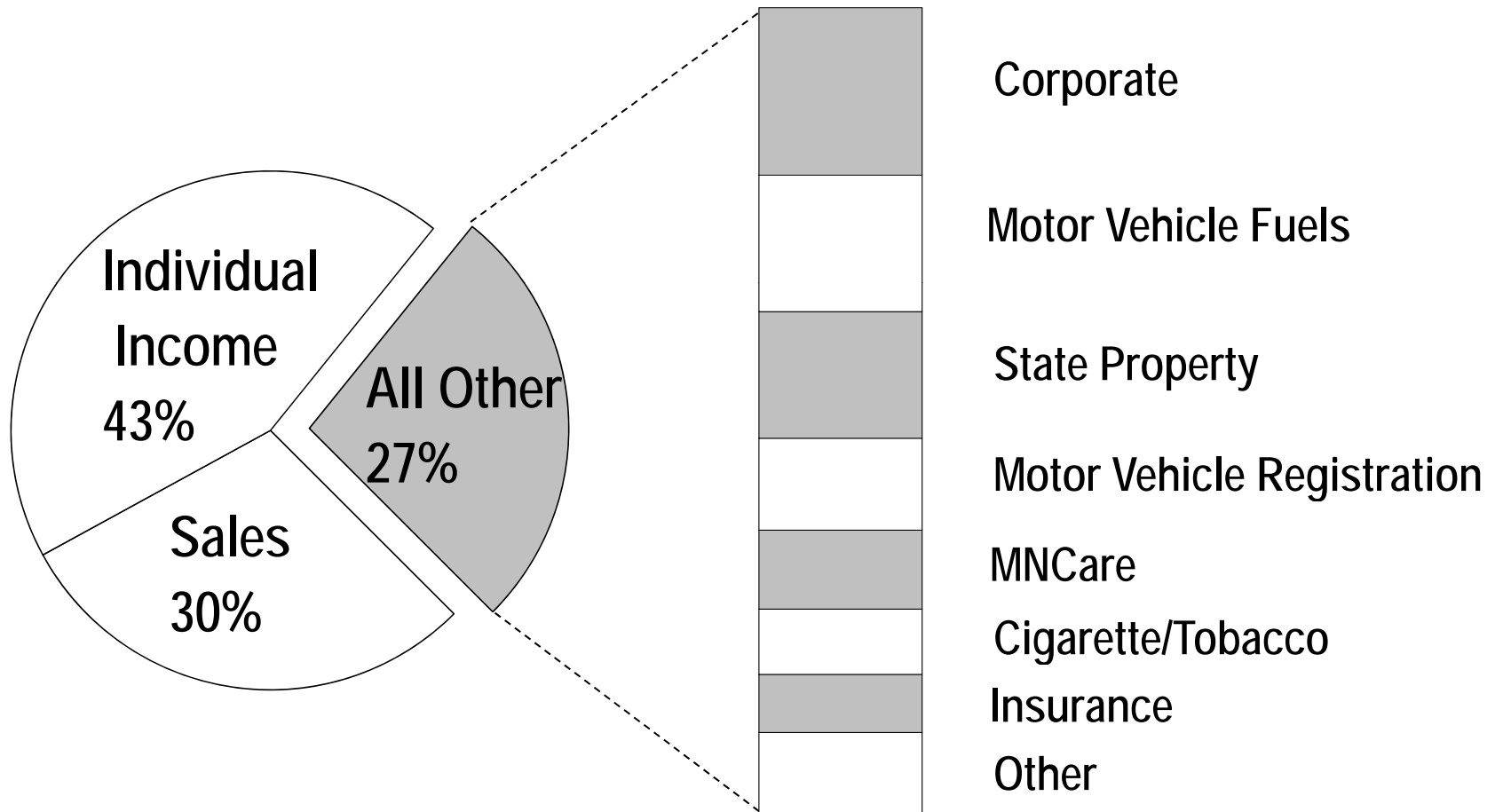


Background Briefing on Minnesota Taxes

Presentation to House Taxes Committee
January 15, 2013

State Tax Revenues



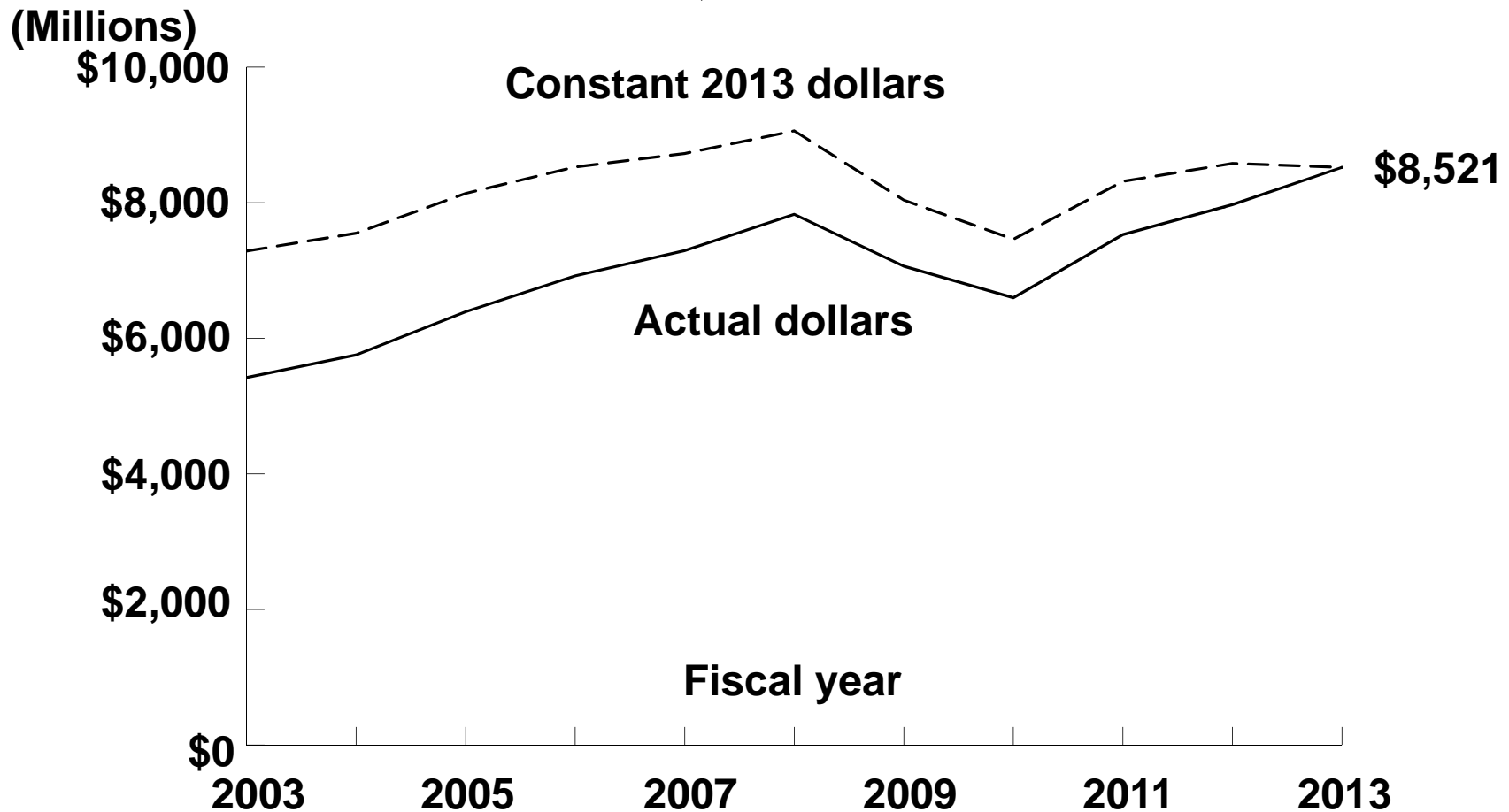
Individual Income Tax

- Collected through withholding, estimated payments, and final payments
- Returns for the tax year filed following the close of the tax year
 - Tax year 2012 returns and final payments due by April 15, 2013

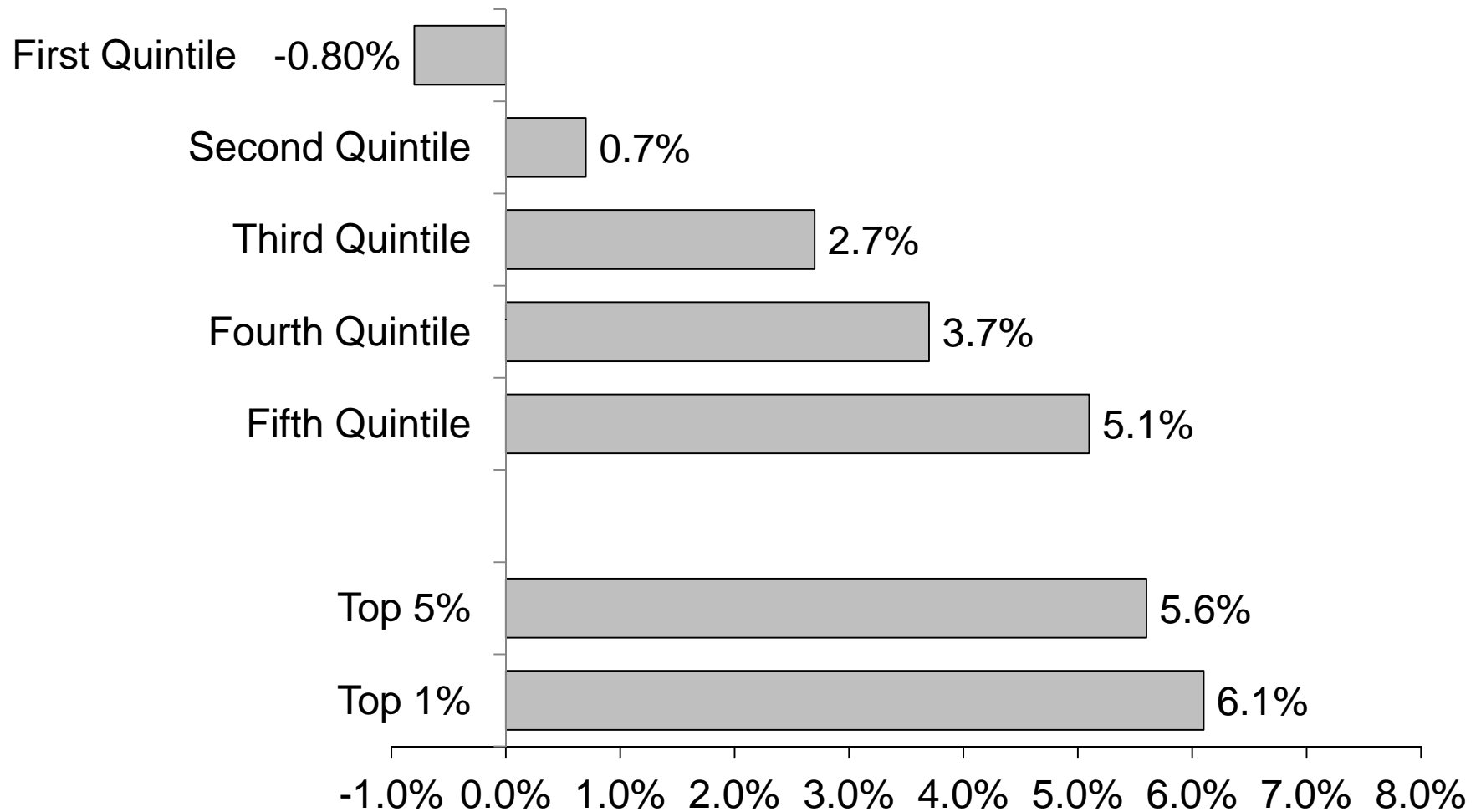
Income Tax Revenue

- \$8.5 billion projected for FY 2013
 - reciprocity with Wisconsin NOT in effect
- Roughly 43% of state tax revenue
- All goes to general fund

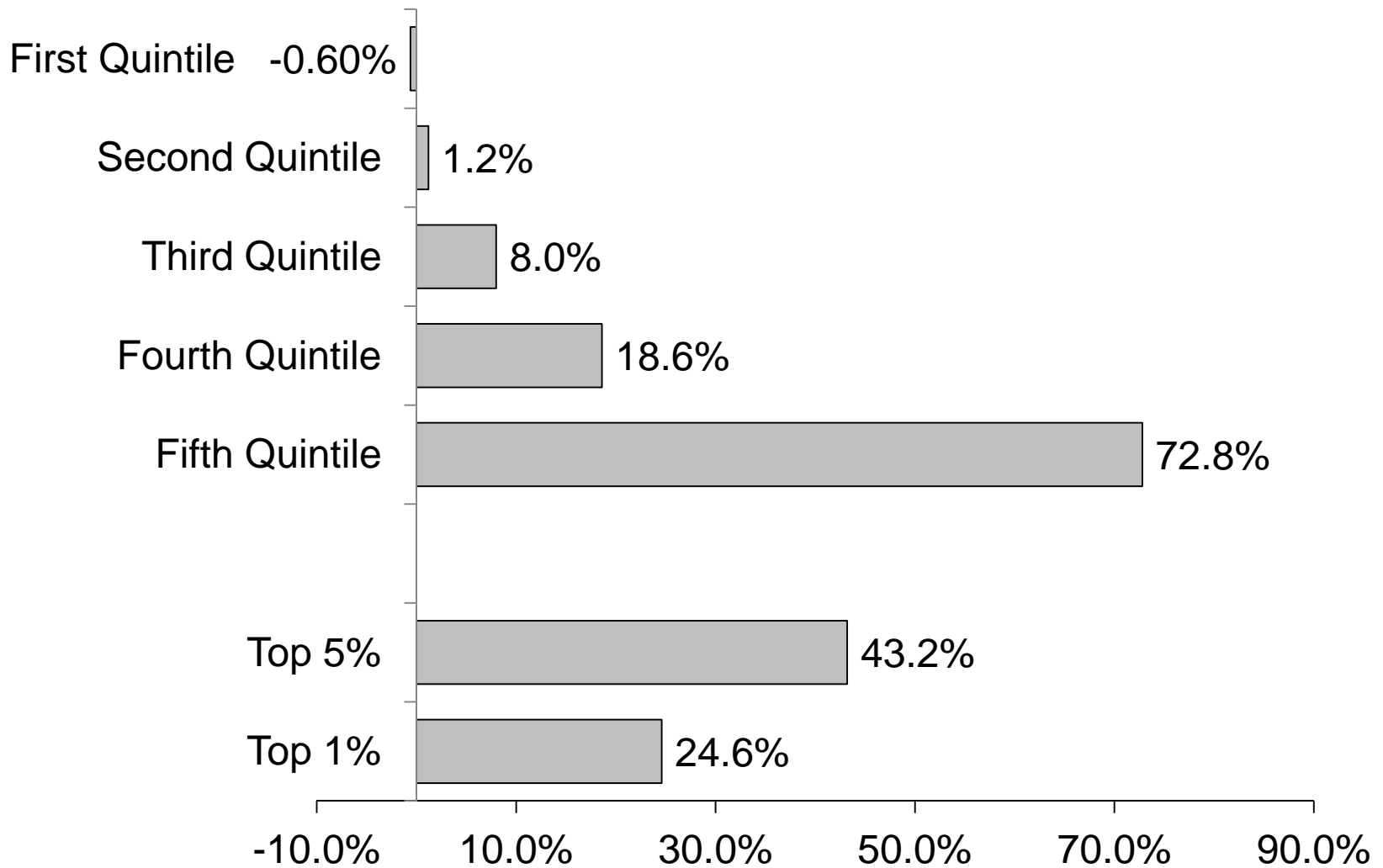
Individual Income Tax Revenues, FY 2003-2013



Effective Income Tax Rates



Percent of Tax Paid



MN Individual Income Tax

- Relies on federal income tax to make it easy for
 - taxpayers to comply with
 - state to administer
- Incorporates federal law by reference
- Federal compliance and enforcement efforts flow through to state

MN Individual Income Tax

- Starts with FTI – income after federal deductions and exemptions
- MN then requires additions to FTI, and allows deductions from FTI
- Tax rates apply to MTI
- Credits allowed against state tax liability

Deductions vs. Credits

- A *deduction* is a subtraction from taxable income
 - reduces the amount of income subject to tax
- A *credit* is a subtraction from tax
 - reduces the amount of tax

MN Additions TY 2013

- Interest on other states' bonds
- Fines, fees and penalties
- Recognition of net operating losses

MN Additions TY 2013

- Additional standard deduction for married filers??
- Higher education tuition ??
- Educator classroom expenses ??

MN Additions TY 2013

- Phaseout of exemptions ??
- Limitation of deductions ??
- Bonus depreciation ??
- Section 179 expensing??

MN Deductions TY 2013

- Required by federal law
 - U.S. bond interest
 - Railroad retirement benefits
 - On-reservation earnings (members of Indian tribes)

MN Deductions TY 2013

- Required by deviating from FTI
 - Section 179, bonus depreciation and net operating losses

MN Deductions TY 2013

- K-12 education expenses
- Charitable contributions (nonitemizers)
- Elderly subtraction
- Active service military pay
- JOBZ
- Organ donation expenses
- Other

K-12 Education Deduction

- No income limit for eligibility
- Maximum deduction equals
 - \$2,500 for students grades 7-12
 - \$1,625 for students grades K-6
- Same eligible expenses as credit PLUS nonpublic school tuition

MN Rates and Brackets

Married joint filers, tax year 2013

Income bracket	Tax Rate
\$0 to \$35,480	5.35%
\$35,481 to \$140,960	7.05%
Over \$140,960	7.85%

MN Credits

Nonrefundable credits offset liability, but not to less than zero

Refundable credits offset liability, with any excess paid as a refund

Nonrefundable Credits

- Taxes paid to other states
- Marriage credit
- Long-term care insurance
- Past military service

Credit for Taxes Paid to Other States

- Resident taxpayers calculate tax on all their income, including amounts earned in other states
- Taxpayers may claim a credit against Minnesota tax equal to the tax paid to other states
- \$156.2 million in TY 2010

Marriage Penalty Credit

- Credit based on
 - earnings of each spouse
 - combined taxable income
- Offsets marriage penalty in MN's rate and bracket structure
- Maximum credit of \$361 in TY 2012
- \$64.5 million in FY 2013

Long-term Care Credit

- 25% of premiums not claimed as federal deduction
- Maximum credit of \$100 per beneficiary (\$200 for married joint filers)
- About 60,000 claims in tax year 2010
- \$8.4 million in FY 2013

Credit for Past Military Service

- Available to retirees with 20 years of service, or disabled
- Maximum credit of \$750
- Phased out for incomes over \$30,000
- 1,616 claimants in tax year 2010
- \$1.0 million in FY 2013

Refundable Credits

- Working family credit
- K-12 education credit
- Dependent care credit
- Military service (combat zone)

Refundable Credits

- JOBZ credit
- Angel investment credit
- Historic structure credit
- Research credit

Working Family Credit

- Equals a percentage of earned income; maximum credit \$1,879 in TY 2013
- Phases out as income increases; maximum income in TY 2013 is \$42,963
- About 344,000 claimants in 2011, average credit of \$606
- \$200.1 million in FY 2013

K-12 Education Credit

- Offsets 75% of eligible K-12 expenses
- Maximum credit equals \$1,000 per child
- Subject to income-based phaseout starting at \$33,500; maximum income depends on number of children
- About 57,000 claimants in 2010, average credit of \$270
- \$14.4 million in FY 2013

Dependent Care Credit

- Tied to federal credit, based on child care expenses
- Maximum credit of \$1,440
- Phases out as income increases; maximum income in TY 2013 is \$38,570
- About 36,500 claimants in 2011, average credit of \$400
- \$14.6 million in FY 2013

Military Service Credit

- \$120 for each month served in a combat zone
- Surviving spouse/dependent child may claim credit for individuals killed in a combat zone
- About 2,500 claimants per year, average credit of \$760
- \$1.9 million in FY 2013

JOBZ Credit

- Refundable credit for businesses that increase employment in JOBZ
- 7% rate applies to wages paid to an employee over \$36,510, but not over \$121,710 (TY2012 amounts; these are indexed for inflation)
- Credit calculation prevents payment if other MN employment reduced

Angel Investment Credit

- 25% of investment in small businesses; maximum credit of \$125,000
- Businesses must be located in MN and be certified by DEED as engaged in one of several fields involving technology
- \$12 million in FY 2013
- Sunsets after TY 2014

Historic Structure Rehabilitation Credit/Grant

- Matches federal credit; offsets costs of rehabbing a certified historic structure
- Credit claimed after rehabilitated property placed in service
- \$28.8 million in FY 2013 in credits and grants (only claimed by corporate filers to date)
- Sunsets after FY 2015

Research Credit

- Allows owners of S corporations, partnerships, and LLCs a credit for increasing R&D expenditures
- Based on similar federal credit
- 10% of 1st \$2 million; 2.5% of excess
- New (under individual tax) for TY2010
- \$8.0 million in FY2013 (individual only)

Bovine TB Testing Credit

- 50 percent of testing costs for noncorporate cattle owners; 25 percent for corporate owners
- Only allowed when testing is required by federal government
- Minnesota declared TB free in 2011
- Credit would come back into effect if TB returns to MN

Tax Policy Principles

- Adequacy
- Administration/Compliance
- Efficiency
- Equity
 - Vertical
 - Horizontal

Tax Policy Principles

- No tax is perfect
 - A tax may be very efficient, but not very fair
 - A tax may be very fair, but very difficult to administer
- Policymakers must weigh strengths and weaknesses of tax mix

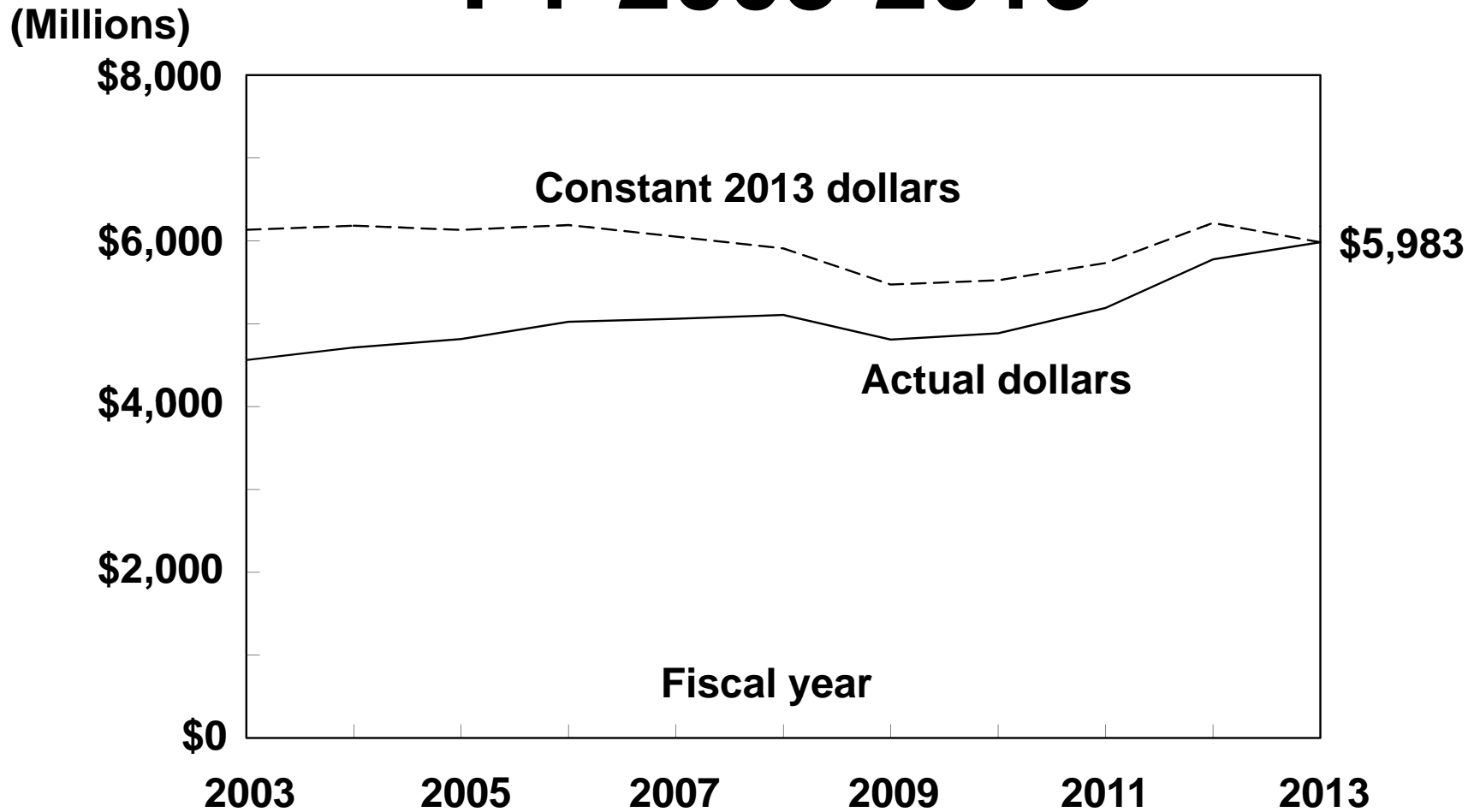
Income Tax Reform Options

- Expand base; reduce rate
 - Eliminate state subtractions
 - Conform more closely to feds
- Consolidate low income credits
- Replace targeted credits with direct appropriations

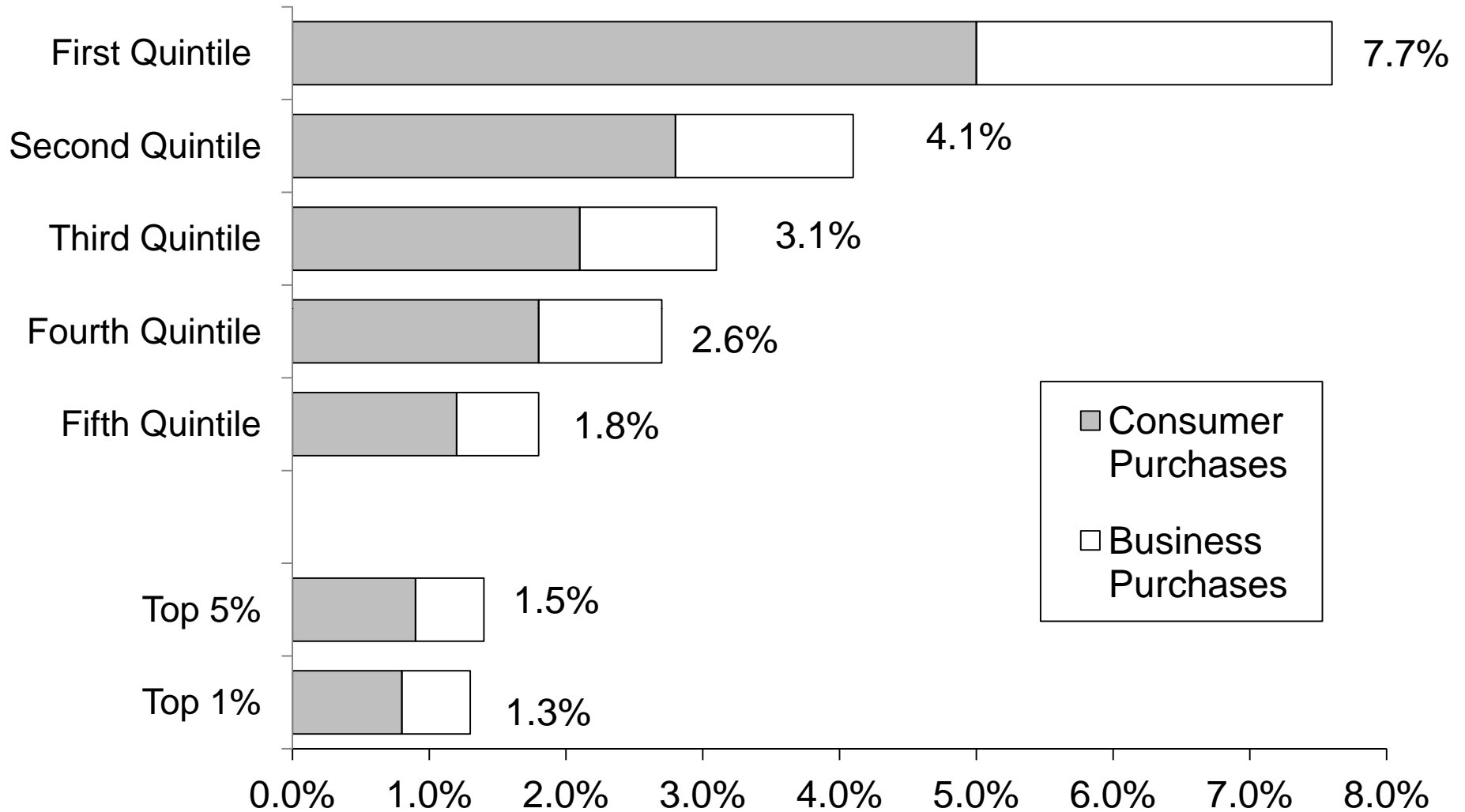
Sales Tax Revenue

- \$6.0 billion projected for FY 2013
 - \$565 million is motor vehicle sales tax
- Slightly less than 1/3 of state tax revenue
- Business pays about 44% of the tax

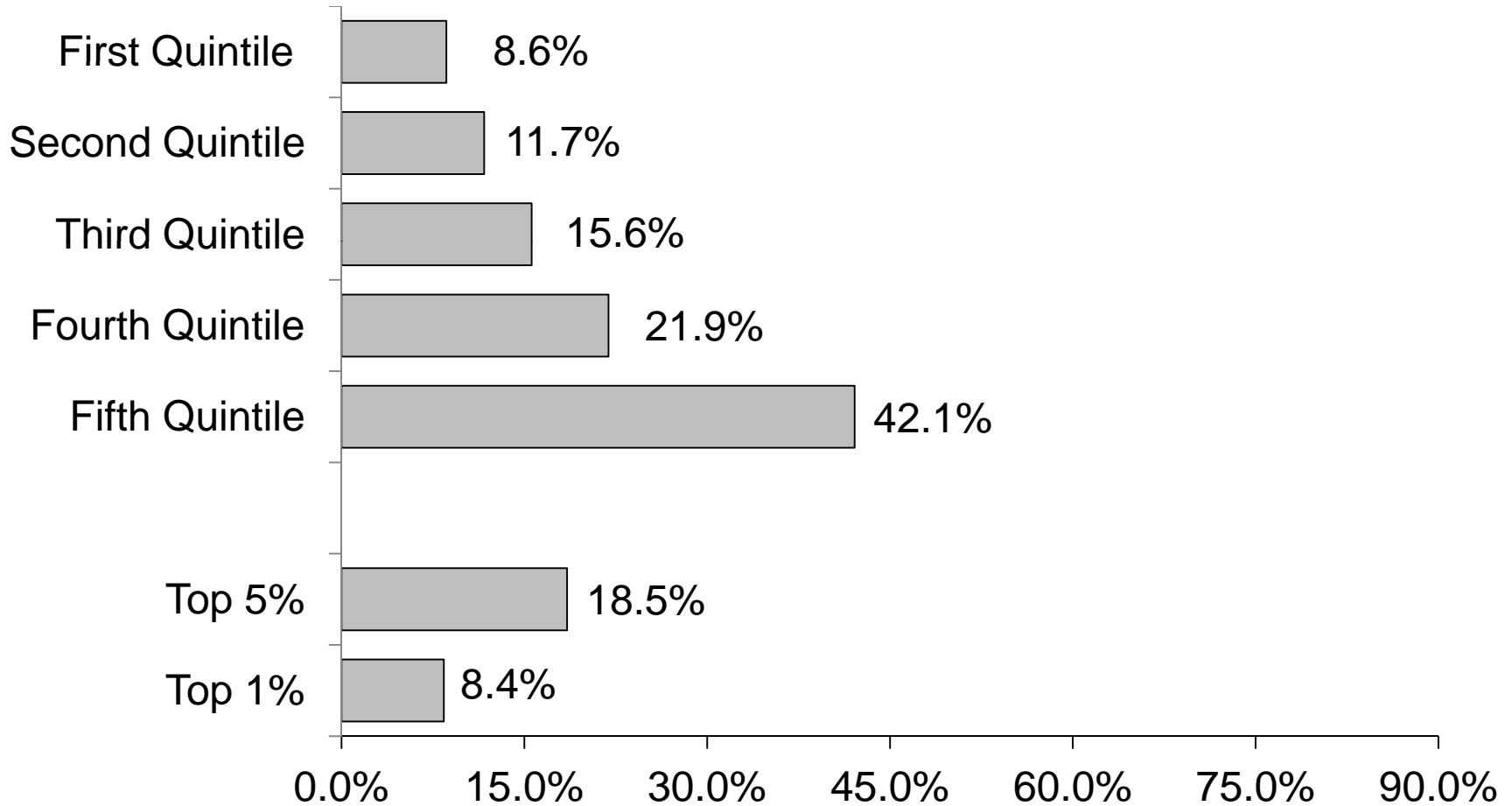
Sales Tax Revenues, FY 2003-2013



Effective Sales Tax Rates



Percent of Tax Paid (Business & Consumer Purchases)



Distribution of Sales Tax Revenues

- Most of the revenues goes to the general fund except the following:
 - motor vehicle sales tax
 - tax on motor vehicle leases
 - Lottery in-lieu payments
 - Revenue from the Legacy amendment rate (0.375%)

The Legacy Amendment

- Rate of 0.375% added to 6.5% rate
- Effective July 1, 2009, for 20 years
- Constitutionally dedicated
- Revenue in FY 2013 - \$275 million
 - 33% to the outdoor heritage fund
 - 33% to the clean water fund
 - 14.25% to the parks and trails fund
 - 19.75% to the arts & cultural heritage fund

Sales Tax Rates

- General rate 6.875%
- Special rates
 - Short term rental motor vehicles: 13.075%
 - Manufactured housing and park trailers:
6.875% on 65% of the cost
 - Motor vehicle sales tax: 6.5%

Sales Tax Base

- Goods (personal property) are usually taxable unless specifically exempted
- Services and other intangibles (e.g., digital downloads) are usually not taxable unless specifically included

Major Exemptions for Individuals

- Food for home consumption
- Clothing
- Home heating fuels
- Motor fuels subject to gas tax
- All drugs for human consumption
- Newspaper and subscription magazines
- Cigarettes (subject to in-lieu tax instead)

Major Business and Farm Sales Tax Exemptions

- Capital equipment
- Farm machinery
- Certain direct inputs to agricultural and industrial production
- Certain direct inputs for some taxable services

Other Major Sales Tax Exemptions

- Sales to schools, the federal government, public libraries, and hospitals
- Selected other sales to local governments
- Sales to nonprofit charitable organizations
- Certain sales by nonprofit charitable organizations

Sales Tax and Remote Sales

- The state cannot constitutionally impose a duty to collect sales tax on remote sellers that do not have a physical presence in the state (nexus)
- Congress can impose a duty to collect on remote sellers but has not done so
- State revenue losses from retail remote sales is estimated to be \$204 million in 2011

Streamlined Sales and Use Tax Agreement (SSUTA)

- An agreement to simplify and standardize tax administration and collection between states
- Minnesota is one of 20 full members of SSUTA which also has 2 associate members
- Since joining SSUTA, Minnesota collected \$149.3 million voluntarily (first 7 years)
- In September Minnesota was found “out of compliance” with SSUTA – sanctions have not been determined

Sales Tax Reform Options

- Expand base to more consumer expenditures and do one or more of the following:
 - Reduce rate
 - Exempt more business inputs
 - Provide a new credit for low income people
- Issues related to base expansion
 - Nexus issues
 - Administrative difficulties

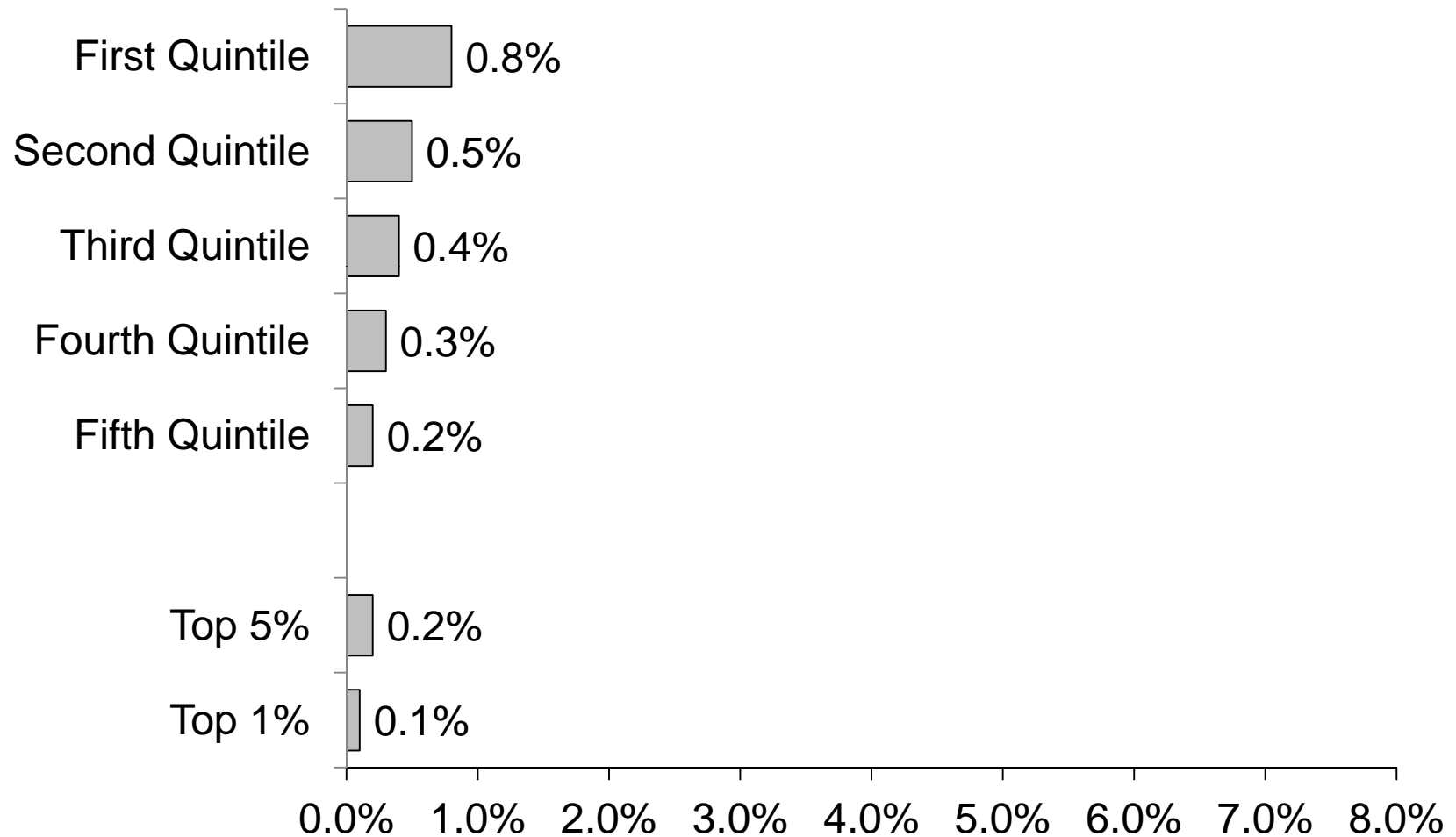
Local Sales Taxes

- 25 cities in the state currently impose a general local sales tax of 0.5%
- Duluth and Cook County impose a tax of 1%
- Hennepin County imposes a tax of 0.15% for the Twins ballpark
- All these local taxes are required to expire except for Duluth tax

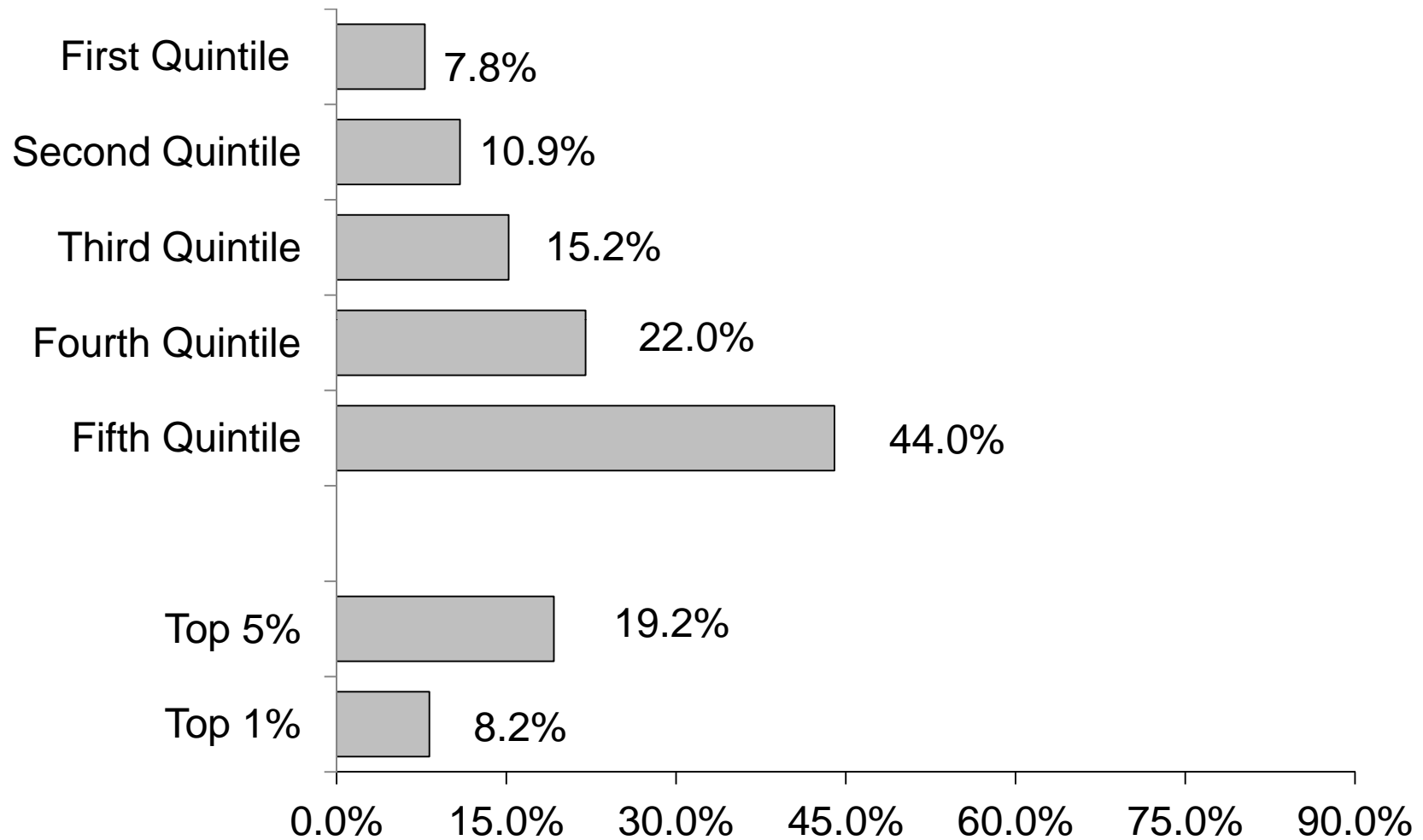
Local Sales Taxes, cont.

- Anoka, Dakota, Hennepin, Ramsey and Washington Co. tax at 0.25% for transit
- The two remaining metro area counties may impose the transit tax in the future
- All other counties may impose a 0.5% tax for transportation purposes with voter approval
- The metro transit taxes do not expire

Effective Corporate Tax Rates



Percent of Tax Paid



Corporate Franchise Tax

- Tax base is (largely) the profits of “C” corporations
- Multi-state corporations use weighted 3 factor apportionment of sales, payroll and property (96-2-2 for TY13); this favors corporations with more operations in Minnesota
- Tax rate of 9.8%

Corporate Franchise Tax

- Credits allowed for
 - Research & development
 - Taxes paid to other states
 - JOBZ
 - Historic structure rehabilitation
- Minimum fee applies to all businesses, including S corporations and partnerships

Corporate Franchise Tax

- \$1.1 billion in FY 2013
- Most volatile revenue source of the major taxes –
 - \$529 million in FY 2002
 - \$1,171 million in FY 2007
 - \$663 million in FY 2010
- Single sales apportionment phasing in by 2014 (next slide)

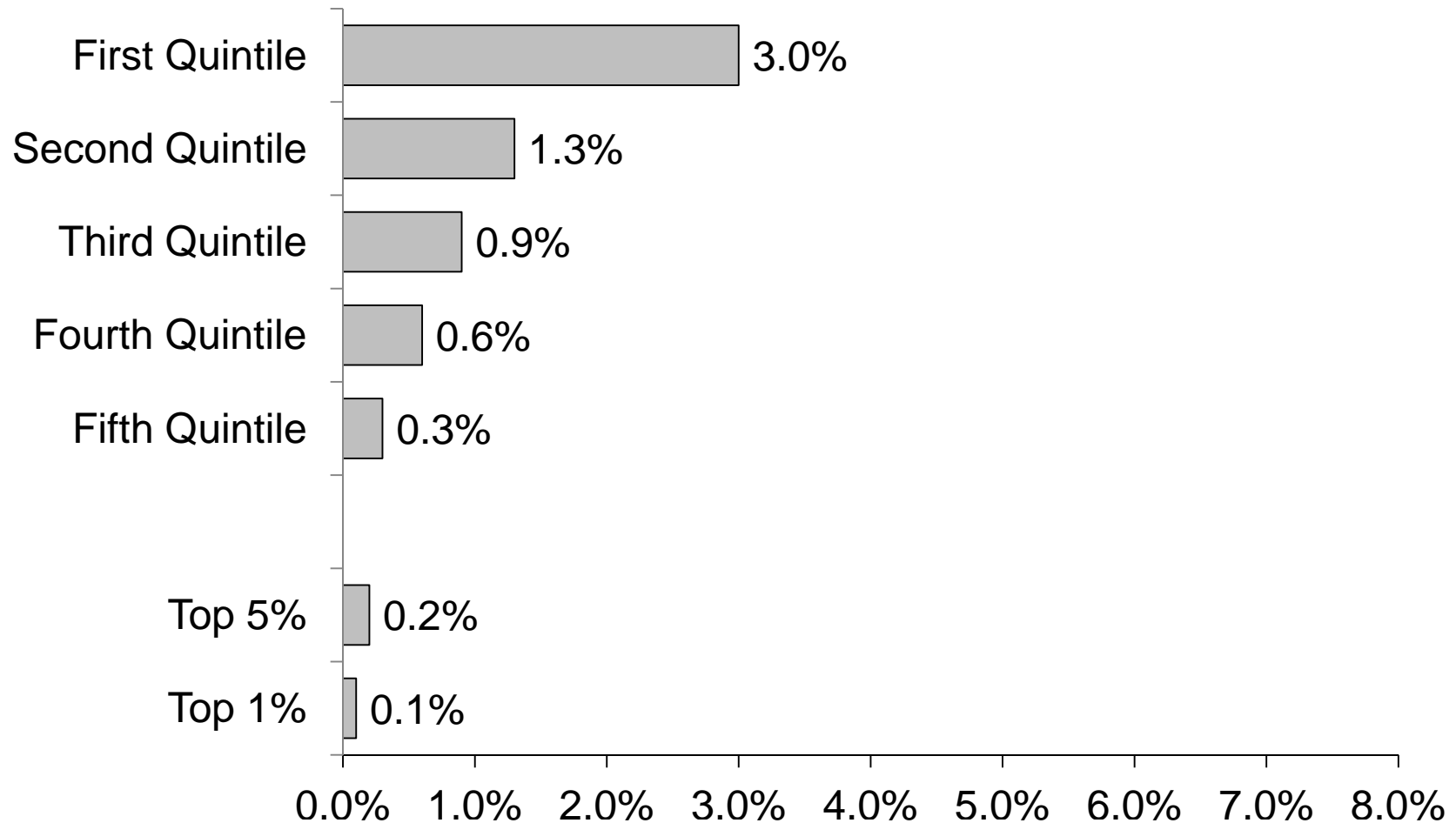
Corporate Franchise Tax Phase-in of Sales Apportionment

Tax year	Sales	Property	Payroll
2009	84%	8%	8%
2010	87%	6.5%	6.5%
2011	90%	5%	5%
2012	93%	3.5%	3.5%
2013	96%	2%	2%
2014	100%	0	0

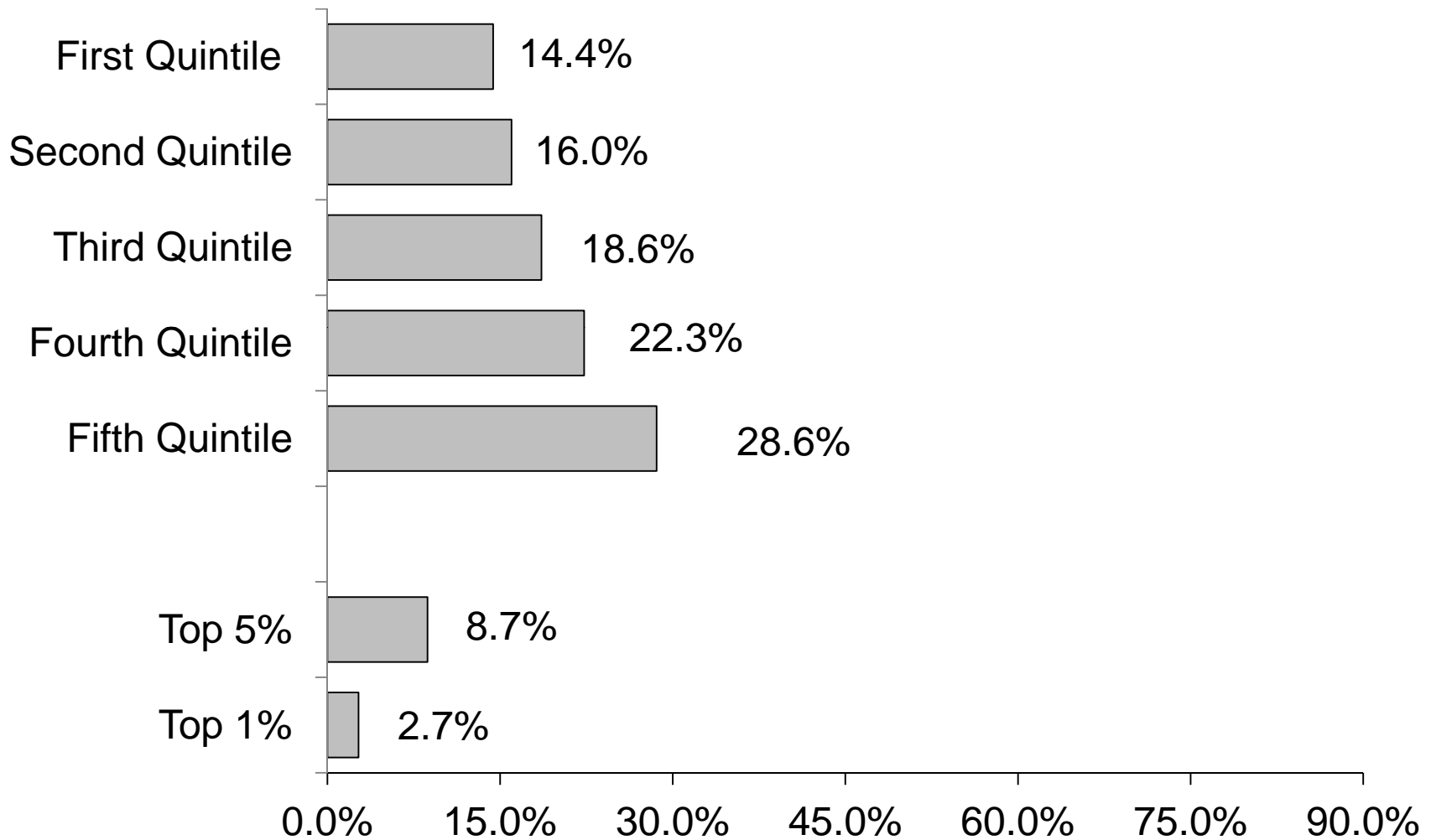
Reform Options: Corporate Tax

- Broaden base to reduce rate:
 - Eliminate some or all preferences for foreign income and/or adopt worldwide unitary apportionment
 - Repeal credits (R&D, other states taxes, JOBZ, etc)
 - Scale back or eliminate single sales apportionment – inconsistent with theory of tax
 - Throwback sales
- Impose substantial alternative minimum tax based on activity to stabilize revenue
- Repeal tax and offset revenues by increasing other taxes – tax is difficult to justify theoretically

Effective Excise Tax Rates (fuels, cigarette, liquor & HIF)



Percent of Tax Paid



Motor Vehicle Fuels Tax

- Tax base is motor fuels used by vehicles on public highways
- Basic tax rate is 25 cents per gallon
- Additional debt service surcharge of 3.5 cents applies (rate effective FY2013; lower rates applied in earlier years)

Motor Vehicle Fuels Tax

- Revenues are constitutionally dedicated to highway user trust fund.
- Local governments receive a share of the revenues from the fund under county and municipal state aid street funds
- \$880 million in FY 2013

Cigarette and Tobacco Tax

- Tax on cigarettes is a per unit tax, while the tobacco products tax is a percent of the price
- Tax rate is 48 cents per pack of 20 for cigarettes; 35% of wholesale price for tobacco products
- Additional health impact fee applies at rates of 75 cents per pack and 35% of wholesale price for tobacco products

Cigarette and Tobacco Tax

- \$421 million in FY 2013 (including fees)
- About \$31 million of the revenues dedicated to health research
- 35 cent/pack fee applies to nonsettlement cigarettes (about \$2.7 million of the revenue)

Alcoholic Beverage Excise Taxes

- Taxes are per unit of the beverage
- Tax rates vary by beverage type
 - \$5.03/gallon for distilled spirits;
 - \$.30/gallon for table wine;
 - \$.15/gallon for strong beer; and
 - \$.08/gallon for 3.2 beer

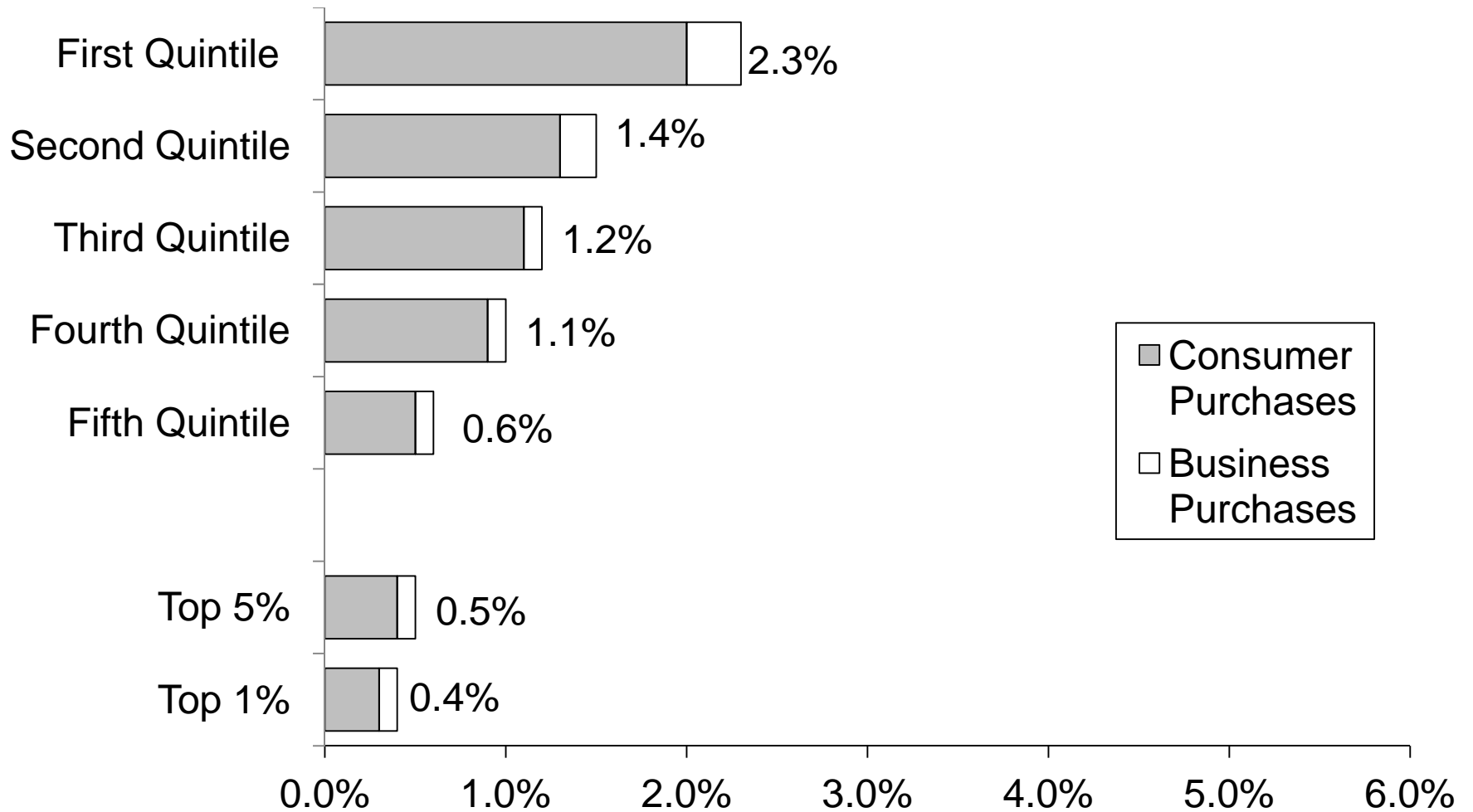
Alcoholic Beverage Excise Taxes

- The tax is generally unrelated to alcoholic content or price, although higher rates apply to wines with higher alcoholic content
- \$79 million in FY 2013

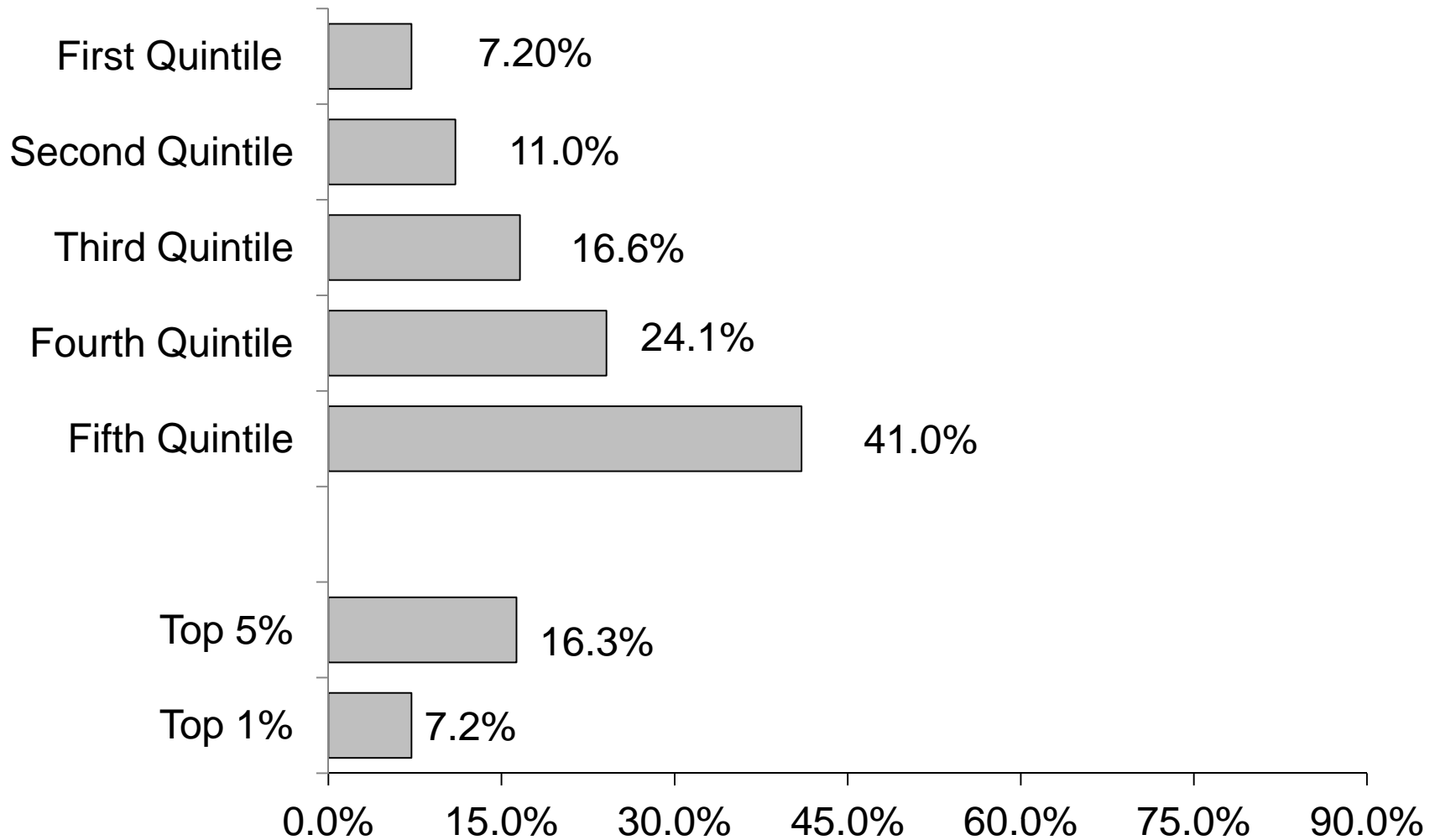
Alcoholic Beverage Gross Receipts Tax

- Functions like a retail sales tax on both on-sale and off-sale purchases of liquor, wine, and beer (including 3.2 beer)
- Replaced high general sales tax rate on these purchases to comply with SSUTA
- \$67.6 million in FY 2010 (receipts also reflected in MMB's sales tax revenues)

Effective Other State Tax Rates



Percent of Tax Paid



Motor Vehicle License

- Tax base is base value of passenger vehicles
- Tax rate is 1.25% of base value
- Tax reduces as vehicle ages under statutory depreciation schedule
- \$35 minimum applies when vehicle is 11 years old

Motor Vehicle License

- Revenues are dedicated to highway user trust fund
- \$545 million in FY 2011

MinnesotaCare Taxes

- Tax base is gross revenues of health care providers
- Tax rate is 2%
- Medicare and federal employees health programs are exempt
- Revenues are used to fund the MinnesotaCare program
- Tax sunsets 1/1/2020
- \$509 million in FY 2013

Insurance Premium Tax

- Tax base is gross premiums
- Basic tax rate is 2%. Lower rates apply to some mutual companies.
- Does not apply to fraternal benefit societies
- 1.5% rate applies to life insurance
- 1% rate applies to HMOs and nonprofit health service plan corporations

Insurance Premium Tax

- Retaliatory tax applies
- Federal law allows discrimination against interstate commerce
- \$377 million in FY 2013
- Portions of the tax are dedicated –
MinnesotaCare; police and fire
pension aid

Estate Tax

Tax is based on federal law rules

- Pick-up tax from 1986-2001 – reduced federal tax dollar-for-dollar
- Tax is now “stand-alone” tax
- Deductible in computing federal estate tax

Estate Tax

- Tax is based on market value of estate, less
 - Transfers to surviving spouse
 - Charitable bequests
 - Exemption amount of \$1 million
 - Exemptions for qualified small business and farm properties
- Tax rates range from 6.4% to 16%

Estate Tax

- \$140 million in FY 2013
- Very volatile tax (\$216 million in FY 2006; \$54 million in FY 2001)
- 30 states (including ND, SD, WI) have no taxes for decedents dying in 2012
- Effect on domicile decisions?
- Progressive: Suits index of 0.25

Mortgage Registry Tax

- Tax imposed on principal debt secured by mortgage of real property in state
- Rate is 0.23 percent of principal debt
- Collected by lender, paid to county treasurer where property is located
- Distribution: State 97%; County 3%
- FY 2013 revenue: \$124.8 million

Deed Transfer Tax

- Tax imposed when real estate is transferred (contracts for deed exempt)
- Rate is 0.33 percent of consideration
- Paid by person who transfers property, to county treasurer where property is located
- Distribution: State 97%; County 3%
- FY 2013 revenue: \$68.8 million