the assumed amount of GILTI income that would be repatriated and were adjusted to reflect the effect of the dividends received deduction. Due to the large amount of income associated with actual repatriations connected to Section 965 during tax years 2018 and 2019, the amount of repatriated income tied to GILTI is assumed to be 7.75% and 17.5% in fiscal years 2020 and 2021.
- In fiscal year 2023 the percentage of total GILTI repatriated is assumed to plateau at 29% of total GILTI income.
- Due to the retroactive effective date, the revenue gain associated with fiscal year 2020 and 2021 is allocated to FY 2022. This gain is about $11.7 million of the FY 2022 total of $22.6 million.

Addition for Cooperatives (Article 1, Sections 3, 8, 12, 20, 21, 24)
Effective beginning with tax year 2021.

Public Law 115-97, known as the Tax Cuts and Jobs Act (TCJA), created a deduction for qualified business income (QBI), including qualified dividends received from an agricultural or horticultural cooperative. As a result, farmers had a tax incentive to sell their crops to a cooperative rather than a private company, to qualify for the QBI deduction. This provision was informally known as the “grain glitch.”

The Consolidated Appropriations Act of 2018 (Public Law 115-141), enacted March 23, 2018, fixed the grain glitch, but allowed specified cooperatives a deduction generally equal to 9% of qualified domestic activities income. This deduction was in place of the domestic production activities deduction, which was repealed by the TCJA.

Minnesota had never conformed to the domestic production activities deduction, so its repeal had no effect on Minnesota tax liability. However, when Minnesota conformed to the TCJA and the Consolidated Appropriations Act, it allowed the domestic production activities deduction for cooperatives under Section 199A. This was a new deduction beyond what had been allowed before the TCJA, giving an additional tax benefit for specified cooperatives.

The bill would create an addition to income for cooperatives that claim a federal deduction under Section 199A. The effect of the bill is to restore the definition of taxable income for cooperatives to what it was prior to the TCJA.

- The fiscal impact of the addition is unknown.
- About 340 cooperatives filed returns in tax year 2018 with total taxable income of about $30 million. Over the past three years, total federal taxable income of cooperatives has averaged about $106 million per year. The amount of Section 199A deductions by cooperatives is unknown.
- The bill would increase the taxable income of cooperatives, raising revenue by an unknown amount beginning in fiscal year 2022.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Increase Corporate Rate to 11.25% (Article 1, Section 15)
Effective beginning tax year 2021.

Under current law the corporate franchise tax rate is 9.8%. The bill would increase the corporate franchise tax rate to 11.25%. The minimum fee would remain unchanged.

- Estimates are based on the November 2020 forecast.
- Due to the retroactive effective date, all of the tax year 2021 revenue gain is allocated to fiscal year 2022. All other tax year impacts were allocated 30% / 70% to fiscal years.

Estate Tax: Reinstate $2.7 Million Exclusion (Article 1, Sections 4, 25)
Effective for estates of decedents dying after December 31, 2020.

During the 2017 legislative session, changes were made to the 2014 Minnesota stand-alone estate tax. Those changes included increasing the exclusion from $2 million to $3 million and changing the definition of taxable estate. The exclusion amounts changed as follows:

	2017	2018	2019	2020 and later
2014 Law	$1.8 million	$2.0 million	$2.0 million	$2.0 million
2017 Law	$2.1 million	$2.4 million	$2.7 million	$3.0 million

The definition of taxable estate was changed by subtracting the exclusion from the amount of the estate. As a result, the maximum tax rate of 16% doesn't go into effect at an estate amount of $10.1 million as it did under previous law. It goes into effect for estates valued at more than $10.1 million plus the exclusion ($12.8 million in 2019).

In addition, the maximum small business and farm subtraction was reduced by the 2017 tax law changes. Simply stated, the maximum small business and farm subtraction plus the amount of the exclusion is equal to $5.0 million under both the 2014 law and the 2017 law. So as the exclusion increases, the maximum small business and farm subtraction decreases, with the sum of the two remaining at a constant $5.0 million. If an estate makes use of the small business and farm subtraction and if a qualified heir of the estate disposes of small business or farm property within three years of the death of the decedent, a recapture tax is imposed. The amount of the recapture tax is 16% of the amount of the small business and farm subtraction claimed when the estate tax return was filed.

The bill will reinstate the $2.7 million exclusion for decedents who die in CY 2021 and thereafter. The small business and farm subtraction will increase to $2.3 million so the sum of the exclusion and the subtraction remains at $5 million.

- A database of estate tax returns filed in 2012 through 2017 was used for this analysis.
- The returns in the database were filed under statutory provisions that were different than current law. Therefore the estate tax amounts for returns in the database were recalculated to be consistent with current law.
- The proposed reinstatement of the $2.7 million exclusion starting in CY 2021 was used to recalculate the estate taxes for the returns in the database.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- Comparing those calculations, the total estate tax database returns increased by 8.81% for CY 2021 and later. The increase ratio was applied to the estate tax estimates in the November 2020 estate tax forecast.
- It is assumed that the estate tax is paid nine months after the death of the deceased.

Vapor and Tobacco Taxes – Article 2

Cigarette Excise Tax Rate Increased $1 per pack (Article 2, Sections 7, 17-18)
Effective July 1, 2021.

The bill would increase the excise tax rate on cigarettes by $1 to $4.04 per pack and similarly increase the minimum tax on each container of moist snuff to $4.04. A floor stocks tax on current inventories of cigarettes of $1 per pack, the difference between the current rate and proposed rate, would be imposed and deposited in the General Fund.

- The estimates are based on the November 2020 forecast.
- An annual price increase of 2% is assumed.
- The cigarette excise tax revenue gain was estimated using an elasticity factor of -1.10. The moist snuff excise tax revenue gain was estimated using an elasticity factor of -0.60.
- It is estimated that there will be about 135.6 million packs of cigarettes and 26.1 million containers of moist snuff sold in fiscal year 2021.
- The tax rate increase has 11 months of impact in fiscal year 2022.
- The cigarette floor stocks tax is based on 11.5 million packs.
- Under current law in fiscal year 2025, the packs of cigarettes sold is forecast to decrease to about 127.6 million packs of cigarettes and the containers of moist snuff are forecast to increase to about 29.3 million containers. Under the bill in fiscal year 2025, it is estimated that the number of packs of cigarettes sold will be 110.1 million and the containers of moist snuff will be 26.0 million.

Vapor Products (Article 2, Sections 1-6, 8-16)
Effective January 1, 2022.

The bill would impose a gross receipts tax of 35% on the retail sale of all nicotine solution products, in addition to the current excise and sales taxes. The nicotine solution products definition would be expanded to include electronic devices meant to be used in the consumption of a nicotine solution regardless of whether sold with the solution containing nicotine. Electronic vaping devices would be subject to the tobacco products excise tax as well as the gross receipts tax. The bill would also require out-of-state retailers to collect and remit the gross receipts tax on all products subject to tobacco tax, including nicotine solution products and devices sold into Minnesota.

A heating device used to heat a cigarette to produce a vapor or aerosol rather than burn the tobacco is defined and added to the definition of tobacco products. Heat devices would be subject to the tobacco products excise tax and the gross receipts tax.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- It is estimated that excise tax collections for vapor products were $19.1 million for fiscal year 2020.
- An elasticity factor of -0.9 was applied and an annual growth rate of 3% is assumed.
- It is estimated that 20% of vapor products are sold online.
- It is estimated that electronic vaping devices comprise 15% of the vapor market.
- The estimates assume remote sellers of vapor products are remitting sales tax due on their sales into Minnesota.
- Heat-not-burn cigarettes are available in the United States but are not in Minnesota. The products are subject to the PACT Act and cannot be sold online or shipped through the mail. It is assumed that heat-not-burn cigarettes will not be available in Minnesota during the forecast period.
- The estimates are adjusted for the federal government raising the legal minimum age for tobacco products from 18 to 21 years old and banning select flavored vapor products.
- The fiscal year 2022 estimates are adjusted for five months of collections.

<u>Sales and Use Tax – Article 3</u>

Qualified Data Center Software (Article 3, Sections 1, 3)
Various effective dates.

Certain computer software for use in a qualified data center is exempt. To qualify, based on recent revised guidance, the original software or the original software license must be loaded at the data center and remain on the equipment located at the data center. The software exemption can be claimed for up to 20 years from the date of the first purchase qualifying for the exemption.

The bill limits the refund for software purchases made after June 30, 2021, to 50% of the tax paid and limit the time that a refund can be claimed.

- For entities whose first qualifying purchase was five or more years prior to June 30, 2021, purchases of software loaded at the data center with either the original software or original software license on equipment at the data center would be exempt, ending with the last purchase made prior to July 1, 2021.
- For entities whose first qualifying purchase was made within five years prior to June 30, 2021, software loaded at the data center with either the original software or original software license on equipment at the data center would be exempt for purchases prior to July 1, 2021. For purchases after June 30, 2021, and within five years of the first qualifying purchase, 50% of all software loaded at the data center would be exempt.
- For entities whose first qualifying purchase was after June 30, 2021, 50% of all software loaded at the data center purchased within five years of the first qualifying purchase would be exempt.

- The estimates are based on Department of Revenue refund claims for qualified data centers.
- It is estimated that 45% of qualified data center claims for refund are attributable to software. The remaining 55% are estimated to be for equipment and hardware.
- Approximately 95% of total refund claims are for entities whose first qualifying purchase is more than 5 years prior to June 30, 2021. It is assumed that 95% of claims for fiscal years 2022, and 2023, and 85% of claims for fiscal years 2024 and 2025 are attributable to entities whose first qualifying purchase is more than 5 years prior to June 30, 2021.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- Based on information on the average time between qualifying purchases and the payment of the refund, it is estimated that sales and purchases made after fiscal year 2021 will represent 25% of refund requests filed in fiscal year 2022, 50% of refunds in fiscal year 2023, 75% of refunds in fiscal year 2024, and 100% of refunds in fiscal year 2025.

Fundraising Sales for School Organizations (Article 3, Section 2)
Effective the day following final enactment.

Fundraising sales made by an educational or social nonprofit organization for people age 18 and under were exempt from the sales tax provided the proceeds from the activities were not deposited with the school district treasurer. After a 2019 law change to conform with federal accounting requirements, fundraising sales made by schools and school-run groups for extracurricular activities are required to be deposited with the school district treasurer and the sales tax exemption is no longer available for certain fundraising activities.

The bill reverses the unintended effect of the accounting change on the sales tax exemption for fundraising sales. The sales tax exemption would again apply to educational or social nonprofit organizations for people age 18 and under, regardless of the accounting with the school district treasurer. The proposed exemption would require that: 1) the fundraising sales are for elementary and secondary school student activities, 2) separate accounting records are maintained by the school group, and 3) the school district reserves and spends revenues raised by a particular extracurricular activity only for that activity.

- Other sales tax exemptions apply to certain fundraising sales including candy, food, clothing, and coupon books, which limited the impact of the legislative change.
- The 2018 Minnesota Tax Expenditure Budget reported a tax expenditure estimate for fundraising sales by nonprofits of $13 million for fiscal year 2022. Based on information from Minnesota Department of Education, it is estimated that 5% of the tax expenditure would be exempt under the bill.

<u>Miscellaneous – Article 5</u>

Stadium Reserve Account (Article 5, Section 1)

The bill limits the amount appropriated from the general fund for deposit in the Stadium Reserve Account to $100 million.

- The estimates are based on the projected Stadium Reserve Account balance in the November 2020 forecast.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Weight-to-Volume Conversion (Article 5, Section 2, 3)
Effective after June 30, 2021.

The solid waste management tax is imposed on charges for the collection and disposal of solid waste. For mixed municipal solid waste, the tax is 9.75% for service provided to residential customers and 17% for commercial customers. The tax is 60¢ per non-compacted cubic yard for non-mixed municipal solid waste (construction debris, industrial waste, and infectious and pathological waste). For self-haulers, the statute provides a weight-to-volume conversion for construction debris of one ton equal to 3.33 cubic yards, or a tax rate of $2 per ton.

The bill provides for a tax on construction debris for self-haulers of 60¢ per cubic yard. The bill would have the Department consult with the Pollution Control Agency to determine a weight-to-volume conversion amount.

- The estimates depend on when and whether the tax rate is adjusted.

Directly Procured Nonadmitted Insurance (Article 5, Section 4)
Effective beginning in tax year 2022.

Nonadmitted insurance may be purchased through a surplus lines agent, or it may be purchased directly by the insured. Nonadmitted insurance typically covers unusual risks that are not covered by insurers that are licensed by state insurance departments. Nonadmitted insurance may be labeled as excess, surplus lines, E & S, or captive.

Under current law, the purchase of surplus lines insurance through a surplus lines agent is subject to a 3% gross premium tax. However, the direct purchase of nonadmitted insurance by the insured is subject to a 2% gross premium tax.

The bill would subject the direct purchase of nonadmitted insurance to a 3% gross premium tax rate. The tax rate would be the same as nonadmitted insurance purchased through a surplus lines agent.

- In 2019, the premiums for directly purchased nonadmitted insurance totaled $67.6 million.
- With a 2% tax rate, the tax on these premiums was $1.35 million.
- The estimate was calculated by applying a 3% tax rate to the 2019 nonadmitted direct purchased tax collections.
- The estimates are adjusted by the growth of insurance gross premium revenue as projected in the November 2020 forecast.
- Because payment of tax is due on March 1 after the end of the calendar year, the bill would change collections beginning in fiscal year 2023.

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