DEPARTMENT OF REVENUE

Senate Omnibus Bill

	Yes	No
DOR Administrative Costs/Savings	x	

April 27, 2021

State Taxes Only—See Separate Analysis For Property Tax Provisions

Department of Revenue
Analysis of S.F. 961 (Nelson) 1st Engrossment

	Fund Impact			
	F.Y. 2022	**F.Y. 2023**	**F.Y. 2024**	**F.Y. 2025**
	(000's)			
Federal Update				
PPP Loan Exclusion				
Individual Income Tax	($191,500)	($18,200)	($14,400)	($9,900)
Corporate Franchise Tax	($183,500)	($15,900)	($12,200)	($9,200)
Educator Expense Deduction	($25)	$0	$0	$0
Subtotal	($375,025)	($34,100)	($26,600)	($19,100)
Individual Income Tax				
Pass-Through Entity Tax	$0	$0	$0	$0
Unemployment Benefit Subtraction	($28,400)	$0	$0	$0
Section 179 Carryovers	($3,800)	$1,000	$1,000	$1,000
Angel Investment Credit	$0	($10,000)	$0	$0
K-12 Subtraction Inflation Adjustment	($400)	($800)	($1,200)	($1,600)
Volunteer Drivers Subtraction	($30)	($30)	($30)	($30)
Education Savings Account Subtraction	$0	$0	$0	$0
K-12 Credit Inflation Adjustment	($200)	($400)	($500)	($700)
Minnesota Housing Tax Credit	$0	$0	($10,000)	($10,000)
Credit for Blended Gasolined Dealers	($2,400)	($2,900)	($3,500)	($4,200)
Liquor Spoilage Credit	($3,400)	$0	$0	$0
Partnership Audit Rules	($600)	($1,400)	($1,500)	($1,600)
Subtotal	($39,230)	($14,530)	($15,730)	($17,130)
Corporate Franchise Tax				
Section 179 Carryovers	($1,400)	$400	$400	$400
Historic Rehabilitation Credit	($2,200)	($2,800)	($2,800)	($2,800)
Subtotal	($3,600)	($2,400)	($2,400)	($2,400)
Sales and Use Tax				
June Accelerated Payments	$0	$0	$0	$0
Fundraising Sales for School Organizations	($640)	($670)	($690)	($720)
Public Safety Facility Construction	($1,980)	($4,140)	($4,290)	($4,440)
Local Excise/Fee Prohibition	$0	$0	$0	$0
COVID-19 PPE Expenses by Restaurants	($9,450)	$0	$0	$0
Subtotal	($12,070)	($4,810)	($4,980)	($5,160)
Cigarette Tax				
Cigarette Revenue Dedication	($5,000)	$0	$0	$0
General Fund Total	**($434,925)**	**($55,840)**	**($49,710)**	**($43,790)**

	Fund Impact			
	F.Y. 2022	F.Y. 2023	F.Y. 2024	F.Y. 2025
	(000's)			
Natural Resources and Arts Funds				
June Accelerated Payments	$0	$0	$0	$0
Fundraising Sales for School Organizations	($40)	($40)	($40)	($40)
Public Safety Facility Construction	($110)	($240)	($250)	($260)
Local Excise/Fee Prohibition	$0	$0	$0	$0
COVID-19 PPE Expenses by Restaurants	($550)	$0	$0	$0
Subtotal	($700)	($280)	($290)	($300)
Special Revenue Fund				
Cigarette Revenue Dedication	$5,000	$0	$0	$0
Total – All Funds	**($430,625)**	**($56,120)**	**($50,000)**	**($44,090)**

EXPLANATION AND ANALYSIS OF THE BILL

Federal Update – Article 1

The bill updates reference to the Internal Revenue Code to include the paycheck protection program exclusion and the modification to the educator expense deduction in tax year 2020 and 2021 only.

Paycheck Protection Program (Article 1, Section 9)
The Paycheck Protection Program (PPP) provides low-interest loans to small businesses with less than 500 employees to assist with payroll, mortgage interest, rent, and utilities. The loans are to be spent over an 8-week to 24-week period for qualified business expenses. The total loan covers up to 2.25 times the business's average monthly costs up to $10 million. After the covered period, business can contact the loan provider to seek possible loan forgiveness. Loans are eligible for forgiveness if they meet certain requirements.

The amount of the loan that is forgiven is not included in gross income. The CAA 2021 clarified that expenses paid with forgiven loans may be deducted from income.

The bill conforms to federal law by excluding the amount of the loan that is forgiven from gross income.

- The first and second round of PPP loans ended on August 8, 2020. At that time, about 5,212,100 loans totaling $525.0 billion had been approved by the Small Business Administration (SBA), as reported in the Paycheck Protection Program Report. Of this total, about 102,400 loans totaling $11.3 billion were approved in Minnesota.
- The CAA 2021 appropriated an additional $284 billion for PPP loans. Based on the loans issued so far, Minnesota businesses are expected to receive an additional $6.1 billion in loans in tax year 2021.
- Based on the distribution and magnitude of the loans, it is assumed 80% of the loans will be forgiven.
- C corporations account for 39.5% of PPP loans in Minnesota, according to information obtained from the Small Business Administration. Pass-through entities, estates, trusts, and individuals account for 51.9%. Nonprofit organizations account for 8.6%.
- Nonprofits are not included in the estimate because their operating income is already excluded from tax.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate was reduced by 68% to exclude businesses without taxable income in tax year 2020, based on taxable income in 2018, adjusted for expected losses in 2020.
- The SBA data for Minnesota loan recipients does not include out-of-state businesses with sales into Minnesota. The size of that impact is unknown but is assumed to be offset by out-of-state sales of businesses located in Minnesota.
- Amounts that cannot be deducted immediately may be carried forward as net operating losses (NOLs) to offset income in future years. Between 2.7% and 6.3% of NOLs are assumed to be claimed each year over the forecast period.
- The CARES Act removed the 80% limitation on NOLs and allowed losses to be carried back for up to five years. Adopting those provisions when combined with the PPP loan exclusion would result in an additional immediate impact in FY 2022. There will be a revenue gain beginning in FY 2023 as the pool of NOLs will be smaller in future years.
- A marginal rate of 8.0% was assumed for individuals and pass-through entities. A marginal rate of 9.8% was applied to corporations.
- Corporate tax impacts are allocated 30% / 70% to fiscal years. Income tax impacts were allocated to the following fiscal year.

Educator Expense Deduction for Personal Protective Equipment (Article 1, Section 9)
The Further Consolidated Appropriations Act, 2021 (Public Law 116-260) expanded the educator expense deduction to include personal protective equipment and other supplies used to protect against the COVID-19 coronavirus.

The bill adopts the expanded definition of educator expenses for tax years 2020 and 2021 only.

- The estimate is based on the estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated December 21, 2020.
- The estimate was apportioned to Minnesota and adjusted for the difference between federal and state tax rates and federal and state fiscal years.
- Retroactive impacts are allocated to fiscal year 2022.

Pass-Through Entity Tax (Article 1, Sections 1, 4-6)
Effective beginning with tax year 2021.

Flow-through entities such as S corporations and partnerships do not pay state or federal income taxes directly. Their income is passed to shareholders, who report the income on their individual income tax returns. There is no election to allow a partnership, S corporation, or limited liability company to file and pay their tax liability as an entity.

For individuals, federal deductions for state and local taxes paid are subject to the federal cap on state and local tax deductions. The cap is $10,000 ($5,000 for married separate filers). The limitation expires after tax year 2025.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The bill creates an option that allows a partnership, S corporation, or limited liability company to file and compute tax liability as opposed to passing all the income to its owners. A pass-through entity would elect to pay a pass-through entity (PTE) tax. It is assumed when the PTE tax is paid at the entity level that the federal government will allow the taxes to be deductible as part of the income flowing out of the pass-through entity.

The income subject to tax under the PTE tax would be an apportioned amount. Under current law, nonresidents have income apportioned to Minnesota. In contrast, under current law residents have 100% of their income assigned to Minnesota.

The pass-through entity's tax is equal to the sum of the tax liability of each qualifying owner. Each qualifying owner's tax must be computed using the tax rates and brackets for married separate filers, estates, and trusts.

If the election is made by the majority owners of the qualifying entity (having more than 50% ownership interest), the election is binding on every owner of the entity. 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 pay the PTE tax.

The owners of the qualifying entity would claim a refundable credit on the individual income tax return equal to the amount of PTE tax.

Taxpayers choosing to pay the PTE tax would calculate their taxes in a three-step process which differs from the one under current law. First, each partner/shareholder would compute their tax on flow-through income as done under current law. Next, information from the individual income tax calculation would be used in the process of computing a PTE tax.
Last, the PTE tax would be claimed as a tax credit on the individual income tax return. If the PTE tax is less than tax on the individual income tax return, the individual income taxpayer would pay the difference in tax.

- The number of qualifying entities that would select PTE tax is unknown.
- In tax year 2018, about 179,300 full-year resident returns reported income from an S corporation, partnership, or limited liability corporation.
- Of those, about 42,500 returns had state and local taxes over the deduction limit ($10,000 or $5,000 for married separate filers).
- About 21,800 of those returns had at least some income in the highest income tax bracket. Those are considered most likely to elect to use the PTE tax option.
- 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 use the PTE tax option if the majority shareholders benefit from the election with a reduced combined federal and state tax liability.
- Because the amount of income reported on the individual income tax return is the same as under current law, the same amount of tax will be collected under the bill as under current law. The tax paid by the PTE will be offset by the refundable credit claimed by the shareholder, resulting in no change in revenue.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Unemployment Insurance Subtraction (Article 1, Section 2)

The bill creates a temporary subtraction for supplemental unemployment insurance benefits. The Coronavirus Aid, Relief, and Economic Security (CARES) Act (Public Law 116-136) provided federal funding for payments of $600 per week in supplemental unemployment benefits, known as federal pandemic unemployment compensation. Under state and federal law, unemployment insurance payments are taxable income.

The bill allows an individual income tax subtraction for 18% of federal pandemic unemployment compensation received in tax year 2020. The subtraction is reduced by $1 for every $4 of adjusted gross income over the following thresholds: $150,000 for married joint filers, $75,000 for single and married separate filers, and $112,500 for head of household filers.

- The estimate is based on the U.S. Department of Labor's publication of Coronavirus Aid, Relief, and Economic Security (CARES) Act funding to states.
- It was assumed that about 65% of unemployment insurance claims would result in taxable income on individual returns.
- A marginal rate of 6.5% was assumed.
- Retroactive impacts were allocated to fiscal year 2022.

Section 179 Carryovers (Article 1, Section 7)
Effective for Federal Section 179 carryovers beginning in tax year 2020.

Prior to tax year 2020, Minnesota law required a taxpayer to add back 80% of the difference between the amount deducted federally and the amount that was allowed under pre-2003 federal law (up to $25,000, reduced by one dollar for each dollar that total expenses exceed $200,000). The amount of the addback could be subtracted in equal parts over the next five years.

Minnesota conformed to the federal treatment of Section 179 property beginning with property placed in service in 2020, eliminating the need for the additions and subtractions. However, full conformity does not apply to carryovers from a previous year if the property was placed in service before tax year 2020. For example, Section 179 expenses for property placed in service in 2019 may be carried over to tax year 2020 if the taxpayer is unable to claim the full deduction in 2019. In that case, the expenses would still be subject to the addition and subtractions on the Minnesota return, since the property was placed in service in 2019.

The bill would extend full conformity for Section 179 expensing to include carryovers beginning in tax year 2020, regardless of when the property was placed in service.

- Based on information from the Internal Revenue Service Statistics of Income, carryovers accounted for about 6.9% of total Section 179 expenses on individual income tax returns in 2018.
- On Minnesota returns, full-year residents claimed about $1.08 billion in Section 179 expensing in 2018. Carryovers are estimated at 6.9% of that amount, or $74.5 million.
- Assuming a growth rate of 3%, carryovers in 2020 are estimated at $79.0 million.
- A marginal rate of 7.75% is assumed.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate was increased by 5% to account for nonresidents.
- The corporate franchise tax impact is estimated at 38% of the individual income tax impact, based on the ratio of Section 179 expenses reported on individual and corporate returns.
- Retroactive impacts were allocated to fiscal year 2022. All other tax years were allocated 30% / 70% to fiscal years.

Individual Income and Corporate Franchise Taxes – Article 2

Angel Credit (Article 2, 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 $10 million.

- It is assumed that the maximum of $10 million in credits will be claimed in tax year 2022.
- Tax year impacts were allocated to the following fiscal year.

K-12 Subtraction Inflation Adjustment (Article 2, Section 3)
Effective beginning with tax year 2021.

A taxpayer may claim a subtraction for certain education expenses of up to $1,625 per qualifying child in kindergarten through sixth grade and $2,500 per child in 7th through 12th grade. Qualifying expenses include amounts paid to others for tuition, transportation, nonreligious textbooks, and instructional equipment for regular school classes. Fees or tuition for instruction outside the regular school day and school year also qualifies, such as tutoring and educational summer camps. The maximum subtraction amounts are not indexed for inflation.

The bill would adjust the maximum subtraction amounts for inflation beginning in tax year 2021.

- The estimate is based on a sample of 2018 individual income tax returns.
- In tax year 2018, K-12 education subtractions totaled $219.8 million on 186,100 returns.
- The education subtraction has declined slightly over time. This estimate assumes that the subtraction will decrease by 1% annually under current law. Under the bill, it is expected to grow by 1.5% annually.
- A marginal rate of 7.2% is assumed, based on the calculated effective tax rate for the subtraction in 2018.
- Tax year impacts are allocated to the following fiscal year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Volunteer Driver Subtraction (Article 2, Section 4)
Effective beginning with tax year 2021.

Under Federal and state law, volunteer drivers may exclude from income any mileage reimbursement payments received from charitable organizations, up to 14 cents per mile. Mileage reimbursements above that rate must be reported as income.

The bill would allow a subtraction for mileage reimbursements paid by a charitable organization to a volunteer driver. The subtraction is limited to the reimbursement that is over 14 cents per mile but not over the standard mileage rate (56 cents in tax year 2021).

- The estimate is based on information from the Volunteer Driver Coalition and a survey from the Metropolitan Area Agency on Aging.
- The Volunteer Driver Coalition estimates there are about 2,000 volunteer drivers in Minnesota.
- A survey from the Metropolitan Area Agency on Aging was used to identify the number of volunteer drivers, the average reimbursement rate, and the average miles driven in 2018.
- Drivers who drove more than 5,000 miles were assumed to be paid employees ineligible for the subtraction.
- Volunteers reimbursed at 14 cents per mile are ineligible for the subtraction. From the survey, it is estimated about 910 volunteer drivers would be eligible for the subtraction. Of those eligible, the average reimbursement was 51 cents per mile. The average amount eligible for the subtraction would be 37 cents per mile. The average miles driven was 941 miles.
- The estimate was increased by 50% to account for drivers not included in the survey.
- A marginal tax rate of 6.5% is assumed.
- The subtraction is assumed to grow at 0.6% a year based on projected population growth from the Minnesota State Demographic Center.
- Tax year impacts were allocated to the following fiscal year.
- About 1,400 taxpayers in tax year 2021. The average reduction in tax would be approximately $25.

Education Savings Account Subtraction (Article 2, Section 5)
Effective beginning with tax year 2021.

House File 1065, 1st Unofficial Engrossment, establishes an Education Savings Account (ESA) program providing education funds to a Minnesota parent of an eligible Minnesota student. To be eligible, the student must have been enrolled in a public school or a public charter school in the semester prior to using the ESA. The student must also be a member of a household whose income is less than three times the income standard needed to qualify for the reduced-price school lunch program.

The bill allows a subtraction for amounts deposited in an ESA.

- Since the Education Savings Account program is not included in the current forecast, allowing a subtraction for amounts deposited in ESAs will not show a revenue impact.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- H.F. 1065, 1st UE, appropriates $2,245,000 for fiscal year 2022 and $74,186,000 in fiscal year 2023. Any remaining balance in the first year is available in the second year.
- If the program was in the current forecast, the subtraction would reduce income tax revenue by a total of about $5.5 million in fiscal years 2023 and 2024, assuming a marginal rate of 7.2%.

K-12 Credit Inflation Adjustment (Article 2, Section 6)
Effective beginning with tax year 2021.

A taxpayer is allowed a refundable income tax credit equal to 75% of eligible education expenses for a qualifying child in kindergarten through 12th grade. The maximum credit is $1,000 for each child. Eligible expenses include fees for instruction outside the regular school day or school year, expenses for textbooks or instructional materials, and transportation costs paid to others. Tuition is not an eligible expense. A maximum of $200 per family for certain computer hardware and software is allowed.

The maximum credit is phased out beginning at household income of $33,500. For taxpayers with one child, the maximum credit is reduced by one dollar for every four dollars of household income over $33,500. For taxpayers with two or more children, the maximum credit is reduced by two dollars for every four dollars of household income over $33,500. The phase-out range is increased by $2,000 for each additional child. The income thresholds are not indexed for inflation. Household income includes income from all sources, both taxable and nontaxable.

The bill would adjust the maximum credit and phase-out threshold amounts for inflation beginning in tax year 2021.

- The estimate is based on a sample of 2018 individual income tax returns.
- In tax year 2018, K-12 education credits totaled $7.7 million on 34,800 returns.
- The credit has declined steadily over the past several years. This estimate assumes that the credit will decrease by 2% annually under current law. Under the bill, it is expected to grow by 0.5% annually.
- Tax year impacts are allocated to the following fiscal year.

Historic Structure Rehabilitation Credit (Article 2, Section 7)
Effective for credits allocated from July 1, 2021 through June 30, 2022.

The historic rehabilitation credit is a refundable credit equal to 20% of qualified rehabilitation expenditures (QREs). In order to receive the state tax credit, the taxpayer must qualify for the federal tax credit. As with the federal credit, the Minnesota credit is spread over a period of five years.

The State Historic Preservation Office (SHPO) cannot allocate credits after June 30, 2021. Projects allocated credits prior to that date can receive credit certificates through fiscal year 2024. A project is issued a credit certificate when work is completed, and the project is placed in service.

No allocation of credits is permitted past June 30, 2021.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The bill extends the sunset provision by one year and limits the total credits to be issued in the fiscal year 2022 to $14 million. The extension would allow allocation certificates to be issued up and until June 30, 2022.

- The State Historic Preservation Office (SHPO) and Minnesota Management and Budget (MMB) provided data on the amount of historic rehabilitation credits between fiscal years 2013 and 2020. The average amount of credits issued per year during this period is about $35 million.
- This amount includes an additional 5% to reflect grants in lieu of credits.
- The amount of tax certificates associated with tax year 2021 is $7.0 million, and in addition the amount of tax certificates associated with tax year 2022 is estimated to be $7.0 million. This amount reflects the new authority to issue up to $14 million of tax credits during fiscal year 2022.
- For fiscal years beyond 2025, there is an additional $3.4 million revenue loss.
- The payment of the credits associated with each project is spread across five years.
- The first payment in tax year 2021 is allocated to fiscal year 2022. For all other payments, tax year impacts are allocated 30% / 70% to fiscal years.

Minnesota Housing Tax Credit (Article 2, Sections 11 & 13)
Effective for tax years 2023 and 2024.

The bill allows taxpayers to claim a nonrefundable credit against the individual income tax, corporate franchise tax, or gross premiums tax for contributions to a designated housing development fund. The credit is equal to 90% of contributions of at least $100 but not more than $5 million. Any unused credit may be carried over for up to 10 years. If a taxpayer is able to claim a credit and a carryover credit in the same tax year, the credit must be claimed first. Total statewide credits are limited to $10 million per year.

To qualify for the credit, the taxpayer must contribute to the Minnesota Housing Tax Credit Contribution Fund, a revolving fund to be administered by the Housing Finance Agency (HFA). Within 30 days the HFA must provide a credit certificate to the taxpayer and send a copy to the Department of Revenue. If there are no remaining credits to match the contribution, the HFA must return the contribution to the taxpayer.

The Fund is to be used for grants and loans for low and moderate income housing developments. Grants and loans should approximately fund the metropolitan area and greater Minnesota equally. Eligible recipients must use the funds to serve households under the income limit for the Economic Development and Housing Challenge Program. A taxpayer contributing to the Fund may indicate that a contribution is intended for a specific project, but not the taxpayer's own project.

The bill appropriates an unspecified amount to the Commissioner of the HFA to administer the program. The Commissioner must report to the legislature by January 15 of each year on the tax credits and financing provided in the previous year, including a breakdown by region and planned financing for the current year.

- It is assumed that the maximum of $10 million in credits will be allocated and claimed in each year.
- Tax year impacts are allocated to the following fiscal year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Credit for Blended Gasoline Dealers (Article 2, Section 12)
Effective for tax years 2021 through 2030.

Highway fuels are taxed at the distributor level. The tax rate for gasoline is 28.5 cents per gallon, and the tax rate for E85 ethanol blends is 20.25 cents per gallon. E85 is defined as any blend of gasoline that contains between 50% and 85% ethanol by volume.

The bill creates a nonrefundable credit for gasoline retailers who are subject to the individual income tax and engage in selling higher ethanol blends that contain at least 15% ethanol but no more than 85% ethanol in the state. C corporations do not qualify for the credit.

The credit is equal to five cents per gallon of higher ethanol blend that is sold at a retail service station. “Higher ethanol blend” means gasoline blended with ethanol that contains at least 15% ethanol but no more than 85% ethanol.

For S corporations, limited liability companies, or partnerships, the credit is passed through to shareholders or partners.

The credit expires after tax year 2030.

- Minnesota Department of Commerce reports about 10.7 million gallons of E85 gasoline (gasoline blended with more than 50% ethanol but no more than 85% ethanol) and 75.1 million gallons of gasoline that is blended with at least 15% of ethanol but less than 50% ethanol (E15 to E50) were sold in Minnesota for tax year 2020.
- Over the past five years, the market share of E15 gasoline has increased very rapidly while that of E85 has been declining.
- The estimate assumes a 20.5% average growth rate for all qualified ethanol blends.
- The estimate was reduced by 45% to exclude C corporations, based on sales and use tax data for gas stations in Minnesota.
- The income tax liability data was not immediately available. The estimate was decreased by 15% to account for businesses whose tax liability is less than the credit.
- Tax year impacts were allocated to the following fiscal year.
- About 810 taxpayers would be eligible for the credit.

Liquor Spoilage Credit (Article 2, Section 14)
Effective retroactively for tax years 2020 and 2021.

To cope with the COVID-19 pandemic, the Governor of Minnesota issued multiple executive orders which require certain businesses to either close or operate at limited capacity.

The bill creates temporary credit against the individual income tax or corporate franchise tax for qualifying brewers, liquor retailers, and wholesalers whose business was subject to closure or limited capacity due to Executive Orders 20-04, 20-74, or related executive orders. Qualified taxpayers include licensed brewers or alcohol wholesalers, and on-sale liquor licensees that were subject to closure or limited capacity.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

A qualified brewer, retailer or wholesaler may claim a credit that is equal to the amount of liquor spoilage in the tax year. The credit is refundable.

"Liquor spoilage" means:

- For a qualified brewer, the dollar amount of product purchased back from a liquor wholesaler or retailer, and the dollar amount of any product disposed of as unsalable due to closure or limited capacity;
- For a qualified retailer, the dollar amount of product returned without reimbursement to a liquor wholesaler or manufacturer, and the dollar amount of any product disposed of as unsalable due to closure or limited capacity; and
- For a qualified wholesaler, the dollar amount of product purchased back from a retailer, the dollar amount of product returned without reimbursement to a manufacturer, and the dollar amount of any product disposed of as unsalable due to closure or limited capacity.

For S corporations, limited liability companies, or partnerships, the credit is passed through to the entity's shareholders or partners.

- The total value of beer spoilage in 2020 is estimated at $3 million, based on information from the beer wholesale industry. The estimate was increased by 5% to account for wine and liquor spoilage.
- It is assumed that most of the spoilage occurred in the first few months the executive orders were in place. The estimate was increased by 10% to account for additional spoilage in 2021.

Sales and Use; Excise Taxes – Article 3

June Accelerated Payments (Article 3, Sections 1 and 2)
Effective July 1, 2021.

Certain businesses are required to remit their June tax payments on an accelerated basis. Taxpayers that have a tax liability of $250,000 or more during a fiscal year are required to pay a portion of the estimated June liability two business days before June 30th for each year. The payment is 87.5 percent of the estimated June liability for 2021 and 84.5 percent for subsequent years.

The bill reverses the fiscal year shift in state tax revenues by reducing the percentage of the June sales tax liability remitted on an accelerated basis by certain businesses until June accelerated payments are no longer required. The bill will reduce state general fund revenues in one or more years that a surplus is forecast, until the percentage of the June liability is reduced to zero.

- The bill would create changes to the Minnesota Management and Budget forecast.
- It is estimated that the forecast adjustments for a first-year full reversal of the June 2022 sales and use tax accelerated payments would be a $263.4 million general fund shift and $15.2 million to the natural resources and arts funds. Also, the changes would incur small ongoing reduced growth impacts.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Fundraising Sales for School Organizations (Article 3, Section 3)
Effective for sales and purchases made after the date of final enactment.

Prior to July 2019, fundraising sales made by an educational or social nonprofit organization for people age 18 and under had a sales tax exemption provided the proceeds from the activities were not deposited with the school district treasurer. A 2019 law change to conform with federal accounting standards required fundraising sales made by schools and school-run groups for extracurricular activities to be deposited with the school district treasurer. The 2019 law change created the unintended effect of negating the sales tax exemption for certain fundraising activities.

The bill would reverse the unintended effect of the recent law 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 change would require that:
1) the fundraising sales are for elementary and secondary school student activities, and
2) 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 Report reported a tax expenditure estimate for fundraising sales by nonprofits of $13.2 million for fiscal year 2021. Based on information from the Minnesota Department of Education, it is estimated that 5% of the tax expenditure would be exempt under the bill.

Public Safety Facility Construction (Article 3, Section 4)
Effective for sales and purchases made after June 30, 2021.

Generally, construction materials, supplies, and equipment are subject to the sales and use tax. Local government purchases are exempt from the sales and use tax including purchases of construction materials by local governments for their own use. The local government exemption does not apply to purchases of materials by a construction contractor unless the contractor is authorized to act as a purchasing agent for the local government.

The bill provides an exemption for materials and supplies used or consumed in and equipment incorporated into the construction, remodeling, expansion, or improvement of a fire station or police station owned by a local government. The exemption would include related facilities, which the bill defines as access roads, lighting, sidewalks, and utility components on or adjacent to the fire or police station. The exemption would be administered as a refund.

- The estimates are based on the U.S. Census publication *Value of Construction Put in Place.* The applicable Census reports are for state and local government construction. National amounts for 2018 and 2019 were averaged for a state fiscal year 2019 estimating base.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The national amounts were apportioned to Minnesota at 1.8%, the state share of GDP according to the Bureau of Economic Analysis.
- The amounts were reduced for the estimated amount of construction materials that a contractor may currently acquire exempt under Rule 8130.1200, Subpart 3.
- It was estimated that 40% of the value of qualifying construction was attributable to taxable building and construction materials.
- Growth rates for governmental entities published by IHS Global Insight, Inc. (*U.S Economic Outlook*) were used to forecast local government spending.
- The timing and processing of refund claims are expected to affect the estimates. The fiscal year 2022 estimates are reduced for an expected partial year refund impact.

Cigarette Excise Tax (Article 3, Section 8)
Effective for revenue received after June 30, 2021.

Revenue from the cigarette excise tax is deposited in the general fund, except for two dedications. A special revenue fund is credited $22,250,000 annually with funds appropriated to the Academic Health Center at the University of Minnesota and $3,937,000 is credited annually to the medical education and research costs account.

The bill would create a new tobacco use prevention and cessation account in the special revenue fund. In fiscal year 2022, $5,000,000 is credited to the account to be appropriated to the commissioner of health for tobacco use prevention and cessation projects and initiatives.

- In fiscal year 2020, $391.5 million was deposited into the state general fund from the cigarette excise tax.

Local Excise/Fee Prohibition (Article 3, Section 10)
Effective the day following final enactment.

The bill prohibits counties, cities, towns, or other taxing authorities from imposing, or increasing, an excise tax or fee on the manufacture, distribution, wholesale, or retail sale of food. The provision would also prohibit local subdivisions from imposing, or increasing, an excise tax or fee on 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.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

COVID-19 PPE Expenses by Restaurants (Article 3, Section 11)
Effective retroactively from March 1, 2020, and applies to sales and purchases made after February 29, 2020, and before January 1, 2022.

The bill would provide a sales and use tax exemption for materials, supplies, or equipment used by a restaurant to adapt to health guidelines or any executive order related to COVID-19. Restaurant is defined as an entity that prepares, serves, or otherwise provides food or beverages for human consumption operating from a location for more than 21 days annually, excluding food carts, mobile food units, grocery stores, convenience stores, gas stations, bakeries, or delis.

Refund claims are limited to $1,000 per federal employment identification number or Minnesota sales and use tax account number. A business filing a consolidated return to report sales tax from more than one restaurant location is eligible for up to $1,000 for each location reported. The tax is to be paid at the time of purchase and refunded for purchases after February 29, 2020, and prior to January 1, 2022. Only the restaurant owner may apply for a refund. Refund claims are to be filed after June 30, 2021.

- The estimates are based on 2019 sales tax filing information. There were approximately 10,500 restaurants filing sales tax returns that are assumed to meet the requirements of the exemption.
- The average claim is based on fee amounts charged by restaurants to cover COVID-19 related costs. It is assumed that the average claim amount related to purchases to adapt to health guidelines or executive orders related to COVID-19 will be $950.
- It is assumed all refund claims will be filed and paid in fiscal year 2022.

<u>Partnership Audits – Article 7</u>
Effective retroactively for tax years beginning after December 31, 2017.

The bill is in response to a 2015 federal law change in The Bipartisan Budget Act of 2015. It created a new federal partnership auditing regime that allows the IRS to review multiple years of a partnership activity and to adjust the tax in the year the audit is completed. The tax associated with the audit is paid at the partnership level, or with an election, it may be paid at the partner level.

Current law allows for the payment of tax only at the partner level. There is no mechanism for audit changes made at the partnership level on behalf of its partners.

The bill allows a partnership to elect to pay the state assessment at the partnership level on behalf of its partners. It includes rules for calculating the tax payable by the partnership. This arrangement mirrors the treatment under federal law.

The assessment is calculated at the partnership level based on the residency of the partners. However, the allocation of income of indirect partners could be reduced compared to current law. The ability to apportion income of nonresidents is no change from our current law, but the bill could reduce the amount of taxes attributable to resident indirect partners.

The bill is based on the multistate tax commission (MTC) model act for implementing the federal law. The bill requires taxpayers to use the same audit elections on both the federal and state returns.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The revenue gain estimate is based on estimates made by the Joint Committee on Taxation.
- On average the ability of partnerships to apportion the resident share of assessments reduces the taxes paid by resident taxpayers by 37%. The 37% 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%.
- It is assumed that 67% of the audit money will be from nonresident taxpayers and 33% will be from resident taxpayers. After weighting the effect from both resident and nonresident taxpayers, there is an overall 19% reduction of revenue.

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

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