House Omnibus Bill

April 27, 2023

	Yes	No
DOR Administrative Costs/Savings	X	

State Taxes Only—
See Separate Analysis for Property Tax Provisions

Department of Revenue
Analysis of H.F. 1938 (Gomez) 2nd Engrossment, As Proposed to be Amended (H1938A56)

	Fund Impact			
	F.Y. 2024	**F.Y. 2025**	**F.Y. 2026**	**F.Y. 2027**
	(000's)			
Individual Income Tax				
Child and Working Family Credit	($289,800)	($297,800)	($305,600)	($305,600)
Newly Eligible Non-filers	($47,300)	($47,400)	($47,600)	($47,700)
WFC for ITINs	($9,800)	($10,000)	($10,200)	($10,400)
Interaction	($4,100)	($4,600)	($5,200)	($5,700)
Beginning Farmer Credit	($6,300)	($9,200)	($9,700)	($10,200)
Film Production Credit	($8,500)	($10,100)	($12,700)	($13,000)
Sexual Harassment Payment Subtraction	($100)	($100)	($100)	($100)
Pass-through Entity Tax	(Unknown)	(Unknown)	(Unknown)	(Unknown)
K-12 Credit; Education Expenses	($15,500)	($16,200)	($16,600)	($17,000)
Interaction: K-12 Subtraction	$1,200	$1,300	$1,300	$1,300
Discharged Student Loan Subtraction	$0	$0	$0	($100)
Social Security Subtraction	($193,200)	($216,000)	($232,200)	($246,500)
Public Pension Subtraction	($41,300)	($41,100)	($41,000)	($40,800)
Interaction	$800	$800	$800	$800
5th Income Tax Bracket at 9.85%	$281,900	$247,400	$244,100	$256,100
Dependent Care Credit	($1,600)	($1,600)	($1,600)	($1,600)
Military Credit Due Date	($200)	$0	$0	$0
Student Loan Credit	($16,800)	($28,600)	($29,200)	($29,800)
Credit for Parents of Stillborn Children	Negl.	Negl.	Negl.	Negl
Teacher's Credit	($500)	($600)	($600)	($600)
Manufactured Home Park Credit	($350)	($380)	($400)	($430)
One-time Refundable Credit	($1,250,100)	$0	$0	$0
Unemployment Benefit Subtraction	($10)	$0	$0	$0
Corporate Franchise Tax				
Worldwide Income Reporting	$100,800	$337,300	$343,000	$350,700
Federal Update				
Secure Act 2.0	$2,700	($800)	($800)	($2,000)
Nonresident Income Calculation	$4,400	($700)	($1,000)	($1,400)
Limit on Excess Business Losses (TY26)	$0	$0	$20,700	$48,300
Limit on Excess Business Losses (TY27-28)	$0	$0	$0	$21,400

	Fund Impact			
	F.Y. 2024	**F.Y. 2025**	**F.Y. 2026**	**F.Y. 2027**
	(000's)			
Sales and Use Taxes				
Edible Cannabinoids	$10	$10	$10	$10
Disregarded LLCs	($710)	($760)	($810)	($860)
Nonprofit Snowmobile Clubs	($50)	($60)	($60)	($60)
Certain Natural Gas Fees	($7,110)	($2,380)	($2,380)	($1,760)
Government and Nonprofit Construction	($177,110)	($78,520)	$0	$0
City of Chanhassen Construction*	$0	$0	($260)	($260)
Edina Public Health Center	$0	$0	($910)	$0
Ely Public Schools Construction*	($180)	$0	$0	$0
Hibbing Public Schools Construction*	$0	$0	$0	$0
MSP Airport Construction*	$0	$0	($1,450)	($1,040)
City of Moorhead Construction*	$0	$0	($240)	($240)
City of Oakdale Construction*	$0	$0	($250)	($250)
City of Ramsey Water Treatment Plant*	$0	$0	($460)	$0
Red Lake County ISD 2906*	$0	$0	$0	$0
Red Rock School Construction*	$0	$0	$0	$0
Rock Ridge School Construction*	($900)	$0	$0	$0
Spring Grove Fire Remediation	($130)	$0	$0	$0
Springfield School Construction*	$0	$0	$0	$0
City of Wayzata Construction*	($380)	$0	$0	$0
City of Woodbury Central Park*	$0	$0	($520)	$0
Renter's Credit				
Renter's Income Tax Credit	($0)	($378,600)	($382,300)	($386,000)
Repeal Renter Property Tax Refund	$0	$0	$245,500	$247,300
Miscellaneous				
Combined Net Receipts Tax	($6,700)	($7,700)	($7,900)	($8,200)
Solid Waste Tax Transfer	($5,600)	($5,800)	($6,000)	($6,100)
Mortgage and Deed Tax Transfer	($27,500)	($27,500)	($7,500)	($7,500)
General Fund Total	**($1,720,020)**	**($599,690)**	**($270,130)**	**($219,290)**
Sales and Use Taxes				
Edible Cannabinoids	Negl.	Negl.	Negl.	Negl.
Disregarded LLCs	($40)	($40)	($50)	($50)
Nonprofit Snowmobile Clubs	(Negl.)	(Negl.)	(Negl.)	(Negl.)
Certain Natural Gas Fees	($410)	($140)	($140)	($100)
Government and Nonprofit Construction	($10,220)	($4,530)	$0	$0
City of Chanhassen Construction*	$0	$0	($15)	($15)
Edina Public Health Center	$0	$0	($50)	$0

	Fund Impact			
	F.Y. 2024	**F.Y. 2025**	**F.Y. 2026**	**F.Y. 2027**
	(000's)			
Ely Public Schools Construction*	($10)	$0	$0	$0
Hibbing Public Schools Construction*	$0	$0	$0	$0
MSP Airport Construction*	$0	$0	($80)	($60)
City of Moorhead Construction*	$0	$0	($10)	($10)
City of Oakdale Construction*	$0	$0	($10)	($10)
City of Ramsey Water Treatment Plant*	$0	$0	($30)	$0
Red Lake County ISD 2906*	$0	$0	$0	$0
Red Rock School Construction*	$0	$0	$0	$0
Rock Ridge School Construction*	($50)	$0	$0	$0
Spring Grove Fire Remediation	($10)	$0	$0	$0
Springfield School Construction*	$0	$0	$0	$0
City of Wayzata Construction*	($20)	$0	$0	$0
City of Woodbury Central Park*	$0	$0	($30)	$0
Natural Resources and Arts Funds Total	**($10,760)**	**($4,710)**	**($415)**	**($245)**
Solid Waste Tax Transfer	$5,600	$5,800	$6,000	$6,100
Environmental Fund Total	**$5,600**	**$5,800**	**$6,000**	**$6,100**
Mortgage and Deed Tax Transfer	$27,500	$27,500	$7,500	$7,500
Housing Development Fund Total	**$27,500**	**$27,500**	**$7,500**	**$7,500**
Total All Funds	**(1,697,680)**	**(571,100)**	**(257,045)**	**(205,935)**

*The amounts shown are costs not covered by Article 5, Section 12 of the bill, Government and Nonprofit Construction.

EXPLANATION AND ANALYSIS OF THE BILL

Income and Corporate Franchise Tax – Article 1

Child and Working Family Credit (Article 1, Sections 1, 9, 11, 12, 31, and 45)
Effective beginning with tax year 2023.

The bill would replace the current working family credit with a Minnesota child and working family credit which is the sum of:

1. A child tax credit that equals $1,275 for each qualifying child with no limit on the number of children;
2. A working family credit that equals 4% of the first $12,500 of earned income.

The combined credit is reduced by 9.0% of earned income or adjusted gross income, whichever is greater, in excess of $36,000 for married joint filers or $28,000 for all other filers.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The income thresholds and the credit amounts are adjusted for inflation starting in tax year 2024.

For taxpayers with no qualifying children, the bill would expand the credit to include 18-year-olds and those 65 years old or older.

The bill also allows taxpayers whose earned income is inadequate for the federal earned income credit but otherwise are eligible for the child tax credit to receive the credit. This allows existing non-filers whose earned income is insufficient but have qualifying dependents to be newly eligible for the proposed credit.

The bill would also allow the credit for 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.

Lastly, the Commissioner of Revenue may establish a process to allow taxpayers the option to elect one or more advanced payments in claiming the credits. The amount of the payment must be based on the estimate of the credit the taxpayer would be able to claim for the tax year beginning in the calendar year in which the advanced payment is made. If the advanced payment exceeds the credit the taxpayer was eligible for the tax year, the taxpayer’s liability will be increased by the difference between the amount of the payments received and the credit.

MN Child and Working Family Credit

- The House Income Tax Simulation (HITS 7.2) 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 2023. The model uses a stratified sample of 2019 individual income tax returns compiled by the Minnesota Department of Revenue.
- The estimate includes the net impact of replacing the current working family credit with the proposed credit for all income tax filers.
- The number of qualifying children for the newly eligible returns is estimated based on the number of dependents, which does not include counts for more than four dependents per return in the 2019 income tax sample. The estimate was increased by 1.5% to account for those returns based on information from 2017 returns.
- Tax year impacts are allocated to the following fiscal year.
- About 816,900 tax returns would receive the credit in tax year 2023. Of those, about 9,100 are ITIN users. The average decrease in tax is $544.
- Since it is unknown whether the Department of Revenue would establish a process for making advance payments, no adjustment was made to the timing of the credits. If an advance payment system were established, all of tax year 2023 would be allocated to the following fiscal year. For other years, 25% of the tax year impact would be allocated to the current fiscal year and 75% would be allocated to the following fiscal year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Newly Eligible Non-filers

- Based on the 2018 incidence database, about 70,900 dependents under 18 are in households that did not file an income tax return. It is assumed that half of those would claim the credit.
- Credit growth for those dependents is based on the five-year average growth rate of children under 18 in Minnesota.
- About 36,000 dependents would be eligible for the credit in tax year 2023. The credit is $1,275 per dependent.
- Also from the 2018 incidence database, about 10,800 nonfilers aged 18 or 65 and above without children would have earned income to claim the credit. It is assumed that half of those would claim the credit. The average credit is $256.
- Tax year impacts are allocated to the following fiscal year.

Credit for Taxpayers with ITINs

- In 2019, there were 21,300 returns filed using an ITIN for the taxpayer and/or the spouse. Of those, approximately 8,200 returns would qualify for the working family credit.
- All dependents were assumed to be qualifying children without regard to whether they had an ITIN.
- The average credit for tax year 2019 would have been about $1,340 per return.
- Growth is based on projected growth in the working family credit in the November 2022 forecast.
- Tax year impacts were allocated to the following fiscal year.

Beginning Farmer Credit (Article 1, Sections 2-5)
Effective for tax years 2023 through 2026.

Current Law: The beginning farmer credit is a credit against the individual income tax or corporate franchise tax for the rent or sale of agricultural assets to beginning farmers. An agricultural asset includes land, livestock, facilities, buildings, and machinery used for farming in Minnesota. A beginning farmer must be a Minnesota resident who is seeking entry or has entered farming within the last 10 years, and who will provide the majority of the labor and management of the farm that is located in Minnesota. Further they must have adequate experience and knowledge of the type of farming for which they seek assistance from the Rural Finance Authority, can provide positive projected earnings statements, is not directly related to the owner of the asset, and have a net worth that does not exceed the eligibility limit for beginning farmer loans.

The credit is equal to one of the following:

- 5% of the lesser of the sale price or the fair market value of the agricultural asset, up to a maximum of $32,000;
- 10% of the gross rental income in each of the first, second, and third years of a rental agreement, up to a maximum of $7,000 per year; or
- 15% of the cash equivalent of the gross rental income in each of the first, second, and third years of a share rent agreement, up to a maximum of $10,000 per year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The credit is nonrefundable but may be carried forward for up to 15 years. The total value of credits allocated by the Rural Finance Authority is capped at $6 million per year. Certificates for the credit are issued on a first-come first-served basis, but with a preference for some re-certifications. The credit will expire after tax year 2023.

Proposed Law: For credits for the sale of agricultural land, the bill eliminates the requirement that the beginning farmer or spouse must not be directly related to the owner. A sale to a family member includes a sale to a beginning farmer who is (or whose spouse is) a family member of the owner of the agricultural land, or a partner, member, shareholder, or trustee of the owner of the agricultural land. For a sale to a family member to qualify for the credit, the sale price of the agricultural land must equal or exceed the assessed value of the land as of the date of sale.

The bill also increases the credit rate for sales from 5% to 8% and increases the maximum credit for sales from $32,000 to $50,000.

For sales to underserved farmers and ranchers, the credit rate is 12%. An underserved farmer or rancher is one who is a veteran, limited resource producer, or who is living in a high poverty area as defined by the United States Department of Agriculture. For each tax year, 50% of newly allocated credits must be allocated to underserved farmers or ranchers. Any reserved amount that is not allocated by September 30 is available for allocation to other credit applications.

The bill extends the credit through tax year 2031.

- About $2.5 million in credits were claimed in tax year 2021. At the end of tax year 2021, there were an estimated $13.6 million in credits carried over from prior years.
- The estimate is based on data from the Electronic Certificate of Real Estate Value database where Minnesota real estate sales are recorded.
- From 2018 through 2021, there were an average of 1,800 relative sales of agricultural land each year. The total purchase amount averaged $546 million per year.
- It is unknown how many of those sales would qualify for the credit. This estimate assumes that 10% of the sales to relatives would qualify.
- The bill increases the credit rate from 5% to 8% and the maximum credit from $32,000 to $50,000. About 45% of the credits are from sales, based on information from the Department of Agriculture. The credit from sales is assumed to increase by about 60%.
- The credit rate is 12% for sales to underserved farmers and ranchers. Data from the 2017 Census of Agriculture (the most recent available) reported that there were 89,383 principal agricultural producers in Minnesota. About 10,400 (11.5%) were identified as being military veterans. Credits for sales were increased by 25% to account for sales to underserved farmers, including limited resource producers and farmers living in high poverty areas.
- A 5% growth rate is assumed.
- Total credits may exceed $6 million in some years due to carryover credits from prior years.
- Tax year impacts are allocated to the following fiscal year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Film Production Credit (Article 1, Sections 6-8, 29, 44)
Effective beginning with tax year 2023.

Current Law: A credit is allowed against the corporate franchise tax and the individual income tax equal to 25% of film production costs for films made in Minnesota by persons or entities that incur such costs and are subject to those taxes. Films include feature films, television or Internet pilots, programs, series, documentaries, music videos, and television commercials. Films must include the promotion of Minnesota and have at least $1,000,000 of production costs expended in the tax year. If a taxpayer elects to transfer the credit in lieu of claiming the credit, the transferred credit may be sold or assigned, in full or in part, to another taxpayer for not less than 80 percent of the credit amount subject to transfer.

The credit or credit transfer can be carried over to each of the five succeeding table years. The amount of the unused credit or credit transfer must not exceed the taxpayer's liability for tax. Credits granted to partnerships, S corporations, or a limited liability company taxed as a partnership are passed through to each partner, member, shareholder, or owner respectively.

A taxpayer must apply to the Commissioner of Employment and Economic Development to qualify for a credit or credit transfer. The application must contain information as prescribed by the Commissioner in consultation with the Commissioner of Revenue. The application must indicate if the application is for a credit or a credit transfer in lieu of credit, or a combination of the two.

The Commissioner of Employment and Economic Development may not issue more than $4.95 million in credits each year. Anything not allocated in the current fiscal year can be allocated to the following years. The Commissioner must issue credit certificates on a first-come, first-served basis beginning on January 1 of each year.

No credits can be awarded for taxable years beginning after December 31, 2024.

Proposed Law: The bill would modify the production costs needed for eligibility from $1 million in a tax year to $1 million in a 12-month consecutive period.

The bill also increases the total maximum credit allocations from $4.95 million to $24.95 million per year beginning with tax year 2023 and extends the sunset on the credits through tax year 2032.

- The estimate is based on information on credit certificates issued in tax years 2022 and 2023 to date and information from other states.
- Credits totaled about $1.1 million in tax year 2022 and are expected to be at least $2.2 million in tax year 2023, based on current projects.
- It is assumed that the increased in the amount of credits with no sunset will cause an increase in demand for the program. This has been seen in other states with a comparable credit program.
- Oklahoma has a similar credit for film productions and increased their maximum credit from $8 million per year to $30 million per year beginning in tax year 2021 (year 9 of the program).

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- Credit usage was modeled based on the growth in credits in Oklahoma, smoothed to adjust for COVID disruptions. Over time the total credits are expected to reach the maximum of $25 million per year.

Number of Taxpayers: Since being implemented, eight productions have claimed the tax credit.

Sexual Harassment Payments (Article 1, Sections 10 & 21)
The subtraction is effective beginning with tax year 2023.
The exclusion of settlement payments from wages or severance pay is effective the day following enactment.

Federal law does not allow a deduction for sexual harassment or abuse payments subject to a nondisclosure agreement. Minnesota conforms to the federal provision. Although compensation for physical injuries or sickness is excluded from the income of the recipient, settlement payments for sexual harassment are generally included in the income of the recipient.

The bill would create a subtraction from taxable income for individual income tax purposes for damages received under a sexual harassment or abuse claim that are not excluded from gross income, or severance pay received under a settlement of a sexual harassment or abuse claim that does not include a nondisclosure agreement. The bill would also prohibit the use of sexual harassment or abuse financial settlements as severance pay or wages regardless of whether there is a nondisclosure agreement.

- The estimate is based on information on sexual harassment payments from the U.S. Equal Employment Opportunity Commission.
- In federal fiscal years 2018 through 2021, $299.8 million in sexual harassment payments were made to 8,147 individuals, including settlement payments and damages recovered through litigation. The average payment was about $36,800.
- Minnesota taxpayers are estimated to account for 1.9% of the total or about $1.4 million, based on Minnesota’s share of civilian employment in 2021.
- An average marginal rate of 8% is assumed.
- No growth is assumed, since the number and amount of payments is unpredictable.
- Tax year impacts are allocated to the following fiscal year.

Pass-through Entity Tax (Article 1, Sections 13-16)
Effective beginning with tax year 2022.

Current Law: Pass-through entities such as S corporations and partnerships do not generally pay state or federal income taxes directly. Their income is passed to shareholders, who report the income on their individual income tax returns.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Beginning in tax year 2021, Minnesota created a pass-through entity tax that allows a partnership, S corporation, or limited liability company to file and compute tax liability at the entity level. The pass-through entity tax is equal to the sum of the tax liability of each qualifying owner. Each qualifying owner's tax by determining the owner's Minnesota source income from the entity. The income of both resident and nonresident owners is allocated to Minnesota in the same way as for nonresident partners and shareholders. The resulting income amount then multiplied by 9.85%.

Certain nonresident owners may have their Minnesota income tax filing requirement satisfied by the entity's Schedule PTE similar to composite income tax. The other owners will receive a refundable income tax credit for their portion of the PTE tax paid by the entity.

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. To qualify, at least one owner of the entity must be limited by the federal limit on state and local tax deductions.

Proposed Law: The bill changes the tax and the credit in several ways. Under the bill, all of the income of a resident qualifying owner of a partnership or limited liability company taxed as a partnership would be allocated to Minnesota for purposes of the pass-through entity tax. The income of a nonresident and a resident qualifying owner of an S corporation would be allocated to the state as under current law.

The bill clarifies that limited liability companies are not qualified entities unless they are taxed as a partnership or S corporation and that a qualifying entity must have at least one qualifying owner.

Currently, multi-level partnerships, LLCs or corporations are not qualifying entities. The bill removes that restriction, although a publicly traded partnership would not be a qualifying entity.

A disregarded LLC with a qualifying owner as its single owner would be a qualifying owner.

Currently, the election to pay the pass-through entity tax is binding on all owners of a qualifying entity. Under the bill, the election must exclude partners, members, shareholders, or owners who are not qualifying owners, and the election could be made by qualifying owners who hold more than 50% of the interest held by qualifying owners, rather than 50% of the total interest in the qualifying entity.

The bill removes the requirement that at least one owner be limited by the federal limit on state and local tax (SALT) deductions and adds a sunset provision so that the tax and credit expire at the same time as the federal limit on SALT deductions.

The bill specifies that if a partnership is subject to a federal audit, the entity must file an amended pass-through entity tax return for all direct partners who were included in the tax in the reviewed year and pay any additional amount owed.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate is based on information from tax year 2021, the first year the pass-through entity tax was in effect. In tax year 2021, about 27,500 entities paid $1,782.4 million in pass-through entity tax. Pass-through entity tax credits totaled $1,536.6 million on 35,000 returns.
- The bill will increase the tax and the credit for resident owners by allocating all of their income to Minnesota. Those owners will pay more tax and therefore be eligible for a higher credit.
- The bill also expands eligibility for the tax and the credit in several ways, including by removing the requirement that at least one qualifying owner be limited by the federal SALT cap, by allowing multi-level entities to be qualifying entities, and by allowing partial elections for qualifying owners only.
- Those provisions will increase the PTE tax and credits by an unknown amount. This estimate assumes a 15% increase in the tax and the credit.
- Because the PTE tax credit offsets the tax, the net effect will generally be revenue neutral. However, the PTE tax pass-through entity tax may reduce a shareholder's federal adjusted gross income and may affect the shareholder's Minnesota tax liability and eligibility for tax credits. For example, the standard deduction and itemized deductions are phased out by adjusted gross income over a certain threshold. The reduction in FAGI may increase a taxpayer's standard deduction. Credits such as the working family credit also depend on FAGI.
- Because the bill expands the pass-through entity tax, it will reduce Minnesota tax liability by an unknown amount.

K12 Credit; Education Expenses (Article 1, Sections 17 & 32)
Effective beginning with tax year 2023.

Under current law, 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 phases out the credit using federal adjusted gross income rather than total household income and increases the phase-out threshold to $70,000 in tax year 2023. The phase-out threshold will be indexed for inflation beginning in tax year 2024. The phase-out rates are unchanged.

For taxpayers with three or more qualifying children, the phase-out threshold is increased by a multiple of the Minnesota dependent exemption amount ($4,800 in tax year 2023).

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- For taxpayers with three qualifying children, the threshold is increased by the exemption amount.
- For taxpayers with four qualifying children, the threshold is increased by two times the exemption amount.
- For taxpayers with five or more qualifying children, the threshold is increased by three times the exemption amount.

The maximum credit is increased to $1,500 per qualifying child and will also be indexed for inflation beginning in tax year 2024.

- The estimate is based on a sample of 2019 individual income tax returns, since the 2020 returns may understate the impact.
- In tax year 2019, K-12 education credits totaled $7.2 million on 28,300 returns.
- Under the bill, an additional 51,700 returns are expected to qualify for the credit. The average credit would be $316 for tax year 2023. Taxpayers in the phase-out range could also receive an increased credit.
- The credit has declined over the past several years including a decline of about 20% in tax year 2020. This estimate assumes that the credit will return to 2019 levels by 2023 and will resume growth in 2024.
- Beginning in 2024, the credit is assumed to grow at the rate of the chained consumer price index.
- Taxpayers who claim the credit cannot claim the subtraction for the same expenses. A marginal rate of 6% is used to calculate the impact of reduced subtractions under the bill.
- Tax year impacts are allocated to the following fiscal year.

Discharged Student Loan Subtraction (Article 1, Section 18)
Effective beginning with tax year 2023.

The American Rescue Plan Act (ARPA) (Public Law 117-2) was enacted on March 11, 2021. The Act included a provision exempting certain forgiven loans from income tax, effective for tax years 2021 through 2025. Minnesota conformed to this provision in Minnesota Laws 2023, Chapter 1.

The bill would create a subtraction for discharged student loan debt that would qualify for the federal exclusion, disregarding the federal expiration date.

- The estimate is based on the estimate for the federal legislation prepared by the staff of the Joint Committee on Taxation.
- Individual income tax impacts are allocated to the following fiscal year.
- The impact may grow over time as the number of individuals with eligible programs increases.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Social Security Subtraction (Article 1, Section 19)
Effective beginning with tax year 2023.

Under current law, a taxpayer may subtract a portion of social security income when calculating Minnesota taxable income. For 2023, the maximum subtraction is $5,840 for married joint filers, $2,920 for married separate filers, and $4,560 for single and head of household filers.

The subtraction is reduced by 20% of provisional income over the following thresholds for 2023: $88,630 for married joint filers, $44,315 for married separate filers, and $69,250 for single and head of household filers. Provisional income is income used to calculate the federally taxable portion of social security benefits. The thresholds and maximum subtractions are adjusted annually for inflation.

The bill allows a subtraction equal to the greater of:

1. The current subtraction using 2023 maximum amounts and thresholds; or
2. An alternative subtraction equal to 100% of taxable social security income, reduced by 10% for each $2,000 ($1,000 for married separate filers) or fraction thereof of federal adjusted gross income over a phase-out threshold.

The phase-out thresholds for 2023 are as follows: $100,000 for married joint filers, $50,000 for married separate filers, and $78,000 for single and head of household filers. The maximum amounts and thresholds for Option 1 will not be adjusted for inflation. The phase-out thresholds for Option 2 will be adjusted annually for inflation beginning in tax year 2024.

- The House Income Tax Simulation (HITS 7.2) 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 2023. The model uses a stratified sample of 2019 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year impacts are allocated for the following fiscal year.
- About 279,600 tax returns would have a tax decrease in tax year 2023. The average decrease in tax would be $691.
- About 24,500 returns would choose the current subtraction.
- The number of returns using the current calculation will decrease over time as the value of the subtraction declines relative to the alternative calculation, due to the lack of indexing. The estimate assumes that by tax year 2028 all returns will benefit more from the alternative calculation.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Public Pension Subtraction (Article 1, Section 22)
Effective beginning with tax year 2023.

Certain government workers who are members of a public pension plan are excluded from Social Security under federal law, provided their pension benefits meet certain requirements. These pension benefits are taxable under Minnesota law to the extent they are included in federal adjusted gross income.

The bill would create a retirement benefits subtraction, allowing taxpayers to subtract from their taxable income pension benefits from service for which the beneficiary is not also receiving Social Security benefits.

The subtraction equals qualified retirement benefits, up to a maximum of $25,000 for married couples filing jointly and $12,500 for all other filers. The subtraction is reduced by 10 percent for each $2,000, or fraction thereof, of adjusted gross income (AGI) above a phase-out threshold specific to a taxpayer's filing status.

In tax year 2023, for married taxpayers filing a joint return and surviving spouses, the phase-out threshold is $100,000. For single or head of household taxpayers, the phase-out threshold is $78,000. For married taxpayers filing separate returns, the phase-out threshold is $50,000. These amounts will be adjusted annually for inflation beginning in tax year 2024.

Taxpayers with eligible pensions include members of the State Patrol Retirement Plan, members of the legacy Legislators Retirement Fund, certain legacy members of the Public Employee Retirement Association (PERA) General Plan, legacy members of the Minneapolis Employees Retirement Fund, members of the PERA Police & Fire Plan, certain legacy members of the Teacher Retirement Association, certain legacy members of the St. Paul Teachers Retirement Fund Association, and certain legacy members of the PERA Correctional Employees Retirement Fund. The proposal also includes any members of a federal pension plan who are ineligible for Social Security, and members of a pension plan administered by another state whose income tax laws permit a "similar deduction or exemption" for beneficiaries of a Minnesota pension plan.

The phrase "similar deduction or exemption" is undefined. For this estimate, a state was considered to have a "similar deduction or exemption" if it offers any deduction or exemption specifically for pension income. The estimate does not include states that offer an additional deduction for elderly taxpayers (irrespective of the source of income), states that offer a tax credit for pension benefits, and states without an income tax.

- This estimate is the sum of nine separate analyses: one for each of the eight state-level public pension plans, and one for the corresponding federal pension plan, the Civil Service Retirement System (CSRS).

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- It is assumed the inclusion of PERA Correctional (353E) among the list of potentially eligible pension plans has no revenue impact. The valuation report for PERA Correctional does not indicate that there are any qualifying members of its pension plan who are exempt from Social Security, in contrast to other valuation reports for pension plans with known Social Security-exempt members.
- The 2022 valuation reports for the eight state pension plans specifically covered by this bill were used to calculate the average pension benefit and the number of taxpayers eligible for this subtraction.
- This estimate is the sum of nine separate analyses: one for each of the eight state-level public pension plans, and one for the corresponding federal pension plan, the Civil Service Retirement System (CSRS).
- The U.S. Office of Personnel Management's Civil Service Retirement and Disability Fund Annual Reports and a Congressional Research Service report were used to estimate the average pension benefit and the number of taxpayers eligible for this subtraction from federal service.
- Since data on this population's taxable income is unavailable, a simulated beneficiary population was constructed using the 2019 income tax sample by selecting a random group of filers reporting Social Security income and replacing their Social Security income with a hypothetical pension income from one of the eligible public pension systems. The size of the sample and average pension amount were chosen to match the number of qualifying pension beneficiaries and total amount of pension income calculated from the valuation reports and CSRS forecast.
- The cost estimates for each of the state pension plans were reduced by the share of Minnesota pension recipients who retired to other states, using data from Minnesota State Retirement System, PERA and TRA. Data on SPTRFA beneficiaries was unavailable. Instead, a weighted average was used to impute a figure for this group.
- Data from the Census Bureau's 2019 Annual Survey of Public Pensions (ASPP), Public Plans Data (PPD) from the Center for Retirement Research at Boston University, and the IRS's U.S. Population Migration Data for 2018-2019 were used to estimate the number of Minnesota residents who receive retirement benefits from another state's pension plan.
- About 2.43 million public plan beneficiaries nationwide are ineligible for Social Security, according to the PPD. Approximately 47% of these beneficiaries were members of a plan administered by a state with a similar deduction or exemption, estimated based on a review of state statutes. It is assumed that 10% of these beneficiaries, or about 115,000 pension recipients, retire to states other than where they worked. Minnesota's share of these pension recipients was estimated using Minnesota's share of inbound state-to-state migrants age 65 and older for 2019 from the IRS migration data. This yields an estimated 1,600 qualifying pensioners from other states who retire in Minnesota.
- The federal estimate was discounted by 7.5% to account for the already tax-free portion of CSRS benefits.
- Minnesota pension plan growth rates through 2022 are based on the observed growth rates in pension payouts from the valuation reports. For the remainder of the fiscal years in this estimate, the projected growth rates of benefit payments from the valuation reports were used instead.
- CSRS growth rates were based on the average historical growth rates for CSRS pension payments.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- Tax year impacts are allocated to the following fiscal year.
- Precise data on the number of state and federal pension recipients affected by the bill is unavailable. A maximum of about 20,200 Minnesota state pension recipients, 1,600 non-Minnesota state pension recipients and 26,300 federal pension recipients could be affected. State and federal pension recipients would receive an average decrease in tax of $856.

Fifth Tier Rate (Article 1, Section 27 & 28)
Effective beginning with tax year 2023.

The income tax rates and brackets for tax year 2023 are shown in the following table:

Income Tax Brackets: Tax Year 2023

	5.35% Up To	6.80%			7.85%			9.85% Over
Married Joint	$43,950	$43,950	to	$174,610	$174,610	to	$304,970	$304,970
Married Separate	$21,975	$21,975	to	$87,305	$87,305	to	$152,485	$152,485
Single	$30,070	$30,070	to	$98,760	$98,760	to	$183,340	$183,340
Head of Household	$37,010	$37,010	to	$148,730	$148,730	to	$243,720	$243,720

The bill adds a new top income tax bracket at a rate of 10.85% starting in tax year 2023. The 10.85% bracket is set at $1,000,000 for married joint filers, $500,000 for married separate filers, $600,000 for single filers, and $800,000 for head of household filers. Beginning in tax year 2024, 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 2023	$223,600
TY 2024	$229,600
TY 2025	$240,500
TY 2026	$252,000
TY 2027	$265,100

- The House Income Tax Simulation Model (HITS 7.2) 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 February 2023. The model uses a stratified random sample of tax year 2019 individual income tax returns compiled by the Minnesota Department of Revenue.
- All of tax year 2023 was allocated to fiscal year 2024. In allocating other tax years to fiscal years, a standard formula was applied.
- For tax year 2023 an estimated 24,200 returns (about 0.8% of all returns) would have an average increase in tax of $9,231 per return.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Dependent Care Credit (Article 1, Section 25)
Effective beginning with tax year 2023.

The federal dependent care credit is a nonrefundable credit equal to a percentage of unreimbursed employment-related expenses related to child or dependent care, up to $3,000 for one qualifying dependent and $6,000 for two or more qualifying dependents. The credit rate depends on income and ranges from 35% for families with incomes of $15,000 or less to 20% for families with incomes over $43,000. The maximum federal credit is equal to $1,050 for one dependent and $2,100 for two or more dependents. The maximum qualifying expenses are reduced by the amount of the exclusion. Married separate filers are not eligible for the federal credit unless the couple has lived apart for the last half of the year and other conditions apply.

The Minnesota dependent care credit is equal to the federal credit except that it is refundable and the maximum credit is phased out by 5% of adjusted gross income over a threshold ($59,210 in 2023). The threshold is indexed annually for inflation. The credit is not available for individuals filing a married separate return. A newborn credit is allowed for a child born in the tax year even if there are no qualifying expenses. The newborn credit is only available to married taxpayers.

A taxpayer with a newborn child is deemed to have the maximum allowed expenses for that child, but not more than the combined earned income reported on the return. To qualify, the taxpayer cannot participate in a federal employer-provided dependent care assistance program. The bill expands the newborn credit to include all taxpayers regardless of marital status.

A taxpayer who claims the credit or the spouse of a taxpayer filing a separate return who claims the credit must add back the amount of any federal exclusion for employer-provided dependent care assistance.

For a married couple filing separate returns, only one spouse may claim the credit.

- Under current law, about 3,800 returns are expected to receive $2.3 million in newborn credits in tax year 2023, based on estimates from the HITS model, assuming the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2023. The average newborn credit is $616.
- Births to unmarried women accounted for about 40.5% of all births in 2020, according to the 2022 National Vital Statistics Report from the Centers for Disease Control.
- If unmarried women claimed the credit at the same rate as married women, the bill would increase the current credit by $1.6 million in tax year 2023. About 2,600 returns would benefit. Their average increased credit would be $616, based on the current credit.
- With the proposed credit, about 4,100 returns would qualify for the newborn credit. The average increased credit would be $1,097.
- The impact is assumed to grow at the same rate as the dependent care credit.
- Tax year impacts are allocated to the following fiscal year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Military Credit (Article 1, Section 33)
Effective beginning with tax year 2023.

A taxpayer domiciled in Minnesota is allowed a refundable credit equal to $120 for each month or portion of a month of active military service in a combat zone. The credit is claimed on the form M99, which is filed separately from the M1 income tax return.

The bill would allow an individual to claim the credit for each calendar year in which active services was performed. The effect would be to allow taxpayers to file for the credit at any time during the year, rather than having to wait until the following year to claim the credit.

- The estimate is based on military credits claimed in tax years 2016 through 2020. Over the five-year period, an average of 880 credits were claimed each year totaling $672,100.
- The bill would not affect the amount of credits, only the timing of payments.
- Currently about 85% of credits are claimed in the first half of the calendar year following the months of active duty. The remainder are claimed in the second half or later years.
- The bill would allow those credits to be claimed in the previous calendar year. Only credits that would be paid in January through June would change fiscal years, about 23.0% of the total credits. The shift in payments across fiscal years would result in a one-time loss in fiscal year 2024.
- No growth in the credit is assumed since the number of credits is volatile from year to year.

Student Loan Credit (Article 1, Sections 29, 30)
Effective beginning with tax year 2023.

Under current law, a nonrefundable income tax credit is allowed for individuals with qualified education loans related to an undergraduate or graduate degree program at a public or nonprofit institution. The credit is equal to the least of:

- Eligible education loan payments of principal and interest made during the tax year minus 10% of adjusted gross income over $10,000;
- The earned income of the eligible individual;
- The interest portion of eligible loan payments made during the tax year plus 10% of the original loan amount of all qualified education loans of the eligible individual; or
- $500.

For married joint filers, each spouse is eligible for the credit. Each spouse's adjusted gross income is defined as the spouse's percentage share of the couple's earned income, multiplied by the couple's combined adjusted gross income.

The credit is allocated to part-year residents based on the percentage of their income that is attributable to Minnesota. Full-year nonresidents are not eligible for the credit.

The bill would increase the maximum credit to $1,000 and make the credit refundable.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate is based on information from 2019 income tax returns.
- In tax year 2019, Minnesota student loan credits totaled on $23.2 million on 50,900 returns.
- The proposed changes would increase the credit for 44,750 returns in tax year 2019. The average increase would be $509 per return.
- Credits for newly eligible returns were estimated based on the federal student loan interest deduction.
- In 2019, about 296,100 full-year and part-year resident returns claimed student loan interest deductions and were not eligible for the current student loan credit.
- It is unknown how many of those would have eligible student loans for the taxpayer or the taxpayer's spouse. The estimate was reduced by about 23% to exclude taxpayers with nonqualifying loans or student debt payments for a dependent. About 228,100 returns are assumed to have eligible student loans for the taxpayer or the taxpayer's spouse.
- Of those, about 4,700 returns would be eligible for the proposed credit. The average credit for newly eligible returns is $680.
- Based on information from a note the Federal Reserve published on May 27, 2022, almost 60% of borrowers with student loans did not make any payments on their student loans from August 2020 through December 2021 because of the federal student loan payment pause.
- It is assumed the federal student loan payment pause will continue through August 29th, 2023.
- For tax year 2023, it is assumed only 40% of borrowers will make repayments for the full year based on the note from the Federal Reserve. The other 60% are assumed to only make repayments from September through December, when the pause has ended. All borrowers are assumed to make full year repayments beginning in tax year 2024.
- Tax year impacts were allocated to the following fiscal year.

Credit for Parents of Stillborn Children (Article 1, Sections 36, 37 & 48)
Effective retroactively beginning with tax year 2016.

A refundable individual income tax credit of $2,000 is allowed for an individual who is a parent of a stillborn child if the Minnesota Department of Health issued a Certificate of Birth Resulting in Stillbirth for that child. To qualify for the credit, the individual must have been eligible to claim the child as a dependent.

For nonresident or part-year residents, the credit must be allocated based on the percentage of their income that is attributable to Minnesota.

Under the bill, a qualifying individual must meet the following criteria:

- Must be either a resident or a nonresident spouse of a resident who is a member of armed forces of the United States or the United Nations.
- Must be the one who gave birth resulting in stillbirth (except as described below).
- Must be listed as a parent on the certificate of birth.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

For a stillbirth occurring in Minnesota, if the person who gave birth is not listed as a parent on the certificate of birth, then the first parent listed on the certificate of birth is eligible for the credit.

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

For part-year residents, the credit is allocated based on the percentage of income attributable to Minnesota.

Stillbirth means a birth for which a fetal death report would be required if the birth occurred in Minnesota.

Certificate of birth means a Certificate of Birth Resulting in Stillbirth issued by the Minnesota Department of Health, or for a birth occurring in another state or country, a similar certificate under that state's or country's law.

The bill allows a taxpayer to file an amended return by December 31, 2023 to claim the credit for a previous year.

- The bill changes eligibility for the credit in several ways. The number affected by the bill is unknown but is assumed to be negligible.
- Retroactive impacts are allocated to fiscal year 2024. All other tax year impacts are allocated to the following fiscal year.
- The estimate is based on information from 2020 income tax returns.

Number of Taxpayers: About 200 credits were claimed for tax year 2020.

Credit for Teachers Attaining a Master's Degree (Article 1, Section 38)
Effective beginning with tax year 2023.

Current Law: Qualifying Minnesota teachers may claim a nonrefundable tax credit in the year that they complete a master's degree program. The credit equals the amount the taxpayer paid for tuition, fees, books, and instructional materials for the master's degree program for which they did not receive reimbursement from an employer or scholarship, up to a maximum of $2,500.

To qualify, a teacher must hold a license issued by the Minnesota Department of Education (MDE) when they begin the master's degree program and when they complete the program, the program must have begun after June 30, 2017, and the program must be in a "core content area," which includes the subjects of reading, English or language arts, mathematics, science, foreign languages, civics and government, economics, arts, history, and geography. Finally, the program must not include pedagogy or a pedagogy component as curriculum.

Proposed Law: The bill would expand the master's degree credit to include a master's degree program in special education. Special education includes programs of study in developmental disabilities, early childhood special education, emotional or behavioral disorders, autism spectrum disorders, and learning disabilities. Qualifying special education programs would not be subject to the restriction on pedagogy components.

- The number of qualifying teachers was calculated using annual staff data published by MDE and compiled by the Professional Educator Licensing and Standards Board (PELSB). PELSB includes teacher-level data on educational attainment and district-level headcounts of teachers by teaching assignment codes.
- About 1,400 teachers attained master's degrees each year. Of those, it is assumed that 18% are special education teachers, based on the percentage of teaching licenses in special education.
- The costs of tuition and other qualifying expenses are assumed to exceed $2,500 for all eligible claimants.
- Since the credit is nonrefundable, the average reduction in tax is estimated at $1,745, based on information on the average tax benefit of the current credit from 2019 income tax returns.
- Projected growth is based on the average growth rates of the total number of teachers, the number of special education teachers, and the number of teachers attaining a master's degree from the 2010-11 school year through the 2018-19 school year.
- Tax year impacts are allocated for the following fiscal year.

Number of Taxpayers: About 300 tax returns would be affected in tax year 2023. The average decrease in tax would be $1,745.

Manufactured Home Park Credit (Article 1, Section 39; Article 7, Section 22)
Effective beginning with tax year 2023.

The bill creates a credit against the individual income tax and corporate franchise tax for sales of manufactured home parks to cooperatives. The credit is equal to 5% of the amount of the sale. The credit is nonrefundable but can be carried forward for up to five years.

To qualify, a taxpayer must sell qualified property to a manufactured home cooperative, a nonprofit organization intending to convert the park to a cooperative, or a representative of residents who intend to convert the park to a cooperative.

Qualified property includes a manufactured home park classified as 4c(5)(i) or 4c(5)(iii) property that qualifies as an Internal Revenue Code section 1250 property (in general, real property that is subject to depreciation, including residential and nonresidential real property).

For nonresidents and part-year residents, the credit is apportioned based on the percentage of income that is attributable to Minnesota.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimated market value of manufactured home parks in 2023 is about $931.9 million, based on Department of Revenue data.
- It is assumed that 1% of non-cooperative manufactured home parks, valued at about $9.2 million, would be converted to co-ops each year.
- The seller would be eligible for a 5% credit. The estimate was reduced by 5% to account for nonresidents and part-year residents.
- The estimate was reduced by 20% since the credit is nonrefundable.
- Credits exceeding tax liability could be carried over for up to five years. It is assumed that 5% of carryovers will be claimed each year.
- Growth is based on projected growth in property values in the February 2023 forecast.
- Tax year impacts are allocated to the following fiscal year.

Worldwide Reporting (Article 1, Sections 20, 23-26, 41-43)
Effective beginning with tax year 2024.

Under current law, other than disqualified captive insurance companies, the net income and apportionment factors of foreign corporations and other foreign entities is not included in the net income or the apportionment factors of a unitary business. Each corporation or other entity, except a sole proprietorship, that is part of a unitary business must file combined reports. A foreign corporation or other foreign entity that is not included on a combined report and that is required to file a return must file on a separate basis.

The bill requires net income and apportionment factors of foreign corporations and other foreign entities to be included in the net income and apportionment factors of a combined unitary group.

The bill also creates a subtraction for Subpart F income for unitary businesses. Subpart F income is a portion of CFC income distinct from GILTI, which has been taxed both at the federal level and in Minnesota since prior to the enactment of the TCJA. Once subtracted, subpart F income must be re-included in the net income through worldwide combined reporting and treated as ordinary income.

- The estimate is based on a 2019 report on tax havens published by The Institute on Taxation and Economic Policy.
- The report estimates that if adopted by all states, worldwide combined reporting would generate an additional $235 billion in taxable income nationally.
- It is assumed that Minnesota would account for 1% of this income increase, or about $2.35 billion.
- Taxing this additional income at a rate of 9.8% would increase revenue by about $230 million in 2018, or about 17.5% of corporate franchise tax collections.
- This 17.5% increase is applied to corporate franchise tax collections as projected by Minnesota Management and Budget in the February 2023 forecast.
- The proposal is effective beginning with tax year 2024. All tax year impacts are allocated 30% to the current fiscal year, and 70% to the following fiscal year.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

One-time Refundable Credit Payment (Article 1, Section 46)
Effective tax year 2021 only.

The bill would create a retroactive refundable income tax credit for tax year 2021 equal to $550 for married joint filers and $275 for all other filers. Households with dependents would get an additional $275 for each dependent, up to three dependents. Returns with federal adjusted gross income (FAGI) in tax year 2021 higher than the specified thresholds are not eligible. The thresholds are as follows:

- $150,000 for married joint filers
- $75,000 for all other filers.

Qualifying individuals include all full-year residents and part-year residents during tax year 2021. For part-year residents, the payment would be apportioned based on the percentage of their total income that is Minnesota source. Full-year nonresidents and dependent filers during tax year 2021 are not eligible for the credit.

The credit is not considered income in determining Minnesota income tax, or income for determining eligibility for social programs. The credit must not be used to offset any unpaid tax or debt.

The Commissioner of Revenue must establish a simplified filing process for individuals who resided in Minnesota but did not file a 2021 income tax return to claim the credit.

- The credits are assumed to be paid after June 30, 2023. The fiscal year impact will depend on the actual timing of the claims.
- The number of income tax filers eligible for a credit is based on a sample of the 2019 individual income tax returns grown by 1.10% to account for population growth from 2019 to 2021.
- The 2018 incidence database was used to identify taxpayers who filed a property tax refund but not an income tax return and increased by 2.65% to account for population growth from 2018 to 2021.
- About 2,562,300 households would receive a credit, including the following:
    - 2,319,200 full-year resident households filing an income tax return
    - 41,900 part-year resident households filing an income tax return
    - 78,500 households with a property tax refund only
    - 122,700 households without an income tax return or a property tax refund.
- The average credit would be about $488.
- Part-year residents are assumed to receive 54.6% of the total credit on average, based on the average percentage of income that is Minnesota source income.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Unemployment Subtraction (Article 1, Section 47)
Effective retroactively for tax year 2021 only.

The bill would retroactively allow a subtraction for unemployment compensation received by individuals during tax year 2021 as a result of the decision issued by the Minnesota Court of Appeals, 956 N.W. 2d 1, filed February 22, 2021.

Prior to the court's reversal on December 1, 2020, it was believed that high school students under the age of 18 were not eligible for Pandemic Unemployment Assistance authorized under the federal CARES Act. DEED agreed to retroactively apply the court's decision to individuals that were previously denied unemployment benefits. Since the benefits were received in 2021, they are not eligible for the temporary income tax subtraction for unemployment benefits, which was only in effect for tax year 2020. The bill would allow a subtraction for the previously denied benefits.

- The estimate is based on individual income tax returns for tax year 2021.
- In tax year 2021, about 6,400 tax returns were filed by taxpayers aged between 14 and 17 with wages and positive tax liability. The average wage was $14,048 with an average tax liability of $272.
- Of these returns, about 90 had unemployment compensation. They are assumed to be eligible for the subtraction.
- Average eligible benefits are estimated at $5,000.
- A marginal rate of 2% was assumed.
- The retroactive impact is allocated to fiscal year 2024.

Number of Taxpayers: About 90 returns would have an average benefit of $100.

<u>Federal Update – Article 2</u>

The Consolidated Appropriations Act, 2023 (Public Law 117-328) was enacted on December 29, 2022. Division T of the Act, known as the SECURE 2.0 Act of 2022, includes several provisions which would affect the definition of income for Minnesota individual income tax purposes.

The bill would update reference to the Internal Revenue Code as amended through March 1, 2023, thereby adopting the changes in the SECURE 2.0 Act.

See the attached tables for a complete list of the provisions adopted by the bill.

<u>Deferral for Sales of Stock to an Employee Stock Ownership Plan.</u> Effective beginning with tax year 2028, the Act allows shareholders of an S corporation to defer recognition of gains on the sale of stock to an employee stock ownership plan. The deferral will reduce taxable income at the time of the sale.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Retirement Account Withdrawals for Emergency Expenses. Effective beginning with tax year 2024, the Act allows an individual to withdraw up to $1,000 from a retirement account for emergency expenses. The withdrawal is exempt from the federal 10% penalty on early withdrawals but is included in taxable income. The taxpayer may choose to repay the withdrawal within three years. If the amount is repaid, the individual may adjust the prior year's return to exclude the withdrawal from income. Conforming to this provision would reduce taxable income for taxpayers who repaid the withdrawn amount.

Simplified Employee Pension Plans. Effective beginning with tax year 2023, the Act allows employers of domestic employees to offer retirement benefits through a Simplified Employee Pension (SEP) plan. Tax is deferred on contributions to a SEP plan until the time of withdrawal. This provision will reduce taxable income at the time of the contributions.

Distributions from 529 Plans to Roth IRAs. Effective beginning in tax year 2024, the Act allows a beneficiary of a Section 529 college savings plan to roll over up to $35,000 into a Roth IRA. The provision will reduce taxable income at the time of the rollover.

Charitable Distributions from IRA. Effective beginning December 29, 2022, the Act allows a one-time charitable distribution from an Individual Retirement Account (IRA) of up to $50,000 to a charitable gift annuity, charitable remainder trust, or charitable remainder annuity trust. The Act also adds inflation indexing to the annual $100,000 limit on charitable distributions from an IRA. The provision will reduce taxable income.

Exclusion of First Responder Retirement Benefits. Effective beginning with tax year 2027, the Act excludes qualified service-connected disability pension payments to first responders from gross income. First responders include law enforcement officers, firefighters, paramedics, and emergency medical technicians. Since the benefits otherwise would be taxable, the provision will reduce taxable income.

Distributions from IRA for Federal Disasters. Effective retroactively for disasters occurring on or after January 26, 2021, the Act allows penalty-free withdrawals up to $22,000 from a retirement account for expenses related to a declared federal disaster. The distribution is included in income over three years, and the amount may be repaid within three years. The provision will spread tax liability for distributions over three years, reducing taxable income in the year of the distribution and increasing taxable income in the next two years.

In addition, individuals who withdrew money from a retirement account to purchase a home but did not complete the purchase due to a federally declared disaster may repay the withdrawn amount to their retirement account. For individuals who recontribute withdrawals, the provision will reduce taxable income.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Limit Deduction for Charitable Conservation Easements. Effective December 29, 2022, the Act limits the deduction for contributions of property to a charitable conservation easement. For each partner in a contributing partnership, the deduction is limited to two and a half times the partner's basis in the partnership. Certain exceptions apply if a 3-year holding period is met, for a family-owned partnership, and for certified historic structures. The provision will increase taxable income for partners in the contributing partnerships.

- The estimates are based on the estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated December 22, 2022.
- 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.

Nonresident Percentage (Article 2, Section 4)
Effective retroactively beginning with tax year 2019.

Current law references to the Internal Revenue Code as emended through December 15, 2022, with certain exceptions, including the following:

- The amount of additional business interest that was allowed under the CARES Act in 2018-2020 must be added back to taxable income but can be deducted over five years beginning in tax year 2023.
- Additional net operating losses (NOLs) that were allowed under the CARES Act in tax years 2018-2020 must be added back to taxable income but can be carried forward for up to 20 years.
- A subtraction is allowed for excess business losses subject to the federal limitation in Section 461(l)(1) of the Internal Revenue Code in tax years 2026-2028.

Nonresident individual income taxpayers must calculate their Minnesota tax liability on their total income. The result is multiplied by the percentage of their income that is Minnesota source income. Current law does not include the above adjustments in the calculation of the nonresident percentage. The bill would include them, which could increase or decrease tax liability for affected nonresidents.

For example, a nonresident taxpayer who claimed additional NOLs under the CARES Act would have to add the amount of the NOLs to his or her income for Minnesota tax purposes. But when apportioning the tax to Minnesota, the calculation of the percentage would not include the addition. If all of the NOLs were assignable to another state, then excluding the addition would reduce the denominator without changing the numerator, increasing the nonresident percentage. If all of the NOLs were assignable to Minnesota, the addition would be included in both the numerator and the denominator, and excluding it would tend to decrease the nonresident percentage. The reverse is true for taxpayers with a subtraction. Excluding the subtraction would tend to decrease Minnesota tax liability for taxpayers with out-of-state NOLs and increase it for taxpayers with Minnesota source NOLs.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate is based on a sample of tax year 2020 individual income tax returns.
- In tax year 2020, about 1,000 nonresident returns had nonconformity adjustments for NOLs or the business interest limitation. It is assumed that a similar number had retroactive adjustments in 2018 and 2019.
- Total tax liability for those returns was $32.5 million.
- It is assumed that on average, the bill would decrease tax liability for affected nonresidents by 5%.
- That would be partially offset by increases in tax liability due to subtractions beginning in tax year 2023. The subtractions are spread over five years for excess interest and 20 years for NOLs.
- Subtractions for excess business losses would begin in tax year 2027 and 2028. The additional revenue gain from those subtractions is about $1.5 million per year. That impact falls mostly outside the forecast window.
- Retroactive impacts were allocated to fiscal year 2024. All other tax years were allocated 30% / 70% to fiscal years.

Repeal Excess Business Loss Subtraction (Article 2, Section 8)
Effective beginning with tax year 2026.

The federal Tax Cuts and Jobs Act limited the deduction for losses from a partnership, S corporation, or sole proprietorship to $250,000 ($500,000 for married joint filers.) Any excess losses over that amount may be carried over to following tax years. As enacted, the limitation was effective for tax years 2018 through 2025.

The American Rescue Plan Act (ARPA) extended the limit through 2026. The Inflation Reduction Act extended the limit again for tax years 2027 and 2028.

Minnesota has adopted the limitation on excess business losses through tax year 2025. Beginning in tax year 2026, a taxpayer may claim a subtraction for any excess business losses not allowed federally.

The bill would repeal the subtraction for excess business losses, adopting the federal treatment of excess business losses in tax years 2026 through 2028.

- The estimates are based on the estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation.
- 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.
- Tax year impacts are allocated 30% / 70% to fiscal years.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Sales and Use Tax - Article 5

Edible Cannabinoids (Article 5, Sections 1-5, 7-9)
Effective the day following final enactment, except if a bill styled as H.F. No. 100 is finally enacted at the 2023 regular session.

Current Minnesota sales tax law does not contain definitions for cannabis, adult-use cannabis, or adult-use cannabis products. All sales to governments, non-profits, nursing homes, and boarding care homes are exempt except for those expressly stated in Minnesota statute. Cannabis and cannabis products are not specifically excluded from any of the above exemptions.

The bill creates definitions for cannabis, adult-use cannabis, and adult-use cannabis products. The bill also adds those terms to the list of taxable items for governments, non-profits, nursing homes, and boarding care homes.

- It is assumed that only senior citizen nonprofit groups would be purchasing these items in the forecast window.
- Information for the estimates was obtained from IRS Form 990's for the largest senior citizen nonprofit groups.
- It is estimated that the largest senior citizen nonprofit groups spent $10.4 million on medical supplies and other expenses.
- It is assumed that 1% of expenses and medical supplies for senior citizen nonprofit groups would be spent on products affected by the bill.
- The amounts were increased 25% to account for all other senior citizen nonprofit groups.
- The fiscal year 2024 estimates are adjusted for eleven months of collections.

Disregarded LLCs (Article 5, Section 6)
Effective for sales made after June 30, 2023.

Under current administrative rules, the transfer of sales taxable property between a single member limited liability company (LLC) and the single member do not qualify for exemption.

The bill creates a sales tax exemption for sales between the sole member of a disregarded LLC and the disregarded LLC.

- Department of Revenue records show that 145,000 single member limited liability companies were registered in 2021 and about 17% of LLCs registered are disregarded entities.
- Department of Revenue records show that about 12,600 single member LLCs are formed each year.
- It was assumed that the number of new LLCs formed each year is constant.
- It is assumed that 7% of the disregarded LLCs would have taxable sales between the company and the member with an average value of $5,000.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Nonprofit Snowmobile Clubs (Article 5, Section 10)
Effective for sales and purchases made after June 30, 2023.

Sales of tangible personal property to nonprofit snowmobile clubs used primarily for grooming of state trails are exempt. The exemption applies to grooming machines, attachments, other associated accessories, and repair parts. A nonprofit snowmobile club is eligible for the exemption if it received, in the current year or in the previous three-year period, a state grant-in-aid maintenance and grooming grant administered by the Department of Natural Resources.

The bill would expand the exemption to include sales of materials and supplies used or consumed in, and equipment incorporated into, the construction, reconstruction, maintenance, or improvement of state or grant-in-aid snowmobile trails.

- The Department of Natural Resources reports providing 178 grants totaling $7.3 million in FY 2023 for grooming and trail maintenance. Additional one-time funding of $650,000 was provided for FY 2023.
- It is estimated that 10% of the grant-in-aid money is spent on taxable materials, supplies, and equipment.
- The estimate is increased by 5% for spending on materials and supplies from other snowmobile club revenues.
- It is assumed that expenditures will increase by 1% per year.

Exemption for Natural Gas Fees (Article 5, Section 11)
Effective retroactively for fees applied to sales and purchases of natural gas that are billed from September 1, 2021, to December 31, 2026.

Natural gas used as a primary source for residential heating is exempt from the sales and use tax for the billing months of November through April. Any fees associated with the sale of natural gas during those billing months is also exempt.

The bill would provide a sales and use tax exemption for certain fees related to natural gas sold to residential customers for the billing months of May to October. To qualify for the exemption, the fees must be separately stated and labeled as a fee subject to a cost recovery plan for the price increase in natural gas during the period February 13, 2021, to February 17, 2021. For fees exempt from September 1, 2021, to June 30, 2023, the utilities would apply for a refund and credit them to the applicable customers.

- Information for the estimates came from documents filed with the Public Utilities Commission.
- There is a total of approximately $660 million to be recovered in fees by four impacted utilities.
- It is assumed that all refunds for fees billed from September 1, 2021, to June 30, 2023 would be paid in fiscal year 2024.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Government and Nonprofit Construction (Article 5, Section 12)
Effective retroactively from July 1, 2021, and applies to sales and purchases made after June 30, 2021, and before January 1, 2025.

Construction materials and supplies are generally taxable in Minnesota. Sales tax-exempt entities such as cities, counties, townships, school districts, special districts, state institutions of higher education, public libraries, most hospitals and nursing homes, and most charitable, educational, and religious organizations may purchase construction materials directly without paying the tax, with certain exceptions. However, building, construction, and reconstruction materials purchased by a contractor or subcontractor as part of a lump-sum or similar type of contract with a guaranteed maximum price covering both labor and materials are taxable, even if the project owner is exempt from sales tax.

There is an administrative rule under which an exempt entity may designate a construction contractor as its purchasing agent so that the contractor can acquire the construction materials exempt from tax under specific conditions.

The bill would provide a sales and use tax exemption for building, construction, or reconstruction materials, supplies, and equipment purchased by a contractor and used or consumed or incorporated into buildings or facilities used principally by cities, counties, townships, public school districts, special districts, nonprofit hospitals and nursing homes, public libraries, nonprofit groups, and nonprofit hospitals and outpatient surgical centers. The bill also exempts materials, supplies, and equipment used in the construction, reconstruction, repair, maintenance, or improvement of public infrastructure of any kind by a school district or local government. Contractors, subcontractors, and builders would pay the tax at the time materials are purchased, and the local governments and nonprofits would submit a tax refund claim to the Department of Revenue. The exemption would apply to purchases made after June 30, 2021, and before January 1, 2025. Refunds would not be issued after June 30, 2025.

- 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 and private construction. National figures for 2020 and 2021 were averaged for a state fiscal year 2021 estimating base.
- 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.
- Annual growth for nonprofit organizations including hospitals and nursing homes was estimated at 2.5%.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The timing and processing of refund claims are expected to affect the estimates.
- Due to the retroactive effective date, the fiscal year 2024 estimates are adjusted for two and a half years of impact.
- It is assumed that no refunds will be issued after June 30, 2025.

City of Chanhassen Construction (Article 5, Section 13)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before February 1, 2027.

The bill would exempt materials, supplies, and equipment used in the construction of the several projects in the city of Chanhassen from the sales and use tax. The exemption would be administered as a refund and apply to purchases made after January 31,2024 and before February 1, 2027. The projects are as follows.

a.) New city hall and city center
b.) Council Chambers
c.) Park amenities

- Information for the estimates was provided by a representative of the city of Chanhassen
- Total construction costs for materials, supplies, and equipment are estimated to be $12 million.
- Based on information from the city it is assumed that the refunds will be claimed and paid out evenly during Fiscal years 2026 and 2027.

Edina Public Health Center (Article 5, Section 14)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before January 1, 2026.

The bill would exempt materials, supplies, and equipment used in the construction and renovation of a community health and safety center in the city of Edina from the sales and use tax. The exemption would be administered as a refund and apply to purchases made after December 31, 2024, and before January 1, 2026.

- Information for the estimates was provided by a representative of the city of Edina.
- Total construction costs for materials, supplies, and equipment are estimated to be $14 million.
- It is anticipated that the project will start in spring 2023 and will take about two years for completion.
- It is assumed that all refunds will be filed and paid in fiscal year 2026.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Ely Public Schools Construction (Article 5, Section 15)
Effective retroactively from May 2, 2019, and applies to sales and purchases made after May 1, 2019, and before July 1, 2021.

The bill provides an exemption from the sales and use tax for materials, supplies, and equipment used in renovations to the elementary school building and high school building and construction of a building connecting the elementary and high school buildings in Ely, ISD 696.

- Project cost estimates were provided by representatives of the impacted project.

Hibbing Public Schools Construction (Article 5, Section 16)
Effective retroactively from May 2, 2019, and applies to sales and purchases made after May 1, 2019, and before July 1, 2021.

The bill provides an exemption from the sales and use tax for materials, supplies, and equipment used in the addition of an Early Childhood Family Education Center to an existing elementary school, improvements to an existing athletic facility, reroofing at Hibbing Washington Elementary School, and a Hibbing High School restroom remodel project in Hibbing, ISD 701.

- Project cost estimates were provided by representatives of the impacted project.

MSP Airport Construction (Article 5, Section 17)
Effective the day following final enactment and applies to purchases made after December 31, 2024, and before January 1, 2028.

The bill would provide a sales and use tax exemption for materials, supplies, and equipment used in the construction, reconstruction, repair, maintenance, or improvement of public infrastructure at Minneapolis-St. Paul International Airport. Materials, supplies, and equipment would need to be purchased after December 31, 2024, and before January 1, 2028, to be eligible for the exemption. The tax would be administered as a refund.

- Information for the estimates was provided by a representative from Minneapolis-St. Paul Airport.
- Total construction costs eligible for the exemption are estimated to be $830 million.
- Total taxable materials, supplies, and equipment are estimated to be $330 million.
- It is assumed that all refund claims will be filed and paid in fiscal years 2026 and 2027.
- There may be additional costs beyond the forecast period.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

City of Moorhead Construction (Article 5, Section 18)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before April 1, 2027.

The bill would exempt materials and supplies used in and equipment incorporated into the construction, reconstruction, upgrade, expansion, renovation, or remodeling of a regional library and community center in the city of Moorhead. The exemption would only apply to purchases made after December 31, 2024, and before April 1, 2027.

- The estimate is based on project information provided by City of Moorhead Governmental Affairs Director.
- The total project cost is estimated to be $32.59 million.
- The total cost of materials is estimated to be $15 million.
- It is assumed that all refunds will be filed and paid in fiscal years 2026 and 2027.
- The project will begin in 2024 and complete in 2027. The distribution of expected refund claims is assumed based on the project timeline.
- There will be additional costs outside of the 2027 forecast window.

City of Oakdale Construction (Article 5, Section 19)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before January 1, 2027.

The bill would exempt materials and supplies used or consumed in and equipment incorporated into the construction of a new public works facility in the city of Oakdale. The exemption would only apply to purchases made after December 31, 2024, and before January 1, 2027.

- The estimate is based on project information provided by Oakdale City Administrator.
- The total project cost is estimated to be $25.5 million.
- The total cost of materials is estimated to be $11.5 million.
- The project will begin in 2023 and complete in 2025. The distribution of expected refund claims is assumed based on the project timeline.

Ramsey Construction Material (Article 5, Section 20)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before January 1, 2026.

The bill would exempt materials and supplies used in and equipment incorporated into the construction, reconstruction, upgrade, expansion, renovation, or remodeling of a new water treatment plant in the city of Ramsey. The exemption would only apply to purchases made after December 31, 2024, and before January 1, 2026.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- The estimate is based on project information provided by City of Ramsey Administrator.
- The total project cost is estimated to be $42.5 million.
- The total cost of materials is estimated to be $21.25 million.
- The project will begin in 2023 and complete in 2025. The distribution of expected refund claims is assumed based on the project timeline.

Red Lake Schools Construction (Article 5, Section 21)
Effective retroactively from January 1, 2021, and applies to sales and purchases made after December 31, 2020, and before July 1, 2021, and after December 31, 2024, and before January 1, 2026.

The bill would exempt materials, supplies, and equipment used in the construction of a new school in Independent School District 2906, Red Lake County School District. The exemption would be administered as a refund and apply to purchases made after December 31, 2020, and before July 1, 2021, and after December 31, 2024, and before January 1, 2026. Refunds for eligible purchases must not be issued until after June 30, 2023.

- This provision is fully contained under Article 5, Section 12 of the bill.

Red Rock Schools Construction (Article 5, Section 22)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before July 1, 2025.

The bill would provide a sales and use tax exemption for materials, supplies, and equipment used in the construction of a new prekindergarten through grade 12 learning facility in ISD 2884, Red Rock Central School District.

The exemption would be administered as a refund. Refunds would not be issued until after June 30, 2023.

- Information for the estimate was provided by a representative of the school district.
- Total construction costs for the Red Rock School District project is approximately $41 million.
- It is estimated that taxable materials, supplies, and equipment for the Red Rock project would be $16.3 million.

Rock Ridge Schools Construction (Article 5, Section 23)
Effective retroactively from May 2, 2019, and applies to sales and purchases made after May 1, 2019, and before July 1, 2021.

The bill provides an exemption from the sales and use tax for materials, supplies, and equipment used in the construction of two new elementary school buildings and a new high school building in Rock Ridge, ISD 2909.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- Project cost estimates were provided by representatives of the impacted project.

Spring Grove Construction Materials (Article 5, Section 24)
Effective retroactively from December 23, 2022, and applies to sales and purchases made after December 22, 2022, and before January 1, 2028.

The bill would provide a sales and use tax exemption for certain items if used to repair, replace, or otherwise recover from real or personal property damage that occurred during a December 22, 2022 fire in the city of Spring Grove. Building materials, supplies, and equipment used in construction, replacement, or repair of real property, and capital equipment to replace equipment destroyed by the fire would be exempt. The exemption would be administered as a refund not to be issued until after June 30, 2023.

- Information for the estimates was provided by a representative of the city of Spring Grove.
- It is estimated that total project costs for fire remediation are $5 million.
- It is assumed that $2 million will be spent on items that would be exempt under the bill.
- It is assumed that all refunds will be filed and paid in fiscal year 2024.

Springfield Schools Construction (Article 5, Section 25)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before July 1, 2025.

The bill provides a sales and use tax exemption for materials, supplies, and equipment used in the construction of the following projects in ISD 85, Springfield School District:

a.) Construction of a main secure entrance
b.) Construction of a required tornado storm shelter
c.) Installation of HVAC improvements
d.) Conversion of the existing school gymnasium for use for career and technical education trades and auto shop, and
e.) Addition of new school gymnasium

- The exemption would be administered as a refund. Refunds would not be issued until after June 30, 2023.
- This provision is fully contained under Article 5, Section 12 of the bill.

Wayzata Construction (Article 5, Section 26)
Effective retroactively from April 1, 2020, and applies to sales and purchases made after March 31, 2020, and before July 1, 2021.

The bill would exempt materials, supplies, and equipment used in the construction of the several projects in the city of Wayzata from the sales and use tax. The exemption would be administered as a refund and apply to purchases made after March 31, 2020 and before July 1, 2021. The projects are as follows.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

a.) Expansion and remodeling of Depot Park
b.) Construction of community docks for accessing Lake Minnetonka
c.) Construction of linear boardwalk
d.) Shoreline restoration
e.) Restoration of Section Forearm house
f.) Construction of Eco Park
g.) Construction of public plaza
h.) Construction of regional multiuse trail
i.) Construction of railroad crossings

- Information for the estimates was provided by a representative of the city of Wayzata
- Total construction costs for taxable materials, supplies, and equipment are estimated to be $16.6 million.
- It is anticipated that the project will start in spring 2023 and would take about a year for completion.
- It is assumed that all refunds will be filed and paid in fiscal year 2024.

Woodbury Construction (Article 5, Section 27)
Effective the day following final enactment and applies to sales and purchases made after December 31, 2024, and before January 1, 2026.

The bill would exempt materials and supplies used or consumed in and equipment incorporated into the construction, reconstruction, upgrade, expansion, renovation, or remodeling of the Central Park project in the city of Woodbury. The exemption would only apply to purchases made after December 31, 2024, and before January 1, 2026.

- This estimate is based on project information by City of Woodbury Parks and Recreation Director.
- The total project cost is estimated to be $39 million
- The cost of materials is estimated to be $16 million
- The project will begin in 2024 and substantially complete in 2025. The distribution of expected refund claims is assumed based on the project timeline.

<u>Renter's Credit - Article 7</u>

Under current law property tax refunds (PTR) are calculated based on a definition of household income that includes federal adjusted gross income (FAGI) and adds other non-taxable income sources including social security, contributions to retirement plans, and government assistance payments. Claimants file form M1PR by August 15 to claim the refund.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

The bill repeals the renter property tax refund and replaces it with a refundable income tax credit. The bill also changes the definition of income for calculating the new credit to be FAGI. Current law subtractions and exclusions would be eliminated, except the subtractions for dependents, disability, and age +65 would be preserved.
Taxpayers would file form M1 generally by April 15 to claim the credit.

- Based on the February 2023 forecast, the current renter property tax refund is projected to total $242.4 million for fiscal year 2025.
- Changing the definition of household income to FAGI would narrow the measure of income used for calculating renter property tax refunds. On average, FAGI is estimated to be approximately 14% lower than household income as currently defined. As a result, more renters would become eligible for the proposed credit compared to the current law refund.
- Changing the refund to an income tax credit would shift the timing in which the payment is made. The analysis assumes a 100% shift to the previous fiscal year.
- The analysis assumes that 100% of current renter PTR filers would file M1 to get the credit.
- Based on the February 2023 forecast, the current renter property tax refund is projected to total $242.4 million for fiscal year 2025.
- Changing the definition of household income to FAGI would narrow the measure of income used for calculating renter property tax refunds. On average, FAGI is estimated to be approximately 14% lower than household income as currently defined. As a result, more renters would become eligible for the proposed credit compared to the current law refund.
- Changing the refund to an income tax credit would shift the timing in which the payment is made. The analysis assumes a 100% shift to the previous fiscal year.
- The analysis assumes that 100% of current renter PTR filers would file M1 to get the credit.
- Among people who did not file for renter PTR but were eligible for the refund under current law and for the proposed credit, the analysis assumes 10% would not file M1 to claim the credit.
- Under the proposed renter income tax credit, tax year 2023 payments are estimated to be $373.6 million.
- Fiscal year 2025 would be the first full year impact from the repeal.

Current PTR Claimants

- Under the bill, just under half of current renter property tax refund claimants would have no change in the net income amount used to calculate refunds. The credit they would receive would be equal to the current refund.
- Approximately half of renter property tax refund claimants would have a lower net income amount for calculating refunds and would receive a credit that is higher than the current refund under current law. These 50% of renters currently receiving a refund would receive an average credit that is $204 higher than their current refund.
- A smaller percentage of current renter refund claimants would have a higher net income amount for calculating credits due to the elimination of certain income subtractions and exclusions, including those for retirement contributions and paid alimony, and would receive a credit smaller than the existing refund under current law. Approximately 5% of renters currently receiving a refund would be estimated to receive a credit that is $64 lower than their current refund.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- In fiscal year 2025 the total increase in property tax refund credits to current renter claimants would be $32 million.

Additional Filers Receiving the PTR Credit

- It is assumed that approximately 119,000 renters currently eligible but not claiming a property tax refund would receive the proposed income tax credit totaling approximately $85 million.
- The change in the definition of income would increase the numbers of renters qualifying for a credit, with an additional 33,000 renters estimated to receive a credit. Newly eligible renters are estimated to receive $14 million.

Number of Taxpayers: Approximately 325,000 taxpayers would be affected.

Local Taxes – Article 9

City of Duluth (Article 9, Sections 1-2)

Duluth has imposed a 1% special lodging tax on lodging facilities with more than 30 rooms, in addition to the 3% lodging tax allowed under general law, since 1970. An additional 1.5% lodging tax was added in 1980 to facilities with more than 30 rooms. In 2014, revenue from 0.5% of the lodging tax was dedicated to public facility capital improvements to support tourism and recreational activities. The 0.5% portion of the tax would expire after $18 million was raised to cover debt service on bonds.

The bill would increase the amount of revenue required to repay the debt service from $18 million to $54 million, extending the 0.5% portion of the tax. Revenue from the tax is to be used to finance capital improvements to park-based public athletic facilities to support sports tourism.

Cook County (Article 9, Section 3)

Cook County has imposed a non-transit sales and use tax of 1% since 2010 and a transit sales and use tax of 0.5% since 2017.

Cook County currently has the authorization to impose a lodging tax of up to 1% and an admissions and recreation tax of up to 3% to finance a new Event and Visitors Bureau. Both taxes terminate 15 years after imposition.

The bill repeals the authority to impose an admissions and recreation tax in Cook County. The lodging tax authorization remains, and the tax would terminate 30 years after imposition.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Miscellaneous - Article 12

Taxpayer Receipt, Appropriation (Article 12, Sections 3, 9, 35)
Effective beginning with fiscal year 2024.

The bill requires the Commissioner of Management and Budget, in consultation with the Commissioner of Revenue, to develop and publish an interactive taxpayer receipt on Management and Budget's website. The website must describe General Fund expenditures by major expenditure category, including the allocation of motor fuel taxes among transportation purposes. The receipt must include the goals and outcomes of the expenditures.

The website must allow the taxpayer to input an income amount and other information, such as tobacco or alcohol use, to receive an estimate of major state taxes paid and the share of the user's tax liability that goes to each major expenditure category.

The receipt must be based on the most recent fiscal year for which data is available and must be updated by December 31 of each year. Beginning with tax year 2023, the individual income tax forms must include an option to get information on the taxpayer receipt by email, U.S. mail, or to not receive any receipt information.

The bill appropriates $100,000 from the General Fund to the Commissioner of Management and Budget for fiscal year 2024 to develop the website and $47,000 per fiscal year after that.

Combined Net Receipts Tax (Article 12, Section 10)
Effective beginning with tax year 2024.

The combined net receipts tax is imposed on lawful gambling organizations' net receipts after prizes from pull-tabs (paper and electronic), non-sports-themed tipboards, and electronic linked bingo games. Gambling tax revenue in excess of $36.9 million in a fiscal year is allocated to the stadium reserve account within the General Fund. In addition, one percent of total gambling revenues each year is appropriated to the Department of Human Services to address problem gambling.

The bill would lower tax rates as follows:

Net Receipts for fiscal year	Current	Proposed
Not more than $87,500	9%	8.5%
Over $87,500 but not more than $122,500	18%	17.5%
Over $122,500 but not more than $157,500	27%	26%
Over $157,500	36%	34.75%

- Estimates are based on data from fiscal year 2022 tax returns.
- Growth is based on the February 2023 forecast.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

- During the forecast window:
  - Combined net receipts taxes would decrease by approximately $30.9 million.
  - The appropriation for problem gambling would decrease by $400,000
  - The net impact on the Stadium Reserve Account of the General Fund is a reduction of $30.5 million.
- The fiscal year 2024 estimate is adjusted for eleven months of impact.

Solid Waste Tax (Article 12, Section 12)
Effective the day following final enactment.

The solid waste management tax (SWMT) is imposed on charges for the collection and disposal of solid waste. Seventy percent of the revenues are dedicated to the Environmental Fund with the remainder deposited in the General Fund.

Beginning in fiscal year 2024, in addition to the 70% allocation to the Environmental fund, five percent of the amount generated from solid waste management tax will be deposited into the resource management account in the Environmental Fund.

- Solid waste Management Tax collections from the February 2023 forecast are used to estimate the transfers
- The estimates reflect the difference between the current law transfer amount and the proposed transfer.

Workforce and Affordable Housing (Article 12, Section 26)
Effective beginning July 1, 2023 for fiscal years 2024 through 2034.

The Workforce and Affordable Homeownership Development Program awards homeownership grants to nonprofit organizations, certain cooperatives, and certain community land trusts in order to develop workforce and affordable homeownership projects. The bill expands the program to include loans in addition to grants. It also establishes a workforce and affordable homeownership development account in the housing development fund. Money in the account is appropriated to the Commissioner of the HFA.

To fund the program, a portion of the proceeds from the mortgage registry tax and deed tax is appropriated from the General Fund to the workforce and affordable homeownership development account. The appropriation must be made by September 15 of each year. The transfer equals $27.5 million each in fiscal years 2024 and 2025 and $7.5 million in each fiscal year from 2026 to 2034.

All loan repayments received under the bill are deposited back into the account. Instead of repaying the loan, a borrower may spend the money on a qualifying project under the program.

The appropriations expire September 16, 2033.

EXPLANATION AND ANALYSIS OF THE BILL (Cont.)

Free File Report, Appropriation (Article 12, Section 29)
Effective July 1, 2023.

The bill requires the Commissioner of Revenue to provide a written report to the Legislature by January 15, 2024 on free electronic filing options for individual income tax returns. In preparing the report, the Commissioner must survey tax preparation software vendors on free electronic tax preparation and filing options. The survey must request specific information on system development, projected costs per return, processes for protecting taxpayer information, and other questions. The report must include a review of other states' options for electronic filing, a taxpayer needs assessment including current filing practices, and analyses of free filing alternative options (for example, tax credits), and of Internal Revenue Service Free File Program use.

The bill appropriates $175,000 from the General Fund to the Commissioner of Revenue for fiscal year 2024 to prepare the report. This is a one-time appropriation.

- The bill would result in a loss of $175,000 from the General Fund due to the appropriation in fiscal year 2024.

Certificate of Rent Paid (Article 15, Section 4)
Effective for refunds for rent paid in 2023 and thereafter.

The Commissioner of Revenue may require a certificate of rent paid to include the social security number or other identification number of the owner or managing agent.

- The provision would have no impact on the state general fund.

Minnesota Department of Revenue
Tax Research Division
https://www.revenue.state.mn.us/revenue-analyses

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April 27, 2023

Federal Update
Consolidated Appropriations Act, 2023, Division T
(SECURE 2.0 Act of 2022)
($000s)

	FY 2024	FY 2025	FY 2026	FY 2027
Deferral for Sales of Stock to an Employee Stock Ownership Plan (beginning TY28)*				
Individual Income Tax	$0	$0	$0	$0
Retirement Account Withdrawals for Emergency Expenses (beginning TY24)				
Individual Income Tax	$0	($1,300)	($1,300)	($1,300)
Simplified Employee Pension Plans (beginnning TY23)				
Individual Income Tax	($100)	($100)	($100)	($100)
Distributions from 529 Plans to Roth IRAs (beginning TY24)				
Individual Income Tax	$0	($1,200)	($1,200)	($1,300)
Qualified Charitable Distributions from IRA (beginning TY23)				
Individual Income Tax	($500)	($1,000)	($1,000)	($1,200)
Exclusion of First Responder Retirement Benefits (beginning TY27)*				
Individual Income Tax	$0	$0	$0	$0
Distributions from IRA for Federal Disasters (beginning 1/26/2021)				
Individual Income Tax	($900)	($500)	$0	$0
Limit Deduction for Charitable Conservation Easements (beginning 12/29/2022)				
Individual Income Tax	$4,200	$3,300	$2,800	$1,900
SECURE 2.0 Act: All Provisions				
Individual Income Tax	**$2,700**	**($800)**	**($800)**	**($2,000)**
Corporate Franchise Tax	**$0**	**$0**	**$0**	**$0**
General Fund Total	**$2,700**	**($800)**	**($800)**	**($2,000)**

*Fiscal impact occurs outside the forecast window.