



While You Were Out....

2000 Interim Fiscal Update

Money Matters: Number 00.06
December 2000

This publication provides members with brief summaries of emerged or emerging fiscal issues that may need to be addressed during the 2001 Legislative Session. It is not intended to be a comprehensive list, nor to suggest what may happen this session, but rather to provide information that has been available to fiscal staff over the interim. For more information on any particular issue, please contact the fiscal analyst assigned to the subject area.

Fiscal Analysis Department
Minnesota House of Representatives

While You Were Out....2000 Interim Fiscal Update

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General Budget Issues

November Forecast: State Revenues are Exceeding Forecast Amounts

The November 2000 forecast of general fund revenues and expenditures projects that the state will have a general fund balance in the current biennium (FY00-01) of \$924 million and another \$2.086 billion in the FY02-03 biennium.

The \$924 million projected general fund balance as of June 30, 2001 results primarily from increases in revenues. The following chart illustrates the sources of the \$924 million:

General Fund Changes - FY 00-01 <i>(in millions of dollars)</i>	
Revenue increase	\$ 865
Expenditure decrease	\$ 41
Dedicated reserve change	\$ 9
Total change	\$ 915
End of 2000 session balance	\$ 9
Projected 6/30/01 Balance	\$ 924

Current law requires the projected June 30, 2001 balance to be reserved for a tax rebate. However, it does not specify a mechanism for implementing that rebate. The projected June 30, 2001 balance is likely to change with the next forecast to be released at the end of February.

The November Forecast also projects a balance of \$2.086 billion in the FY02-03 biennium. Again, most of the change from the end of the 2000 session is in revenues as illustrated by the following chart:

General Fund Changes - FY02-03 <i>(in millions of dollars)</i>	
Revenue increase	\$ 1,625
Expenditure decrease	\$ 118
Total change	\$ 1,743
End of session balance*	\$ 343
Projected 6/30/03 Balance	\$ 2,086

* The end of session balance resulted from not committing an amount approximately equal to tobacco settlement (one-time) funds for FY02-03.

The expenditure estimates for FY02-03 include \$737 million that is not committed for specific programs under current law but is set aside to cover the effects of inflation on the delivery of services provided for

in the budget.

This is the first forecast to make projections for FY04-05. This forecast projects a balance as of June 30, 2005 of \$2.937 billion, essentially the difference between projected revenues and projected expenditures for that biennium. Again, the expenditure forecast includes an amount set aside to cover costs of inflation (\$2.025 million for the FY04-05 biennium.)

Another forecast will be issued at the end of February. The February forecast will determine the amounts that the 2001 Legislature will use to make budget decisions.

For more information on general fiscal issues, contact Bill Marx, Chief Fiscal Analyst, at 651-296-7176 or Bill.Marx@house.leg.state.mn.us.

Environment and Natural Resources

DNR Proposes to Buy Water Scooping Planes

Historically, the Department of Natural Resources (DNR) shared the cost with the U.S. Forest Service to lease water scooping planes (CL-215s) designed to fight forest fires. It was not until January of 1998 that the DNR acquired their own lease of two CL-215s from Bombardier, Inc. During the summer of 2000 Bombardier, Inc. gave the DNR the opportunity to purchase the two planes. Both the DNR and the Department of Finance have agreed that a lease/purchase would be more cost effective than a five-year lease.

	5 Year Lease/Purchase	5 Year Lease
Cost of Planes (interest included in purchase)	\$6,912,330	\$15,682,092
Maintenance Costs	\$6,630,000 (over 5 years)	Included in Lease
Operation Costs	\$2,700,000 (over 5 years) based on hourly usage	\$4,296,600 based on per drop
5 Year Total Cost	\$16,242,330	\$19,978,692

The purchase proposal put forth by the DNR in September includes Lease/Purchase of the planes with the firefighting open appropriation made available to them by MN Laws 1999, Chapter 231. The DNR has issued a Request for Proposal in October of 2000 and expects final purchase of the planes by January of 2001.

Conservation Reserve Enhancement Program to Lose Federal Matching Funds September of 2002

The Federal Conservation Reserve Program (CRP) encourages farmers to retire marginal cropland where it would be beneficial to water quality or wildlife habitats. It requires farmers to enter into a limited term

contractual agreement lasting 15 years. The Conservation Reserve Enhancement Program (CREP) was established to enhance the existing CRP program in the Minnesota River Watershed. The Minnesota Board of Water and Soil Resources (BWSR) uses state dollars to continue easements on CRP lands as permanent easements. BWSR has designed the program to take land near streams and wetlands in the watershed out of production. The CRP provides \$163 million of Federal funds, while the State is required to provide \$70.7 million in matching funds along with \$14.1 million in implementation funds (6% of total state and federal easement costs.) To date, the State has appropriated CREP \$27.7 million of easement acquisition funding and \$4.3 million in implementation funds. With the Federal funding available until September of 2002, the State needs to provide an additional \$43 million in easement funding and \$8.5 million in implementation funds to take full advantage of the Federal CRP funding.

For more information on environment, natural resources or agriculture issues, contact Peter Skwira at 651-296-4281 or Peter.Skwira@house.leg.state.mn.us.

Health and Human Services

Mixed Results for Minnesota's TANF Program

This fall, the U.S. Department of Health and Human Services reported Temporary Assistance for Needy Families (TANF) work participation rates for all states for Federal Fiscal Year (FFY) 1999 (October 1, 1998 - September 30, 1999). For the second consecutive year, Minnesota met its overall work participation rate, but failed to meet the two-parent family rate (see the table on next page). All states met the overall work participation rate, while 28 of the 36 states subject to the two-parent rate met the adjusted target rate for their state.¹

Federal Fiscal Year 1999 TANF Work Participation Rate				
	Target rate	Caseload reduction credit	Adjusted target rate	Rate achieved
Overall rate (MN)	35%	21%	14%	37%
Overall rate (US)	35%	N/A	N/A	38%
Two-parent rate (MN)	90%	21%	69%	44%
Two-parent rate (US)	90%	N/A	N/A	55%

Source: FFIS Issue Brief 00-28, National Conference of State Legislatures, August 22, 2000.

According to the Personal Responsibility and Work Opportunity Reconciliation Act, commonly known as the welfare reform act of 1996, states are required to meet minimum work participation rates for adult

¹ States that operate a separate state program for two-parent families, have no two-parent program, or no two-parent cases are exempt from the two-parent work participation rate.

recipients of TANF. For TANF purposes, work participation is defined to include paid employment as well as work activities such as job search, job counseling, education, and training, provided it is included in the TANF participants work plan. In FFY 1999, the overall work participation rate for the United States was 35 percent for the overall caseload and 90 percent for two-parent families. States can reduce the target participation rate for the fiscal year by the amount they have reduced their average monthly assistance caseloads compared to FFY 1995. States that do not meet the participation rates are subject to a financial penalty, but state's may take a corrective action or appeal the penalty for reasonable cause exceptions.

In FFY 1999, Minnesota's overall work participation rate was 37 percent (up from 31 percent in FFY 98) and 44 percent (up from 31 percent in FFY 98) for two-parent families. Minnesota's caseload reduction was 21 percent. The Minnesota Department of Human Services submitted a corrective action plan to the federal government, agreeing to meet a 42.5 percent work participation rate for two-parent families as of FFY 2001. At this time, it is not clear if the state will be subject to a financial penalty for failing to meet the two-parent work participation rate.

For more information on health and human services issues, contact Joe Flores at 651-296-5483 or Joe.Flores@house.leg.state.mn.us.

Higher Education

Internal Allocation Changes to Be Proposed by MnSCU

When legislators consider the higher education budget in the 2001 Legislative session, major changes to the way those funds are distributed to campuses will also be part of the discussion. After more than three years of preparation, the Minnesota State Colleges and Universities (MnSCU) are close to finalizing a proposal for a new method of distributing state appropriations to campuses. The new method is a cost-based model intended to provide equity between campuses on a per student basis and also incorporates a mechanism to account for higher funding levels of national peer institutions. Current simulations show that to full implementation of the model as it is proposed would require additional state funding of more than \$50 million annually. The proposal that is currently before the MnSCU board would anticipate stretching the implementation (and cost) over a four-year period.

While the current implementation proposal would not reduce funding for any campus, changes in the share of state allocations and concern about the future implications of the model are causing great concern with some campuses. In addition, MnSCU is scheduled to hire a new Chancellor in December causing some to question the timing of such a major change in policy. While the legislature does not need to specifically approve this proposal since the system governing board has the authority to implement the new model on its own, major changes in distribution of funds among campuses coupled with a request for a large budget increase are likely to make this a central topic in higher education budget discussions in the coming session.

For more information on higher education issues, contact Doug Berg at 651-296-5346 or Doug.Berg@house.leg.state.mn.us.

K-12 Education

Inflation Pressures on the General Education Formula Allowance

Basic Revenue and General Education Levy: The basic general education formula establishes the minimum level of funding for school districts. General education aid is determined by subtracting the amount raised by the general education levy from the formula allowance times pupil units. Both the basic formula allowance and the general education levy are set each year in legislation. As you can see, between the FY96-97 and FY00-01, the formula has increased by an amount equal to or greater than the rate of inflation. For FY01-03, there will be pressure to continue to increase the basic formula at least by the rate of annual inflation.

School Year	Formula Allowance	Percent Change
1996-97	3,505	
1997-98	3,581	2.2%
1998-99	3,530	2.2%
1999-2000	3,740	4.7%
2000-01	3,964	3.2%
2001-02	3,964	0.0%

Note: The percent change column is calculated on the “net” change in the formula, after removing “roll-ins” and “roll-outs” and other factors which change the formula, but do not change revenue.

Declining Enrollment Districts

During FY99-00, there were more than 250 districts facing declining enrollment. Statewide enrollment, however, was still increasing. After FY00-01, the overall statewide pupil headcount will begin to decline for the first time since FY84-85. This decline will increase attention on the unique needs of school districts with fixed costs and falling enrollment, accompanied by falling revenue.

Teacher Pay Examined

During the 1999 and 2000 interims, the House K-12 Education Finance Committee has reviewed a variety of issues regarding teacher supply and demand as well as teacher compensation. Several different models of compensation, as well as methods of encouraging people to enter the teaching profession and retaining those new teachers, were examined for potential inclusion in legislation. Following that review, both the Governor’s Department of Children, Families and Learning, as well as the Association of Metropolitan School Districts, have proposed incentive programs, whereby the state would offer school districts additional revenue, (\$100 per pupil in the Department proposal, \$200 per pupil in the Association proposal), to give school districts incentives to link teacher pay to student performance.

Governor Ventura Proposes Increasing the State Share of Education Funding

Throughout the past year the Ventura Administration has been engaged in a broad-based review of Minnesota's tax system. The Governor is expected to propose specific reforms to a variety of tax types as part of his FY02-03 budget proposal. In September, the Governor unveiled the first component of his plan to reform the property tax system by proposing full state funding of the state-determined general education levy. If adopted, the proposal would reduce local school taxes by about \$900 million annually but would likely require reductions in other state spending or increases in other tax collections to fund the proposal.

Minnesota raises about \$7.3 billion from state and local sources to fund K-12 education each year. Of that amount, 25 percent, or about \$1.8 billion, is paid for by the local property tax. Of that \$1.8 billion, roughly one-half is dictated in the state-set general education levy. The remainder of the \$1.8 billion reflects local levy decisions such as operating referendum and debt service levies. The Governor proposes to move the \$900 million in state-mandated costs from the local property tax and fund it from statewide sources while leaving locally-determined referendum, capital, and other smaller levies in place.

While no specific proposals have yet been made on how the proposed state takeover of the general education levy would be funded, the Administration has identified the following options as possible changes to Minnesota's current state and local finance system:

- imposition of a uniform state tax on business property to help fund education combined with some overall reduction in business property tax;
- reductions in state-funded local government aid programs combined with an expansion of the non-property tax revenue sources available to cities and modifications to existing general-purpose county aids to align those aids with specific areas of shared state and local responsibility like courts or child protection; and
- an expansion of the sales tax base to goods and services which are currently exempt from sales tax.

Although the Governor may seek reduction in the overall level of taxation as part of his FY02-03 budget proposal, he has maintained that the goal of any tax reform proposal will not be to reduce taxes but to make Minnesota's tax system simpler and more fair. For example, while approximately \$440 million of the \$900 million in lower general education taxes would accrue to businesses, a goal of the proposed statewide business property tax would be to offset some of that reduction with a new tax. Ultimately, the impact on individual taxpayers will depend on the specific reform proposals and on how those reforms are funded.

Pupil Counts Up Slightly, Overall Decline Continues

Since the end of the 2000 legislative session, pupil counts (the number of students in average daily membership, or ADM) have increased slightly for FY00-02. As shown in the table on the next page, beginning in FY01, each year's current ADM count is slightly higher than the end of session ADM count was (FY04 and FY05 are "n/a" because at the end of session, we were only estimating four years of data, FY00-03). In addition, during the 2000 legislative session, the projection was that statewide enrollment would decline overall beginning in FY 2000. The current estimate is that overall statewide ADM enrollment will decline beginning in FY 2001.

Change in Pupil Counts			
	End of Session	Current	Difference
FY 2000	847,893	847,758	(135)
FY 2001	847,131	847,970	839
FY 2002	846,198	847,170	972
FY 2003	844,968	846,119	1,151
FY 2004	n/a	844,340	n/a
FY 2005	n/a	842,383	n/a

Because this change in enrollment is so small, less than one percent of total enrollment, the impact will be relatively small. However, the continued projection of overall statewide declining enrollment will contribute to continued legislative concerns about the unique needs of individual districts with declining enrollment.

For more information on K-12 education issues, contact Greg Crowe at 651-296-7165 or Greg.Crowe@house.leg.state.mn.us. For information on the Governor's property tax proposal, contact Matt Massman at 651-296-7171 or Matt.Massman@house.leg.state.mn.us.

Jobs & Economic Development Issues

Workforce Development Task Force & Mini-Cabinet

Workforce Development is a key economic issue facing Minnesota both today and into the extended future. The issue is being driven by the fact that our state is simply running out of skilled employees to meet the needs of the state's employers. The potential for more significant worker shortfalls threatens the future ability of Minnesota's economy to continue to grow.

Responding to the need to revamp Minnesota's workforce development system to better serve the need of both workers and employers, Minnesota's Legislative leaders established a 12-member Legislative Workforce Development Task Force. The bipartisan Task Force includes six House members and six Senate members, and is co-chaired by Rep. Dan McElroy and Sen. Dave Johnson. The Task Force has held hearings throughout the interim to evaluate how Minnesota's current employment and training programs are performing, and hear suggestions from interested parties on how the state's workforce development system should be reformed. The Task Force will present its findings to the 2001 Legislature.

The Governor and his administration will also weigh in on reforming the state workforce development system. In 1999, the Governor convened an inter-agency Workforce Development Mini-Cabinet to examine the way state government supports workforce development. The Mini-Cabinet issued a report

in February 2000 which set out 36 recommendations for improving Minnesota's workforce development system. The Mini-Cabinet has continued to meet since the report was released to further refine their recommendations. The Governor is expected to include many Workforce Development Mini-Cabinet recommendations in his 2002-03 Biennial Budget.

Assigned Risk Plan Surplus

An additional \$73 million in Assigned Risk Plan surplus is available for the Governor and Legislature to consider in 2001. Two sources account for the additional \$73 million surplus:

1. The \$54 million growth in the Assigned Risk Plan surplus in calendar year 1999. This represents 74 percent of the total surplus growth.
2. The interaction between the Assigned Risk Plan reserve requirements and the 2000 Legislature's \$325 million appropriation to the Workers Compensation (WC) Special Fund. This appropriation allowed the WC assessment rate to be reduced from 30 percent to 20 percent. Because the Assigned Risk Plan pays this assessment, the reduction will save the Plan \$19 million in what otherwise would have to be held in reserve for the Plan's Workers Compensation Special Fund payable liability. The \$19 million became additional Plan surplus as of July 1, 2000.

It is important to note that these dollars are one-time funds and thus any actions regarding these funds need to be consistent with this fact.

For more information on jobs and economic development issues, contact Ron Soderberg at 651-296-4162 or Ron.Soderberg@house.leg.state.mn.us.

Judiciary Finance Issues

The Fiscal Impact of Federal 0.08 DWI Legislation on Minnesota

On October 23, 2000, President Clinton signed into law a national drunken-driving standard. This legislation was part of the federal transportation bill (HR 4475). The federal government is attempting to encourage states to adopt the per se standard for impaired driving of 0.08 percent, which is lower than the 0.10 percent currently allowed by Minnesota law.

The law includes sanctions on states that do not implement the 0.08 standard. Those sanctions, which are phased in beginning in 2004, provide that states will lose 2 percent of their federal highway funding, with the penalty increasing to 8 percent by FY07.

Minnesota is one of 30 states that defines a driver as legally impaired if that person has an alcohol concentration level of 0.10 or higher as measured by breath, blood or urine (Massachusetts and South Carolina do not set a specific blood-alcohol level for drunken driving but leave it up to the judgment of the arresting officer.) The other 18 states and the District of Columbia have already adopted the lower per se standard of 0.08 alcohol concentration.

Implications for Minnesota

If Minnesota does not adopt the 0.08 percent alcohol concentration standard, the state will face a graduated loss of federal highway dollars. The sanctions include a 2 percent loss in FY04, 4 percent in FY05, 6 percent in FY06, and 8 percent in FY07. If a state adopts the 0.08 standard by the end of FY07, it will be reimbursed for the funding it lost during the preceding years. The estimated fiscal penalties are as follows:

Estimated Penalty for Minnesota - Loss of Federal Dollars			
FY2004 2% Penalty	FY2005 4% Penalty	FY2006 6% Penalty	FY2007 8% Penalty
\$6,157,071	\$12,314,142	\$18,471,214	\$24,628,285

Source: *National Conference of State Legislatures*

For more information on judiciary finance issues, contact Gary Karger at 651-296-4181 or gary.karger@house.leg.state.mn.us

State Government Finance Issues

State Agencies Owe Employees Back Pay for Overtime

The State of Minnesota must pay back pay to approximately 8,000 employees for uncompensated overtime. This back pay is the result of a consent agreement between the federal Department of Labor (DOL) and the state's Department of Employee Relations (DOER). In response to employee complaints and previous audits of small groups of state jobs, DOL and DOER determined that professional jobs throughout the executive branch must be audited for compliance with the Federal Fair Labor Standards Act (FLSA). The FLSA generally requires employers to pay time-and-one-half pay for all hours worked over 40 in a seven-day week. However, some employees are "exempt" from FLSA provisions if they qualify as administrators, executives, or meet other specific professional salary and duty requirements. The consent agreement required DOER to review the duties and work schedules of approximately 15,000 "exempt" state employees to determine if they should be reclassified as "non-exempt" from FLSA requirements.

On November 15, 2000, the Legislative Coordinating Commission's Subcommittee on Employee Relations heard testimony on the issue from DOER Commissioner Julian Carter. Commissioner Carter reported that of the positions self-audited by the state, approximately 8,000 were ruled "non-exempt" from FLSA requirements and 7,000 "exempt." Employees (and former employees) who have held positions now ruled "non-exempt" are eligible for back pay for uncompensated overtime worked since January 1998.

Commissioner Carter also reported that the state's cost will probably be one-half of the original estimated cost of \$30 million to \$40 million, but the final impact will not be known until agencies have completed their internal calculations. The state is required to make all back pay payments by July 31, 2001.

However, any payments made after January 1, 2000 will be subject to interest at the current federal rate.

The executive branch is not expected to request a budget initiative to cover the costs, although some individual agencies may ask the 2001 Legislature for supplemental appropriations if they are unable to cover the costs within their existing budgets. Agencies with law enforcement jobs, including the PCA and Department of Corrections, may face the largest impact. Some smaller state agencies could also have significant obligations.

State Employee Medical Insurance Costs Increase 19 Percent

The state's cost for medical insurance for state employees will increase 19.3 percent for plan year 2001. This is the third year of projected double-digit increases in medical insurance costs. The estimated annual impact to agency budgets for the increased employer costs is \$45 million (over plan year 2000), bringing the state's total costs for health insurance to approximately \$307 million.

Some of the major factors contributing to these increases include the rising cost of medical services (driven in part by technological advances), a projected increase of 26 percent in the cost of prescription drugs, increased utilization of new treatment methodologies, and limited competition in some areas of Minnesota. These factors are also contributing to double-digit increases in medical insurance costs for private employers. The table below compares recent state plan increases to those of major Minnesota private sector employers.

Annual Premium Increases		
Year	Minnesota State Employee Plan	Minnesota Private Sector
1995	(5.1)%	(0.5)%
1996	(2.5)%	0.5%
1997	6.7%	4.0%
1998	9.7%	8.6%
1999	13.2%	10 - 12%
2000	23.3%	15 - 25%
2001	19.0%	N/A

Sources: Department of Employee Relations and Minnesota Chamber of Commerce

Department of Finance Plans for 3% Annual Increase to Agency Salary and Benefits Base

The FY 2002-03 budget instructions issued by the Department of Finance in June include instructions for a 3 percent annual increase in state agency salary and benefits base budgets. This increase is intended to cover potential wage and benefit increases, including increases in health insurance costs. If the increase remains in the Governor's budget, it will appear in the budget documents as an adjustment to agency base budgets. The table below shows the estimated new dollars needed to fund the proposed base adjustment.

Preliminary Estimated Costs for 3% Annual Salary and Benefits Increase						
<i>Dollars in Thousands</i>						
<i>Source: Biennial Budget System</i>						
Fund Name	FY 02	FY 03	FY 02-03	FY 04	FY 05	FY 04-05
General	30,438	62,136	92,574	62,136	62,136	124,272
Game & Fish	1,341	2,731	4,072	2,731	2,731	5,462
Trunk Highway	10,628	21,586	32,214	21,586	21,586	43,172
Other funds	3,353	6,821	10,174	6,800	6,800	13,600
Total ALL Funds:	45,760	93,274	139,034	93,253	93,253	186,506

Post-retirement and Active Employee Health Care Task Force

The 2000 Legislature required the Department of Employee Relations (DOER) to convene a task force to study strategies for providing post-retirement and active employee health care coverage for public employees. The task force, which is chaired by former representative Wayne Simoneau, includes representatives from pension plans, associations representing local units of government, public employee unions, and major public employers.

The task force report must address:

- alternative methods of providing and paying for post-retirement and active employee health care;
- the estimated cost of providing post-retirement and active employee health care under various alternatives, including statewide, regional, or market alternatives;
- the most efficient administrative structure for providing for post-retirement and active employee health care; and
- issues of adverse selection, cost containment, consumer choice, and options for dealing with other employee concerns.

The report was due to the legislature on November 15, but the task force members have requested additional time to study the issues, and now expect to complete the work in mid-December.

The task force has focused primarily on two areas: pooled health care purchasing, and prefunding post-retirement health care. Pooling was identified because of its perceived potential to provide greater risk sharing and potential administrative efficiencies. Prefunding of retiree health care was chosen because

of the large number of state public sector employees anticipated to retire in the next two decades, and because the health care costs of these future retirees are largely unfunded.

For more information on state government finance issues, contact Helen Roberts at 651-296-4117 or Helen.Roberts@house.leg.state.mn.us.

Tax Issues

Minnesota Joins National Effort to Simplify Sales Tax System

As authorized in the 2000 Tax Bill, Minnesota has joined 26 other states as an official “participant” in the Streamlined Sales Tax Project, a national effort to radically simplify state sales taxes. Participating states include all of Minnesota’s neighboring states. An additional 14 states are represented as “observer” states. The project is supported by the National Conference of State Legislatures, the National Governors Association, and the Federation of Tax Administrators.

The project’s goal is to radically simplify payment of sales and use taxes by multi-state companies. Companies with sales in many states now face high administrative costs. They must file separate returns in each state, and the definitions used to identify taxable purchases vary greatly. Administrative rules and payment dates and procedures also vary. Tax exemption certificates issued by one state are not recognized by other states, and the treatment of bad debts and rounding rules differ from state to state. Adopting uniform definitions and uniform administrative rules would greatly simplify tax filing while allowing tax rates and the tax base to vary by taxing jurisdiction.

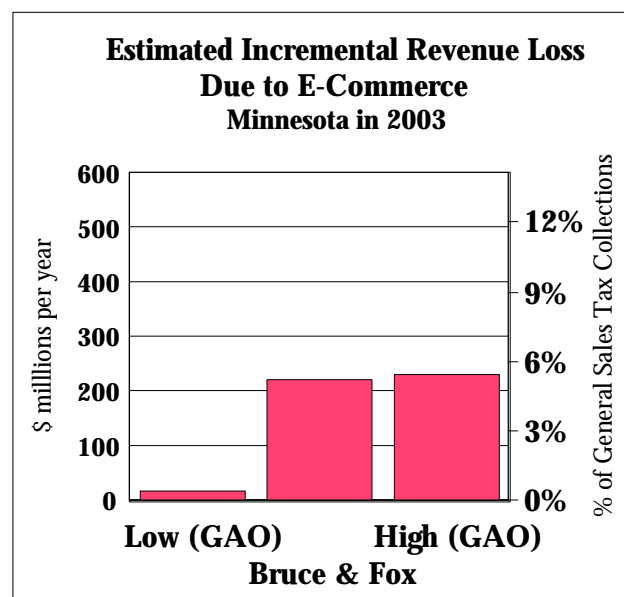
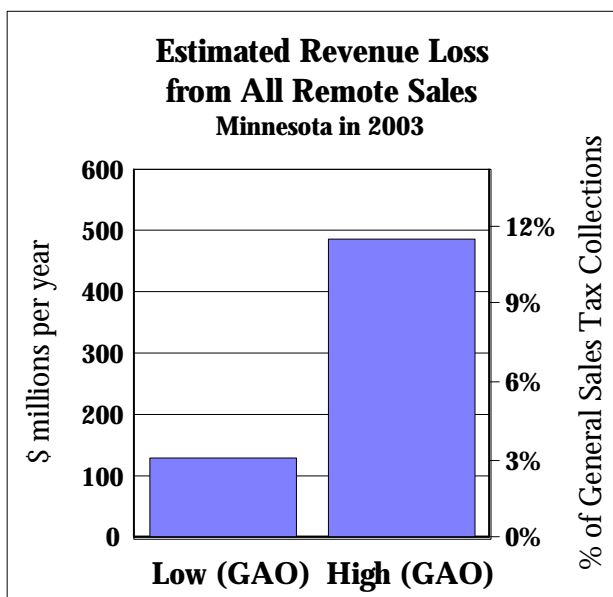
The Streamlined Sales Tax Project hopes to move toward a “zero burden” sales tax system. Companies would use either their own certified automatic payment technology or a certified service provider to send tax payments to every state that adopts the streamlined system, and the states would help pay the costs of developing and using that technology. A pilot project is currently underway in four states – Kansas, Michigan, Wisconsin, and North Carolina. Following a competitive bidding process, three private companies have been selected to develop prototype computer systems that allow automated tax payments while fully protecting consumer privacy.

The Streamlined Sales Tax Project is largely a response to the rapid growth of e-commerce, which is likely to substantially increase sales by out-of-state sellers who are not legally required to collect tax. *Quill v. North Dakota* (1992) concluded that out-of-state companies can only be required to collect sales tax if they have employees or property in the state (thus creating *nexus*). Given the complexity of the tax system now facing multi-state sellers, requiring other companies to collect sales tax would impose an “excessive burden on interstate commerce.” When taxes are not collected by the out-of-state seller, those buying such products (businesses or consumers) are legally required to pay “use tax.” However, few consumers pay use tax on purchases from out-of-state companies, and compliance rates for businesses are less than 100 percent.

If the Streamlined Sales Tax Project can significantly reduce the administrative costs for multi-state

companies, some out-of-state companies might agree to pay the tax voluntarily. Even if that does not occur, courts may be willing to require out-of-state companies to withhold taxes if administrative costs are minimal. Alternatively, Congress might be persuaded to enact legislation requiring such payments to any state that has adopted the streamlined sales tax system.

The potential revenue implications for Minnesota are uncertain, but two recent estimates for 2003 are summarized in the charts below. The first study, released by the U.S. General Accounting Office (GAO) in June 2000, provides a range of estimates. Minnesota's total revenue loss from all remote sales (e-commerce along with catalog, telephone, and home shopping network sales) is estimated at between \$129 million (3.0 percent of general sales tax revenues) and \$489 million (11.5 percent of general sales tax revenues).



Some e-commerce sales simply replace other remote sales, which would not be taxed anyway. E-commerce results in less tax revenue only to the extent that untaxed e-commerce sales replace taxable sales by the “bricks-and-mortar” sector. The incremental revenue loss due to e-commerce represents \$19 million of GAO’s \$129 million “low estimate” and \$232 million of their \$489 million “high estimate” for all remote sales in 2003. Thus, e-commerce is estimated to reduce Minnesota’s 2003 general sales tax revenue by between 0.4 percent and 5.5 percent. Another recent study by Donald Bruce and William Fox at the University of Tennessee estimates Minnesota’s incremental e-commerce impact in 2003 at \$220 million (5.2 percent of projected general sales tax revenues).

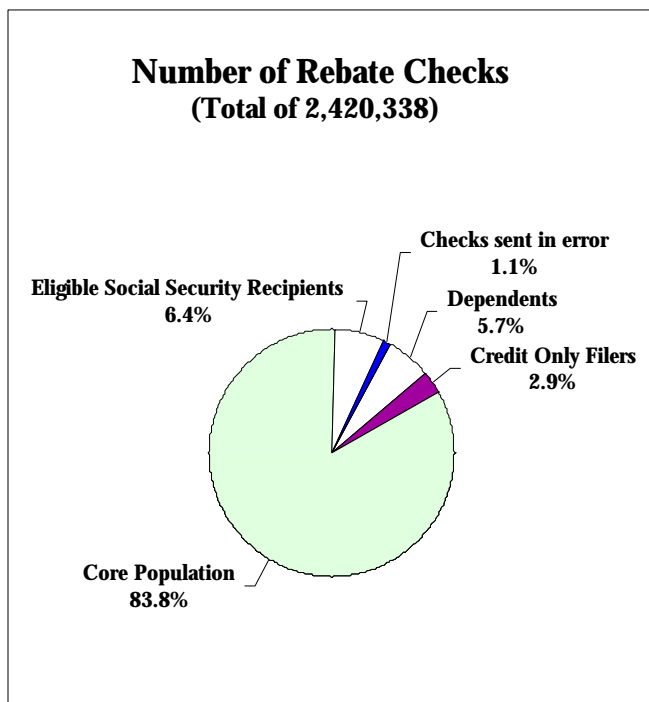
The project will propose model legislation for consideration during the 2001 legislative session. The Department of Revenue’s role in the national effort is described on their web page at www.taxes.state.mn.us/reform/stdygr/nga.html.

More Than 2.4 Million Sales Tax Rebate Checks Delivered

The Department of Revenue delivered more than 2.4 million sales tax rebate checks last summer, providing \$635 million in tax relief.

The “core population” -- those who either paid Minnesota income tax in 1998 or received the 1998 property tax rebate – received 85 percent of the rebate checks and 96 percent of the total rebate dollars. In addition to this “core population,” the 2000 rebate was extended to include three new groups of taxpayers – groups who had not received the 1999 rebate. These three new groups received 15 percent of the rebate checks and 4 percent of total rebate dollars.

- 156,000 social security recipients (age 18 and over) who did not otherwise qualify for the rebate each received a \$95 rebate.
- 138,000 dependents who paid Minnesota income tax in 1998 (and had some earned income) received rebates averaging about \$40.
- 29,000 income tax filers who did not otherwise qualify for a rebate but claimed one of three refundable income tax credits in 1998 received rebates of either \$95 rebate (single) or \$168 (married joint or head of household).



Computer programming errors at the Department of Revenue caused more than 27,000 checks (1.1 percent of the total) to be sent in error. Most of the errors involved the newly eligible group of social security recipients, who were identified from computer tapes provided by the Social Security Administration. Erroneous checks were received by three different groups of social security recipients:

- (1) 22,000 minors who received social security because a parent was deceased or disabled;
- (2) 200 people who were ineligible for the rebate because they died before January 1, 1998; and
- (3) 5,000 people who died in 1998. This latter group, though eligible for the rebate, received duplicate checks.

About 55 percent of the 27,000 erroneous checks to social security recipients had been cashed by early October. Another 25 percent had been returned (uncashed) to the Department of Revenue. In October, all who had not returned the checks were sent a letter apologizing for the mixup and telling them to return the check or, if already cashed, to repay the state with a \$95 check. Taxpayers who do not comply will be subject to revenue recapture in future years – with the \$95 subtracted from any future income tax refund. The Department of Revenue has described two other known sources of error. First, some dependent

taxpayers could not be identified as dependents from tax records available at the time of the rebate. Second, some nonresident taxpayers appeared to be part-year residents. A small but unknown number of these taxpayers received automatic rebates in error.

For more information on sales or income tax issues, contact Paul Wilson at 651-297-8405 or Paul.Wilson@house.leg.state.mn.us.

Motor Vehicle Tax Reduction Becomes Effective One Month Earlier Than Planned

Motor vehicle registration tax reductions adopted by the Legislature in May 2000 became effective one month earlier than intended due to an inconsistency between existing statutes and the effective date specified in the Omnibus Tax Act of 2000 (Chapter 490, Minnesota Laws of 2000). As a result, unanticipated refunds totaling \$11.725 million were sent to approximately 125,000 vehicles owners whose vehicle registrations expired June 30, 2000.

The change occurred as a result of the effective date specified for the tax cut. The language in the Omnibus Tax Act of 2000 defined the effective date “for taxes first due after June 30, 2000.” However, when combined with an existing statutory provision which specifies that annual registration taxes on passenger vehicles are not due until “the first day of the month commencing the 12-month registration period,” it became evident that the tax cut would first be effective for registrations expiring June 30 with renewals due on July 1. The statutory interpretation adds all June registrations into the tax reduction.

The refunds were paid out of the Highway Users Tax Distribution Fund (HUTDF), to which motor vehicle registration taxes are dedicated. The administration is expected to submit a proposal to replace the lost revenue to the HUTDF during the 2001 legislative session.

For more information on motor vehicle taxes, or property tax issues, contact Matt Massman at 651-296-7171 or Matt.Massman@house.leg.state.mn.us.

Transportation Issues

Higher Fuel Prices Affect Consumer Use; Gas Tax Collection

Transportation revenue growth has begun to show a slowing trend which may have been caused by higher fuel prices affecting driving behavior. According to the Minnesota Department of Transportation (MnDOT), motor fuels tax collections had been averaging close to 2 percent annual growth in revenues over the last several years. With the motor fuels or “gas tax” set at a fixed twenty cents per gallon of gasoline and diesel fuel, the growth is due to an increase in consumption throughout the state.

It has been debated in the past that increases in fuel prices would not show an impact on driving habits until gasoline prices increased significantly, some arguing as much as 50%-100%. Fuel prices have gone up significantly from the prior year from an average cost of around \$1.20 per gallon to about \$1.60 per gallon today, an increase of about 33%

MnDOT had estimated gasoline consumption to be 225 million gallons in the first four months of FY01. The actual gallons sold during this time period are 214.5 million gallons; this compared with 216.8 million gallons over the same period last year. That represents \$2.1 million of revenue shortfall below estimates, and nearly \$500,000 less in collections for the same period last year. Most of the decline has been on the diesel fuel side of the ledger.

Decreased revenues (to the Highway User Tax Distribution Fund) have already affected the budgets of agencies (Met Council Transit Operations and the State Patrol) that have fuel costs as a significant part of the budget. It may also affect agencies like the Department of Transportation and the Department of Natural Resources that use motor fuel tax revenue to deliver programs such as state road construction, or construction and maintenance of waterway accesses and snowmobile trails.

Declines in revenues have been minor to this point, and represent a very small fraction of overall transportation revenues. However, if consumption continues to drop further, it could have a detrimental impact on the delivery of transportation programs.

For more information on transportation finance issues, contact John Walz at 651-296-8236 or John.Walz@house.leg.state.mn.us.