

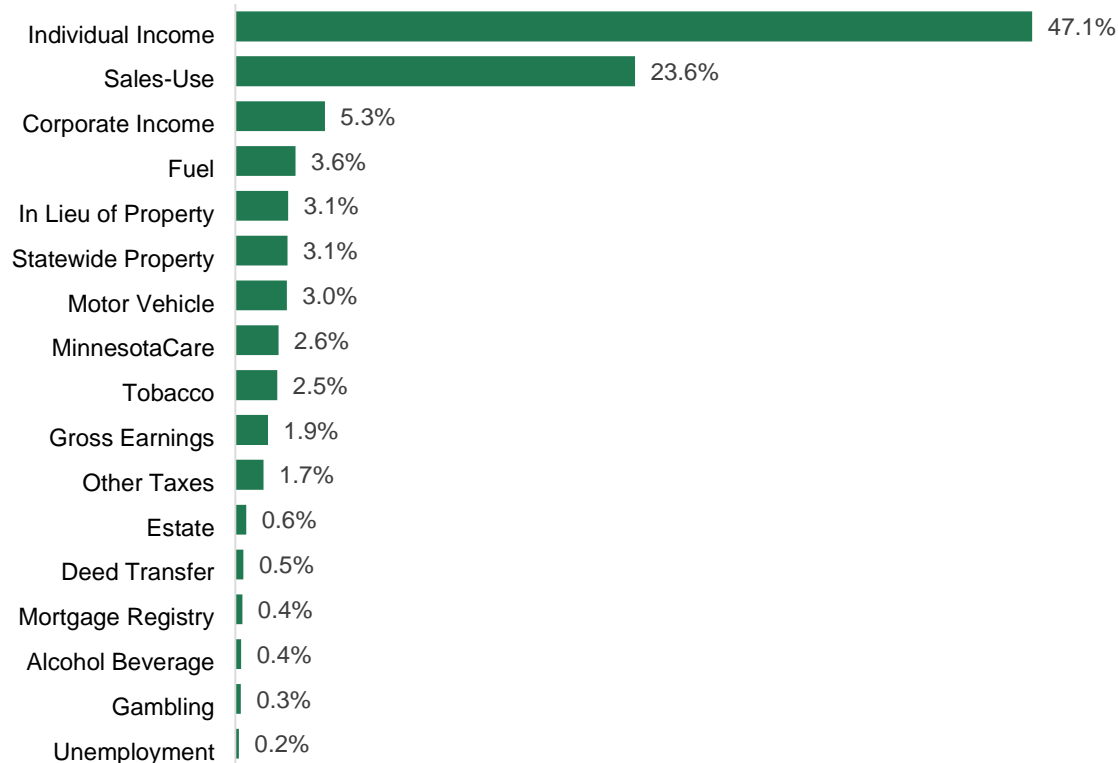
# **Background Briefing on Minnesota Taxes**

January 2019

# State Tax Revenues

Income and Sales are by Far the Largest State Taxes

Total FY 2019 Projected Taxes (All Funds):  
\$26.2 Billion



Share of FY 19 Projected Tax Revenues

Graphic by House Research.

Data from Minnesota Management and Budget, November 2018 Consolidated Fund Statement.

# State Tax Revenues

## Minnesota State Tax Collections \$26.2 Billion in Fiscal Year 2019

FY 19 Projected  
Revenue (Million \$)

Individual Income	\$12,350
Sales-Use	6,195
Corporate Income	1,389
Fuel	936
In Lieu of Property	821
Statewide Property	808
Motor Vehicle	798
MinnesotaCare	671
Tobacco	651
Gross Earnings	506
Other Taxes	463
Estate	168
Deed Transfer	127
Mortgage Registry	109
Alcohol Beverage	92
Gambling	85
Unemployment	58
<small>Table by House Research. Data Compiled from Minnesota Management and Budget, November 2018 Consolidated Fund Statement.</small>	

# Fiscal Resources

- Revenue Estimates – Estimates by the Minnesota Department of Revenue (DOR) that provide analysis about how the bill language would change state tax collections or state expenditures for property tax relief programs
- Fiscal Notes – Provides estimates of administrative costs for relevant state agencies prepared under the direction of the Minnesota Management and Budget Department (MMB) with the assistance of all relevant state agencies. Starting in September 2019, the Legislative Budget Office will be also preparing fiscal notes.
- Local Impact Notes – Estimates the local government or school district fiscal impact of proposed legislation or rule
- Legislative Budget Tracking Spreadsheet – Provides a compilation of cost information from revenue estimates, fiscal notes, and other sources for a bill or omnibus bill

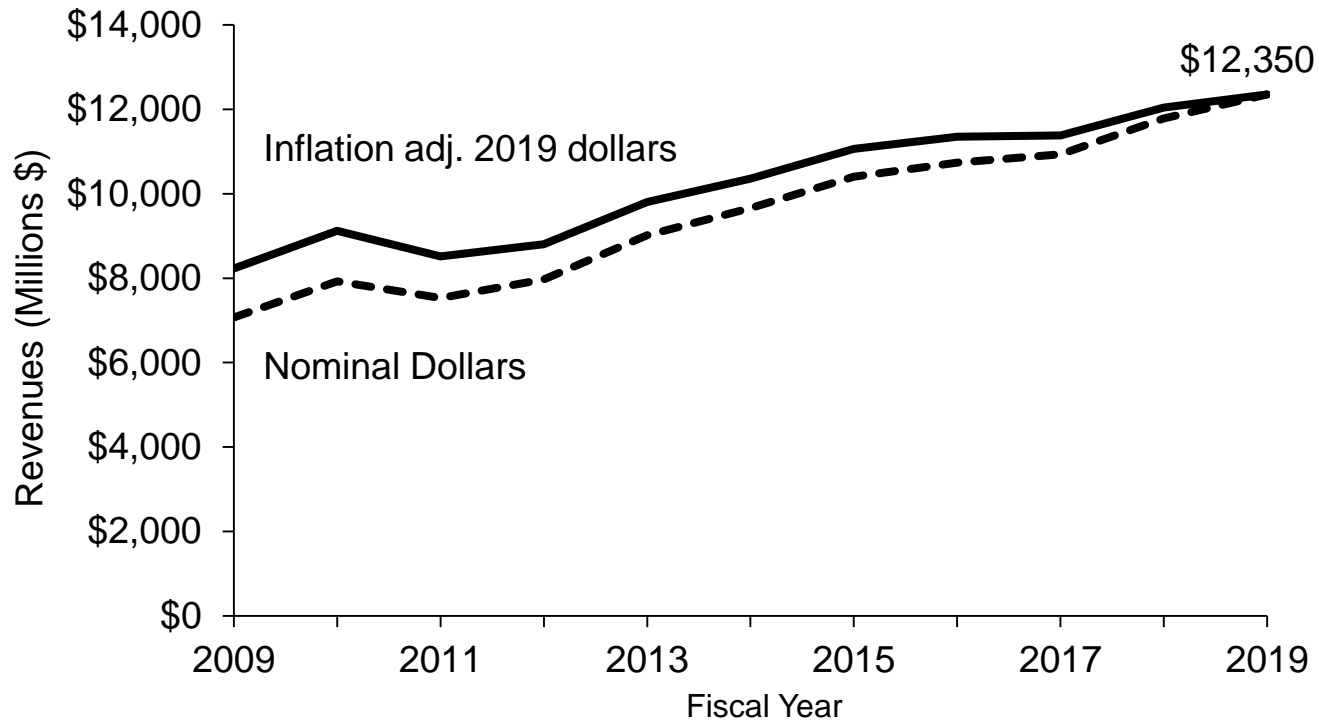
# Individual Income Tax

- Collected through withholding, estimated payments, and final payments
- Returns for the tax year filed following the close of the tax year
  - Tax year 2018 returns and final payments due by April 15, 2019

# Income Tax Revenue

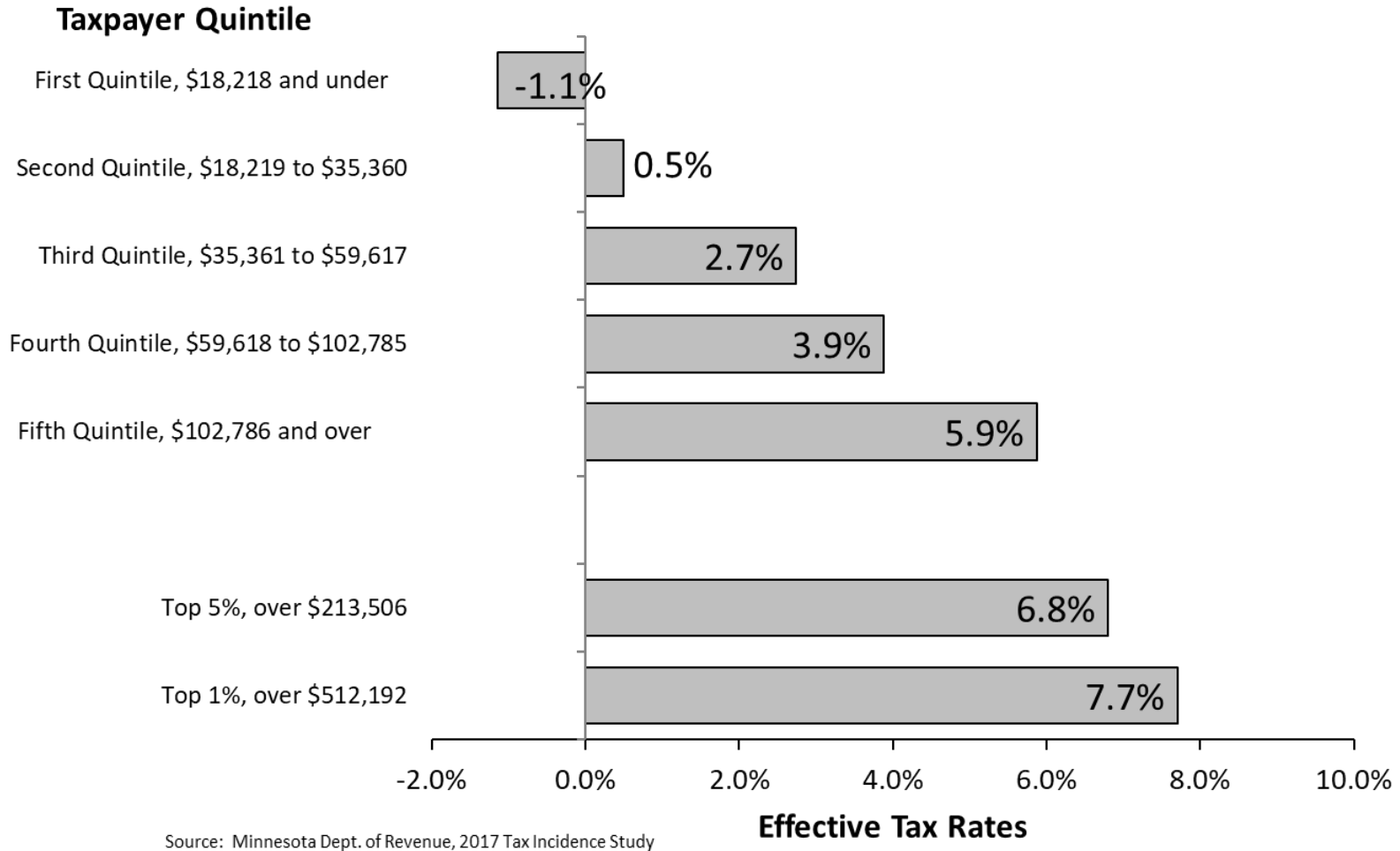
- \$12.2 billion projected for FY 2019
  - reciprocity with Wisconsin NOT in effect
- Roughly 47% of state tax revenue
- All goes to general fund

# Individual Income Tax Revenues, FY 2009-2019



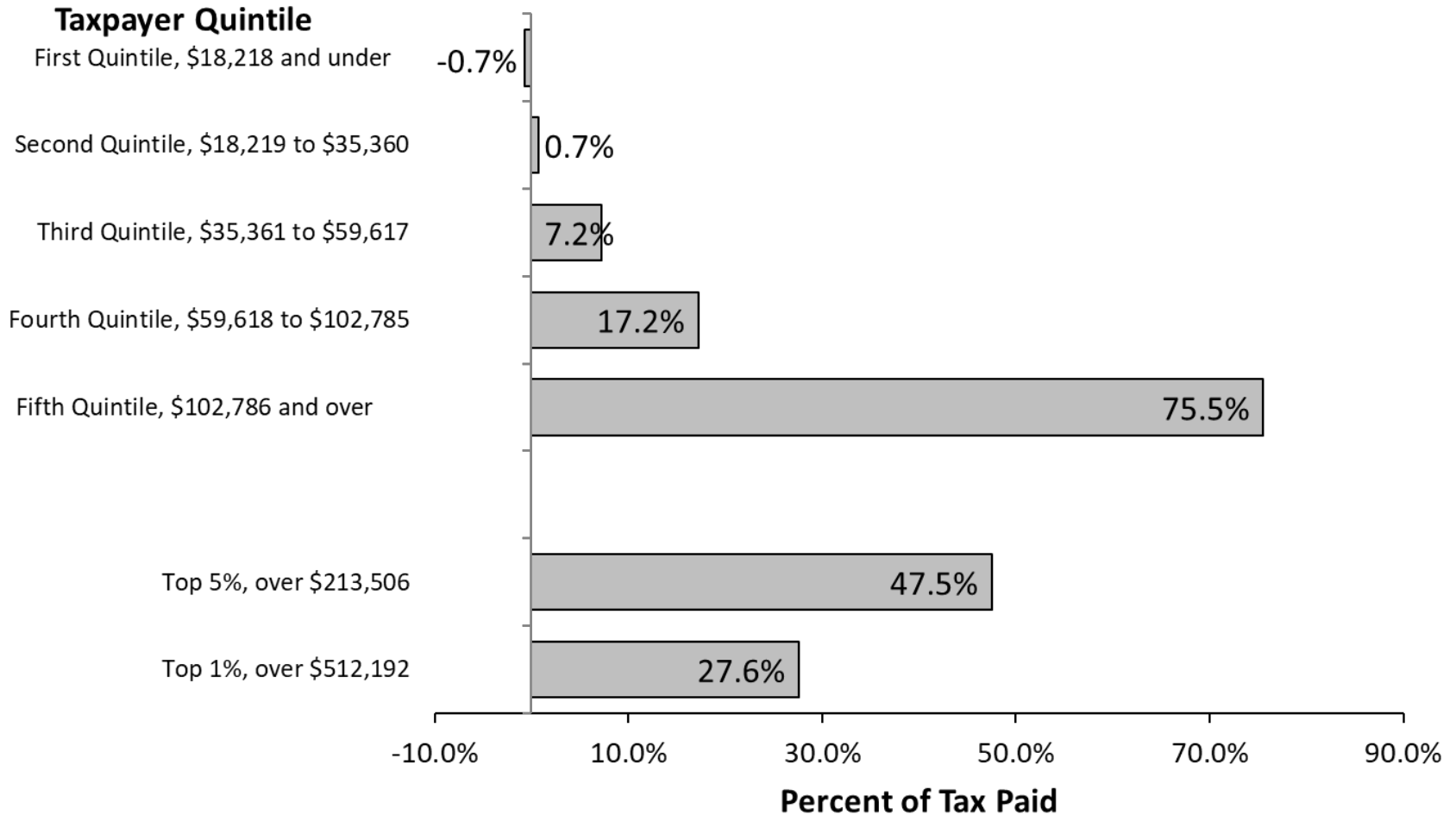
Graphic by House Research.  
Inflation adjusted using the Consumer Price Index for All Urban Consumers (CPI-U).  
Source: MMB. February 2012 through November 2018 consolidated fund statements.

# Individual Income Tax: Effective Rates





# Individual Income Tax: Who Pays the Tax



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study

# Individual Income Tax

Tax Base *times* Tax Rates

*equals*

Preliminary tax

*minus*

Tax Credits

*equals*

Final tax

# Choices for Legislators

- What tax base to use?
- What tax rates to use?
- What credits to allow?

# Minnesota's Tax Base

## Current Law

### Tax Base

*equals*

Federal taxable income

*plus*

Minnesota additions

*minus*

Minnesota subtractions

# Federal Taxable Income (FTI)

**Federal taxable income**

*equals*

**Federal adjusted gross income (FAGI)**

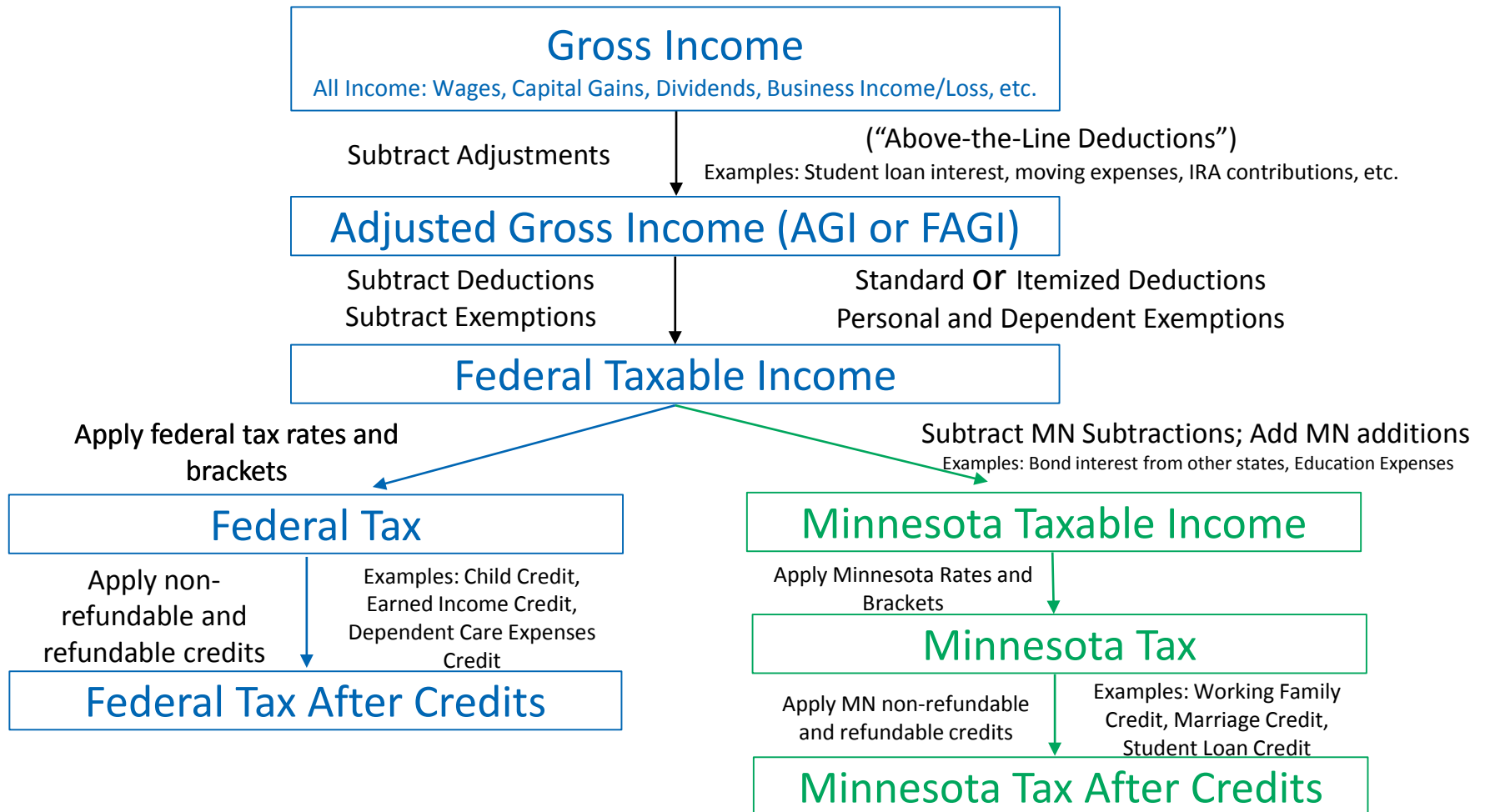
*minus*

**Standard or Itemized deductions**

*and*

**Personal and Dependent exemptions**

# Federal-State Tax Relationship



# Choices for Legislators

- Continue to conform using FTI as the starting point? Conform to federal changes?
  - For tax year 2019, only 5 states use FTI (including Minnesota). All of the 2018 tax bills proposed moving to FAGI.
- What additions to require?
- What subtractions to allow? (*some required by federal law*)

# Choices for Legislators

The Tax Cuts and Jobs Act of 2017 (TCJA) fundamentally changed the composition of FTI and FAGI. The following changes to the federal individual income tax code will be in effect through TY 2025:

- Repealed and limited some itemized deductions and “above-the-line” deductions.
- Increased the standard deduction.
- Repealed personal exemptions.
- Numerous changes to pass-through businesses that pay the individual income tax.
- Changed the inflation index used by the tax code.



# Choices for Legislators

- Three federal laws (including TCJA) have passed that put Minnesota out of conformity with numerous federal provisions.
- Conforming to federal changes simplifies compliance for taxpayers and administration to DOR. But there will be winners and losers under conformity.

# MN Additions TY 2019

- Interest on other states' bonds
- Federal changes that we don't conform to

# **MN Subtractions TY 2019**

*(required by federal law)*

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

# MN Subtractions 2019

## *(past non-conformity to FTI)*

- Timing issues: Expensing items recognized *earlier* under the federal tax, *later* under the state tax
  - Section 179 expensing
  - Bonus depreciation
  - Net operating losses

# **MN Subtractions TY 2019**

## ***(state discretionary items)***

- A portion of taxable Social Security Benefits
- K-12 education expenses
- Charitable contributions (nonitemizers)
- A portion of college savings (529) contributions
- Military pay, including retirement pay
- Elderly subtraction
- Organ donation expenses
- AmeriCorps education awards
- Interest earned in first-time homebuyer accounts

# Minnesota's Tax Rates

<b>Tax Rate</b>	<b>2019 Income bracket (married joint filers)</b>
5.35%	\$0 to \$38,770
7.05%	\$38,771 to \$154,020
7.85%	\$154,021 to \$273,150
9.85%	Over \$273,150

# **MN Credits**

## ***(State discretionary items)***

### *11 Nonrefundable credits*

offset liability, but not to less than zero

### *8 Refundable credits*

offset liability, with any excess paid as a refund (*eight of these*)

# Nonrefundable Credits (1/3)

Credit	Description	FY 2019 Cost
Credit for taxes paid to another state	Avoids double taxation of income taxed by other states. Full & part-year residents only. Courts have ruled such a credit is required.	\$240.3 million
Marriage credit	Reduces marriage penalty for filing a joint return. Maximum credit is \$1,462.	\$92.6 million
Student loan credit	Enacted in 2017. Maximum credit is \$500 per person. Phases out with income.	\$27.8 million
Research and development credit	Based on the federal credit. Available to c-corps and pass-throughs.	Pass-throughs: \$27.1 million C-Corps: \$46.2 million

Source: MN Department of Revenue 2018 Tax Expenditure Report.  
Amount of credit for taxes paid to other states estimated by House Research using HITS version 6.7.



# Nonrefundable Credits (2/3)

Credit	Details	FY 2019 Cost
Long-term care insurance credit	Maximum \$200 credit for long term care insurance premiums.	\$9.4 million
College savings (529) credit	Credit for 529 account contributions. Max is \$500, phased out by income.	\$7.8 million
Credit for sales of agricultural assets to a beginning farmer	Effective TY 19, sunsets in TY 2023. Capped at \$5 million.	\$5.0 million
Past military service credit	Available to veterans with a military pension or service-connected disability and income below < \$37,500. \$750 maximum credit.	\$400,000

Source: Minnesota Department of Revenue 2018 Tax Expenditure Report.

# Nonrefundable Credits (3/3)

Credit	Details	FY 2019 Cost
Beginning farmer credit	Effective TY 19, sunsets in TY 2023. Max credit is \$1,500 per year for 3 years.	\$300,000
Employer transit pass credit	Credit equals 30% of the cost of providing employees transit passes.	Less than \$50,000
Credit for a teacher completing a master's degree	Must complete a master's program in a "core content area" (other than pedagogy).  Maximum credit is \$2,500 (1 time).	Less than \$50,000

Source: Minnesota Department of Revenue 2018 Tax Expenditure Report.

# Refundable Credits (1/2)

Credit	Description	FY 2019 Cost
Working family credit	State equivalent to the federal earned income credit. Paid to lower-income families, mostly (95%) with children. Max credit is \$2,156.	\$266.1 million
Historic structure rehabilitation credit	Incentive to rehabilitate historic structures. Mostly claimed against the corporate income tax.	\$44.8 million
Child and dependent care credit	Credit amount tied to federal credit. Maximum credit is \$2,100 (for families with 2 or more dependents). Phased out for married couples with income above \$76,160.	\$32.9 million
Credit for K-12 education expenses	Credit for 75% of certain education expenses. Phases out at \$37,500 for families with 2 children. Max credit is \$1,000 per child.	\$11.6 million

Source: MN Department of Revenue 2018 Tax Expenditure Report.

# Refundable Credits (2/2)

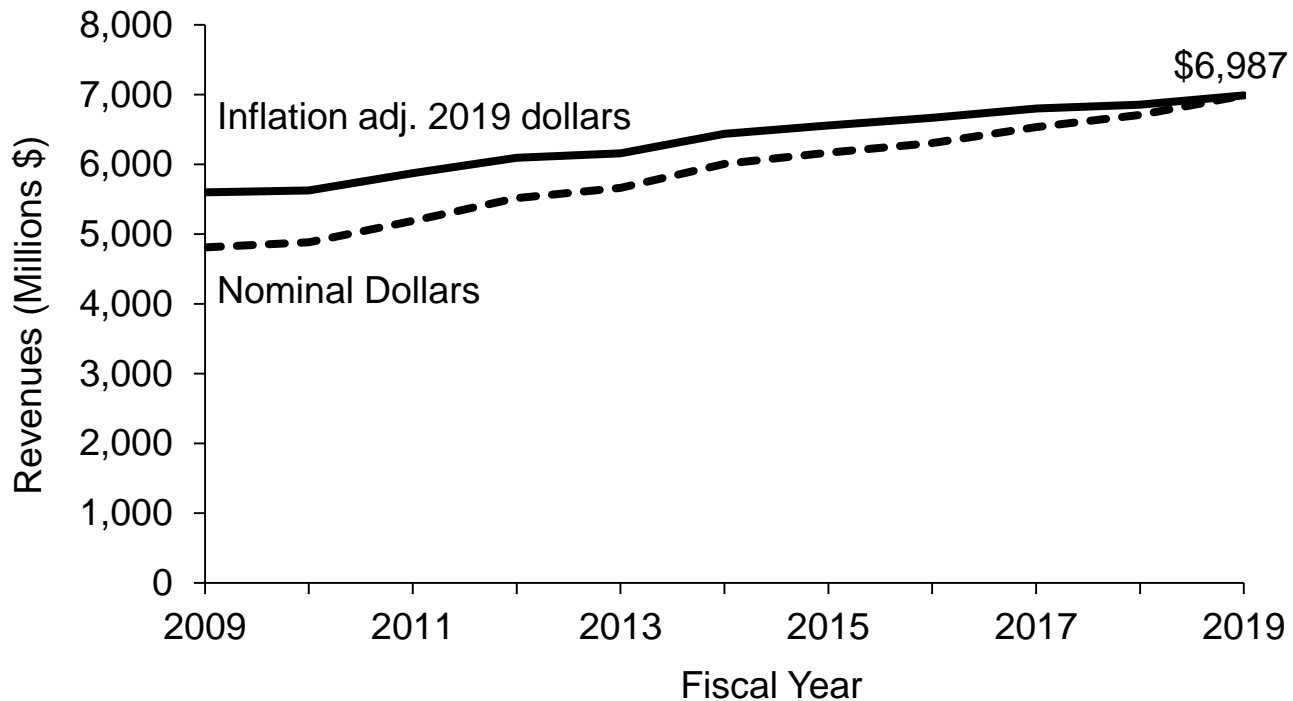
Credit	Description	FY 2019 Cost
Credit for taxes paid to Wisconsin	General credit for taxes paid to another state is nonrefundable. Applies to personal service income (such as wages) only. Only applies when no reciprocity agreement is in place with Wisconsin.	\$5.8 million
Credit for parents of stillborn children	Intended to replace tax benefit of dependent exemption. Max credit is \$2,000.	\$800,000
Credit for military service in a combat zone	Maximum credit is \$120 per month of service in a designated combat zone.	\$700,000
Enterprise zone employer tax credits	Credits for employers in border cities enterprise zones. Max credit is \$3,000 per additional employee working in the zone.	\$100,000

Source: MN Department of Revenue 2018 Tax Expenditure Report.

# Sales Tax Revenue

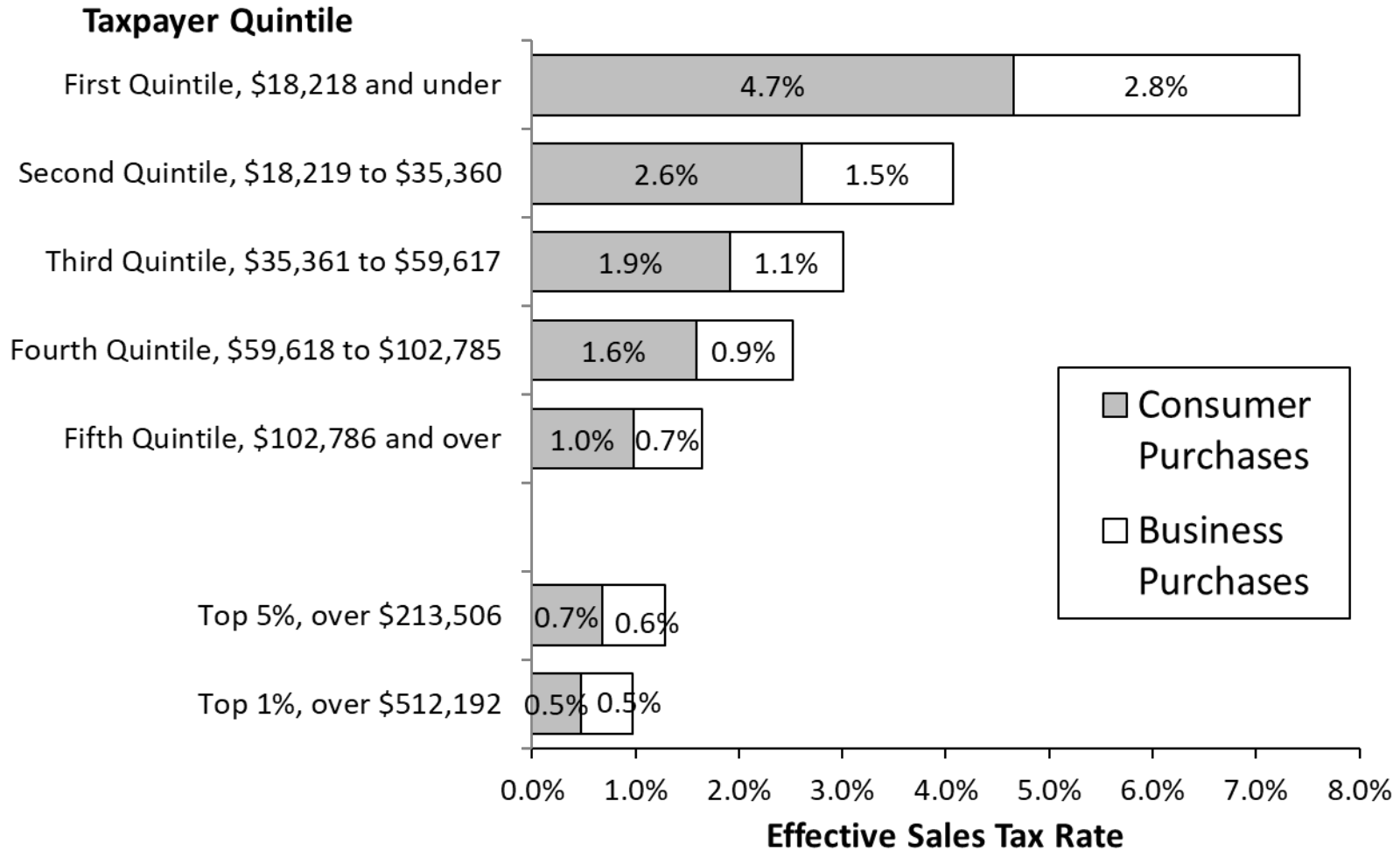
- \$7.0 billion projected for FY 2019
  - \$795 million is taxes on motor vehicle sales and leases
- Less than 1/3 of state tax revenue (27%)
- Business pays about 46% of the tax

# Sales Tax Revenues, FY 2009-2019



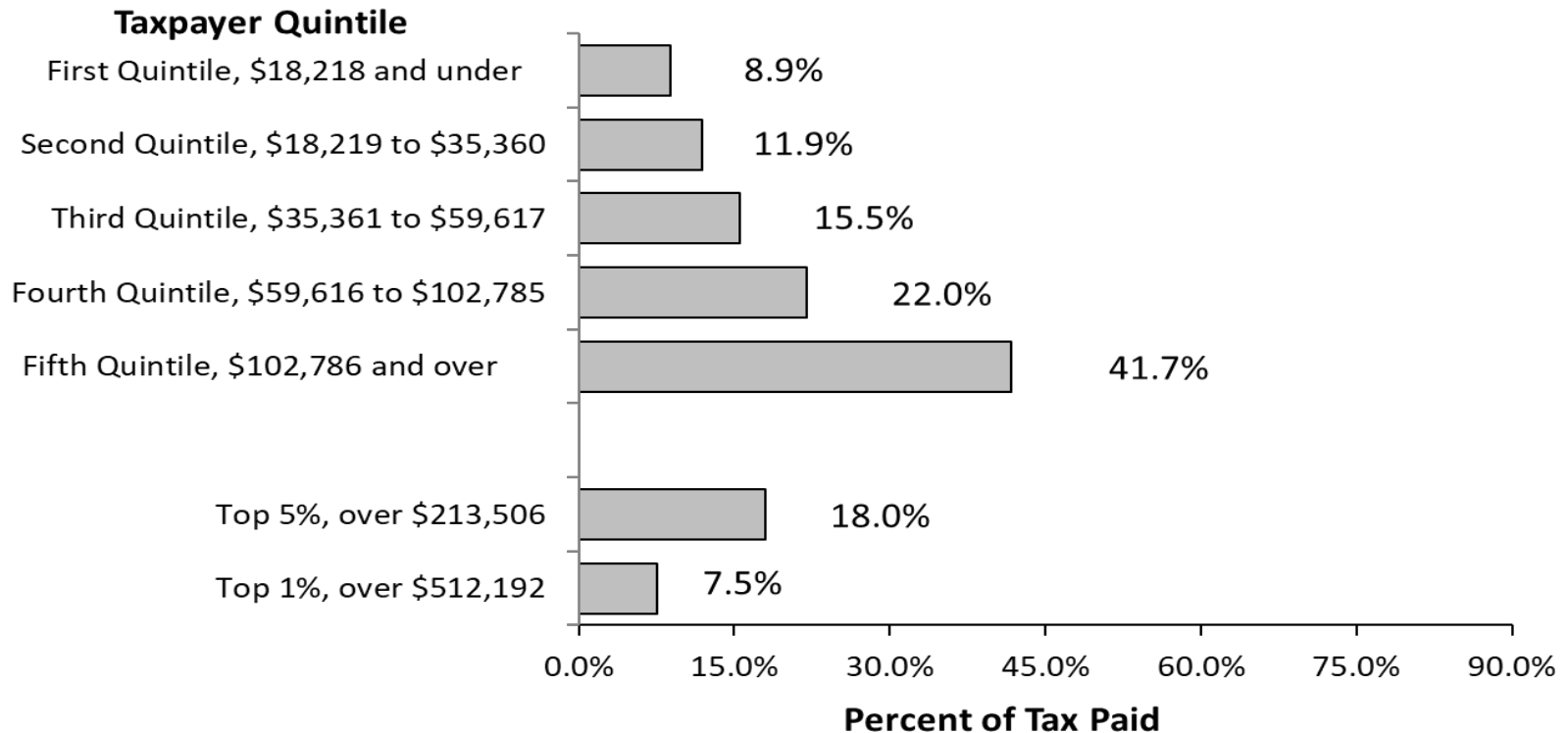
Graphic by House Research.  
Inflation adjusted using the Consumer Price Index for All Urban Consumers (CPI-U).  
Source: MMB. February 2012 through November 2018 consolidated fund statements.

# Sales/Use Tax: Effective Rates



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study

# Sales and Use Tax: Who Pays The Tax (Business & Consumer Purchases)



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study



# 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
  - taxes on rental vehicles (both 6.5% tax and 9.2% tax)
  - tax on autoparts (partial)
  - tax on fireworks
  - tax on general aviation aircraft parts
  - Lottery in-lieu payments (partial)
  - 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 25 years
- Constitutionally dedicated
- Revenue in FY 2019 - \$335 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: 21.075%
  - 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 taxable unless specifically exempted
- Services and intangibles are not taxable unless specifically included. Examples of taxed items:
  - lodging
  - digital downloads
  - cleaning services
  - telecommunications

# 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
- Certain purchases by data centers

# Other Major Sales Tax Exemptions

- Most sales to the federal government and to local governments (sales to the state government are still taxable)
- Many sales to nonprofit charitable, religious, educational, and youth organizations
- Certain sales by nonprofit charitable organizations

# Sales Tax and Remote Sales

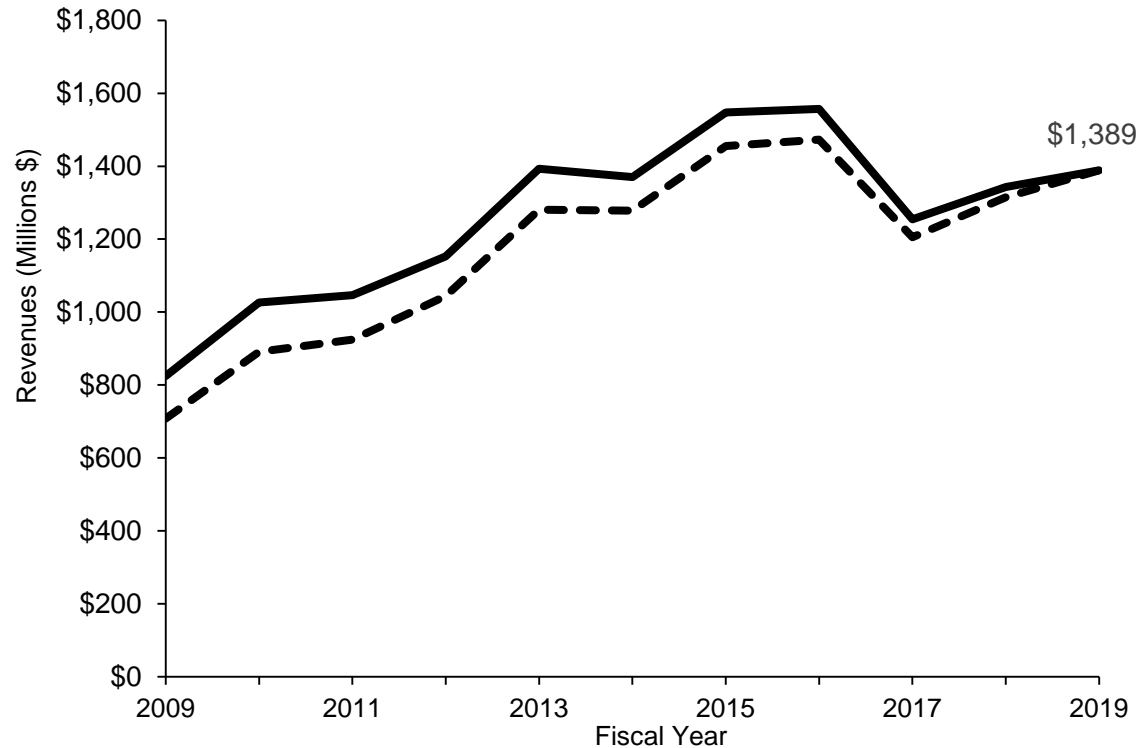
- The June 2018 Supreme Court case *South Dakota v. Wayfair* allows states to require remote sellers to collect sales taxes if certain conditions are met.
- Most remote sellers required to collect Minnesota tax starting October 1, 2018
- Membership in the Streamlined Sales and Use Tax agreement facilitated state imposition



# Local Sales Taxes

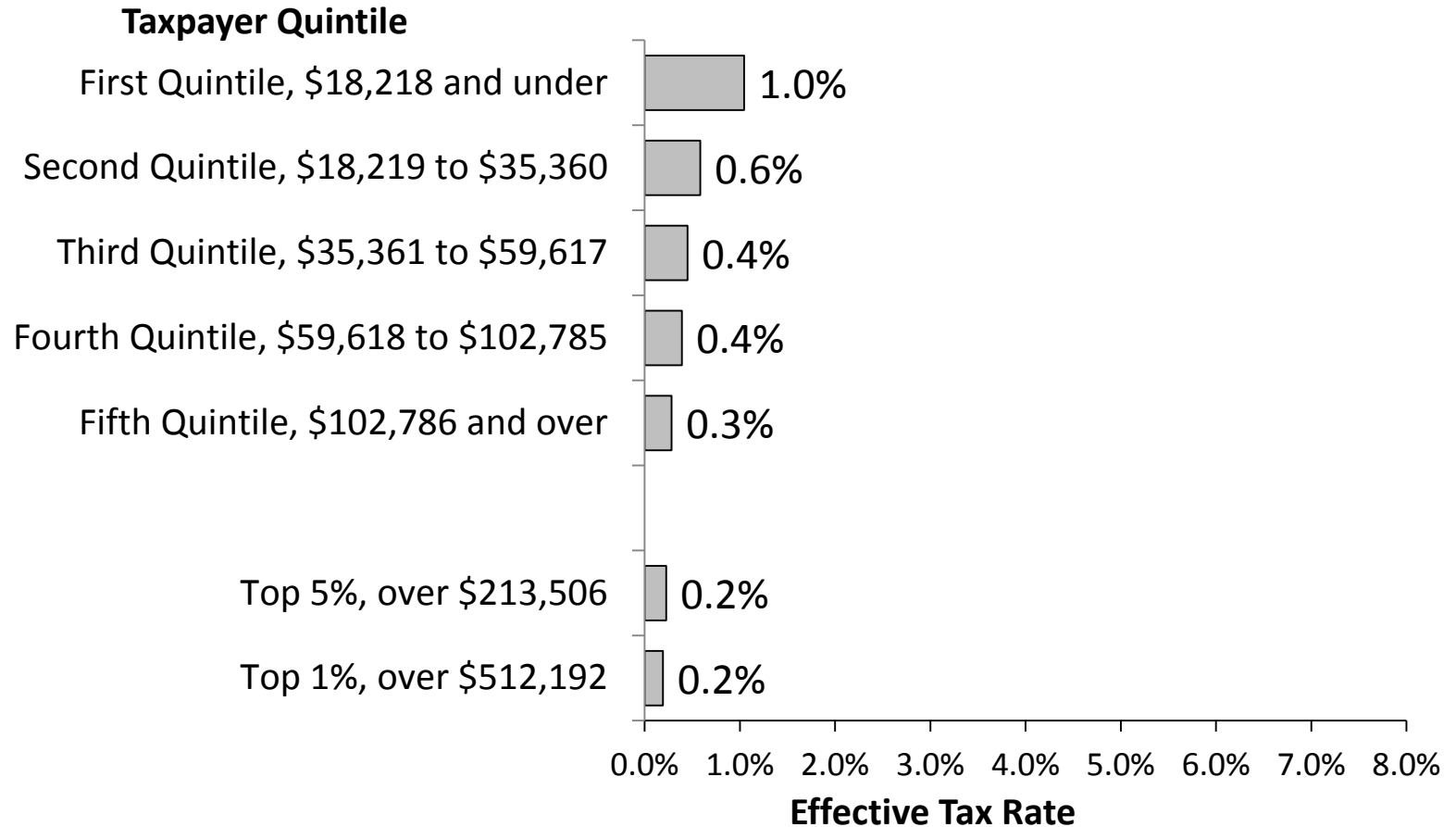
- General prohibition against local sales and income taxes enacted in 1971
- Counties can impose transportation and transit local sales taxes without voter approval – imposed in 41 counties as of 1/1/19
- Most other local sales taxes imposed under special law with local voter approval – 31 imposed as of 1/1/19

# Corporate Franchise Tax Revenues, FY 2009-2019



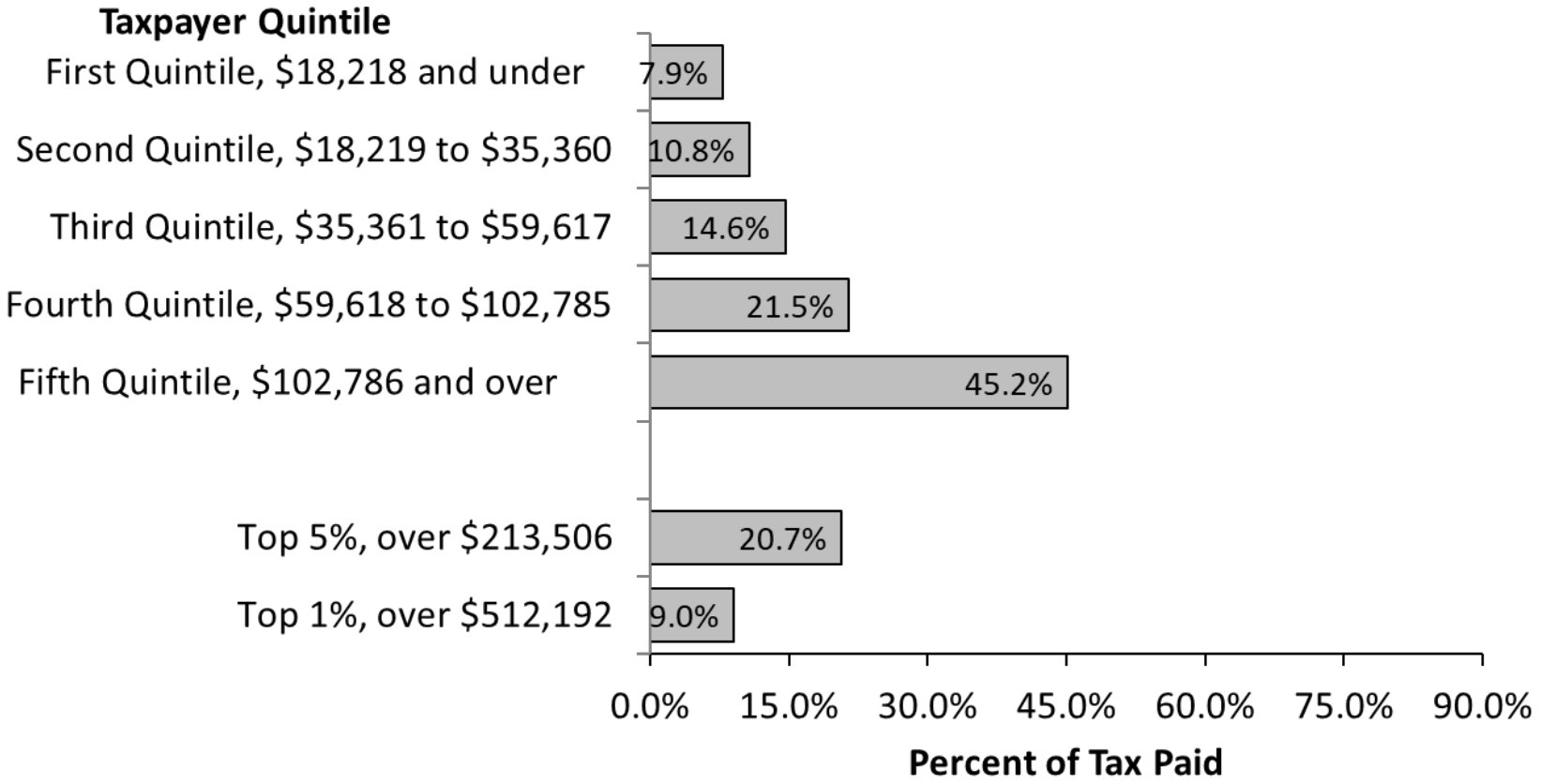
Graphic by House Research.  
Inflation adjusted using the Consumer Price Index for All Urban Consumers (CPI-U).  
Source: MMB. February 2012 through November 2018 consolidated fund statements.

# Effective Corporate Tax Rates



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study

# Corporate Tax: Who Pays the Tax



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study

# Corporate Franchise Tax

- Tax base is (largely) the profits of “C” corporations
- Multi-state corporations use 100% sales apportionment; this favors corporations with more operations in Minnesota
- Tax rate of 9.8%

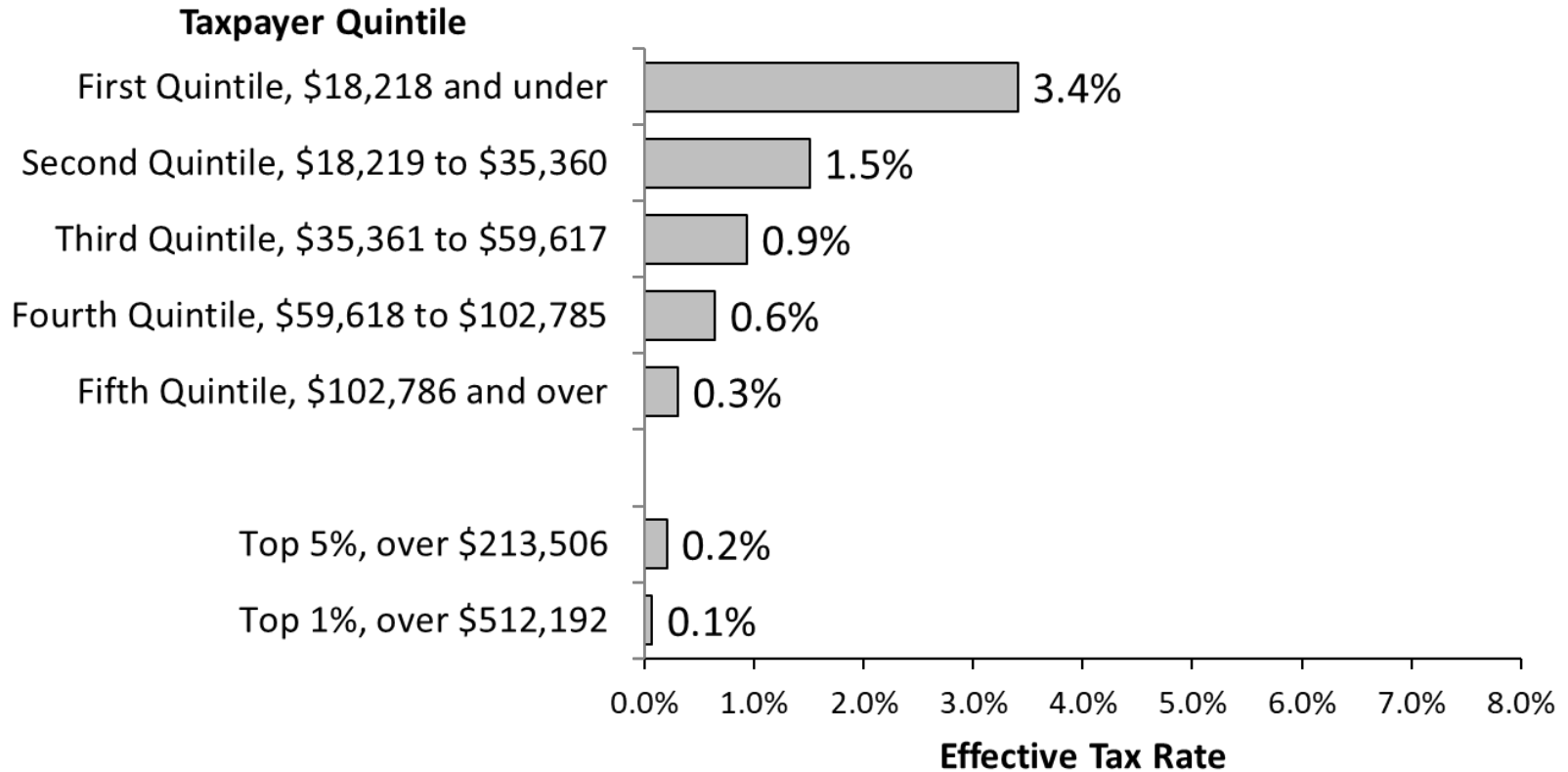
# Corporate Franchise Tax

- Credits allowed for
  - Research & development
  - Transit passes
  - Historic structure rehabilitation
- Minimum fee applies to all businesses, including S corporations and partnerships

# Corporate Franchise Tax

- \$1.3 billion in FY 2019
- Most volatile revenue source of the major taxes –
  - \$529 million in FY 2002
  - \$1,171 million in FY 2007
  - \$663 million in FY 2010

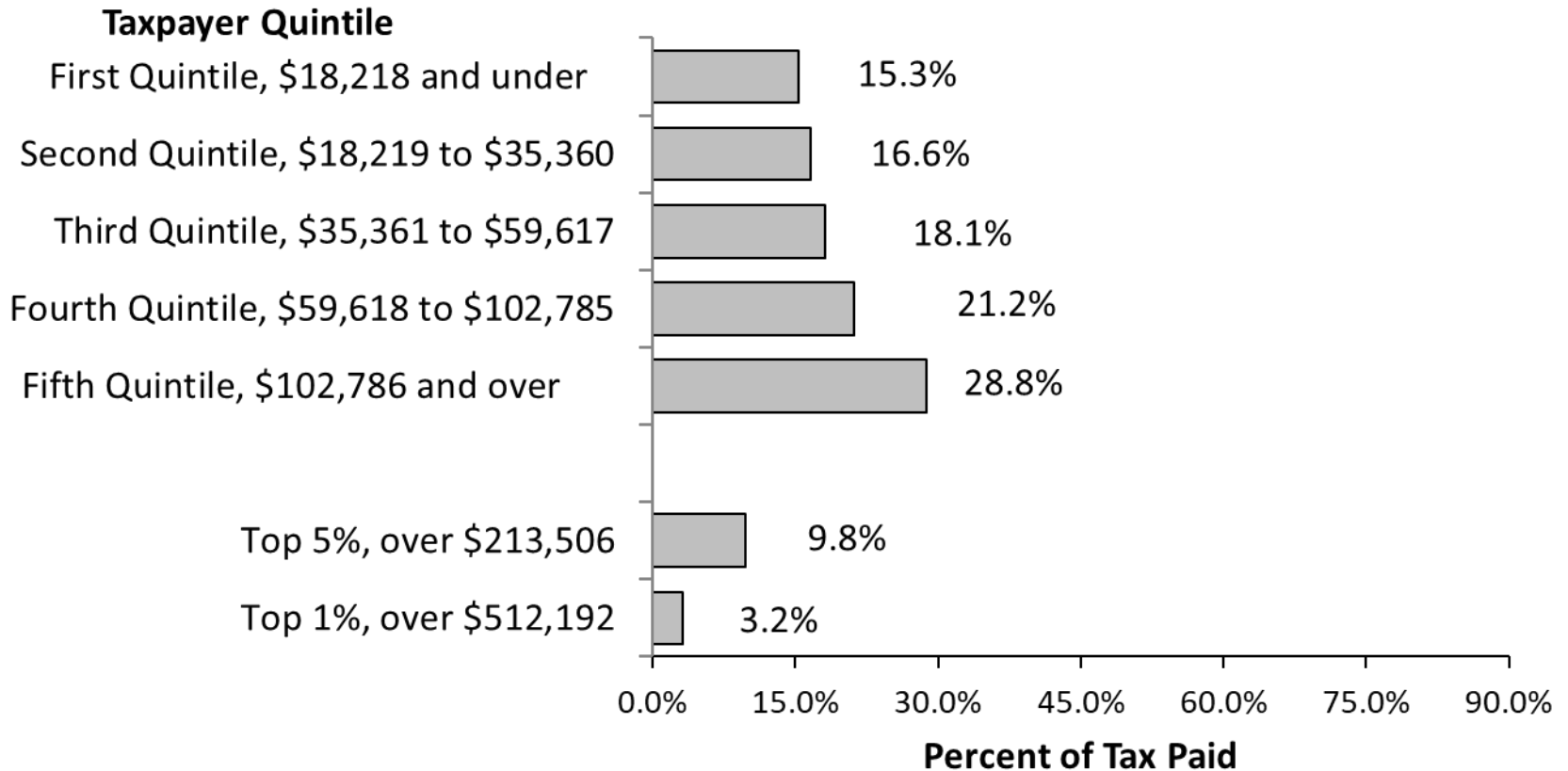
# Excise Taxes: Effective Rates (fuels, cigarette, & liquor)



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study



# Excise Tax: Who Pays the Tax



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study

# 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 for total tax rate per gallon of 28.5 cents

# 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
- \$925.3 million in FY 2019

# Cigarette and Tobacco Tax

- Tax on cigarettes is a per unit tax, while the tobacco products tax is a percent of the price
- For cigarettes, the excise tax rate is \$3.04 per pack of 20, and the in-lieu sales tax is \$0.55 per pack; 95% of wholesale price for tobacco products

# Cigarette and Tobacco Tax

- \$624 million in FY 2019 (including fees)
- About \$26 million of the revenues dedicated to health research
- 50 cents/pack fee applies to nonsettlement cigarettes (about \$6.5 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

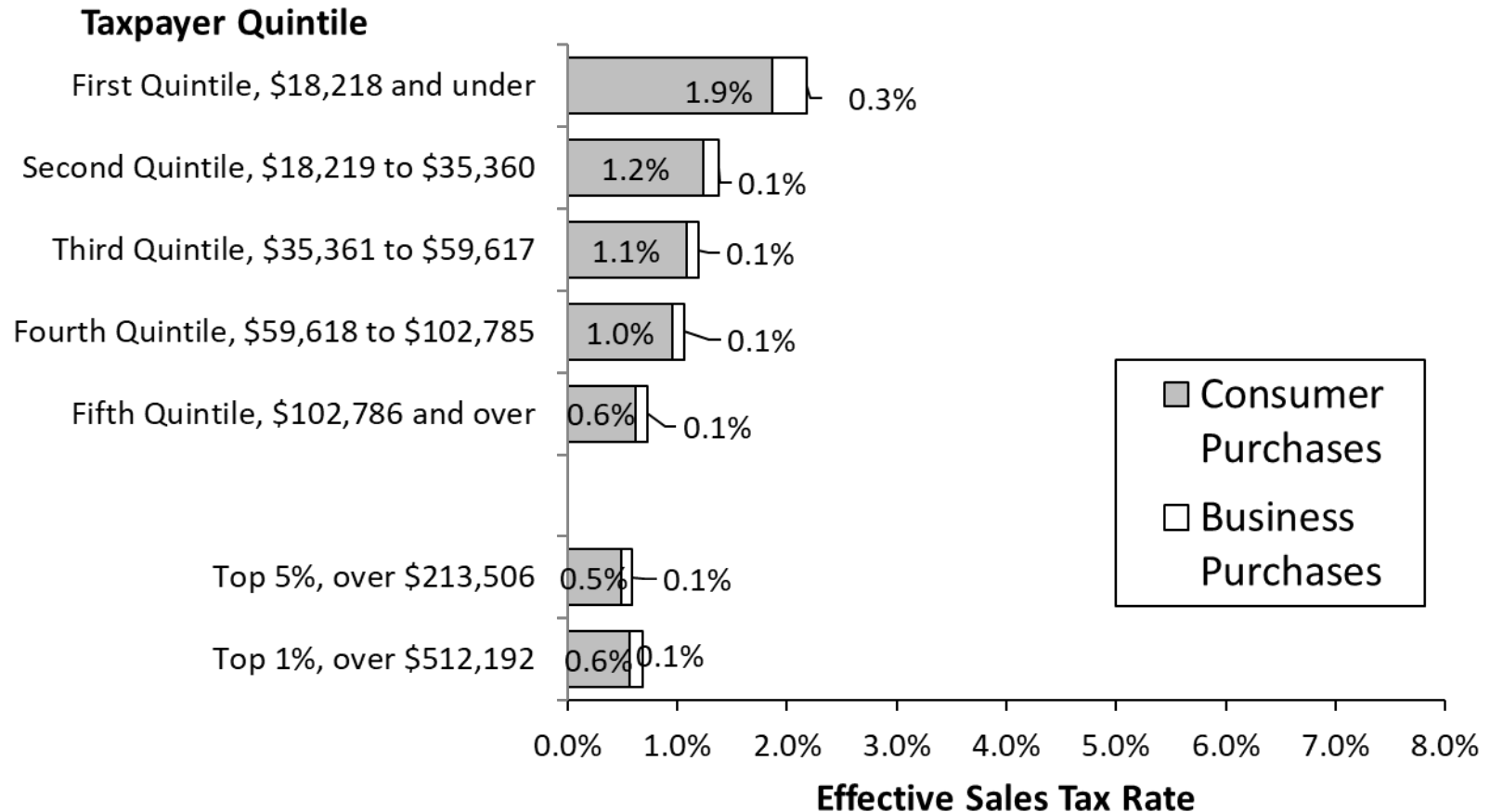
- The tax is generally unrelated to alcoholic content or price, although higher rates apply to wines with higher alcoholic content
- \$93.1 million in FY 2019

# 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
- \$95.2 million in FY 2019 (receipts also reflected in MMB's sales tax revenues)

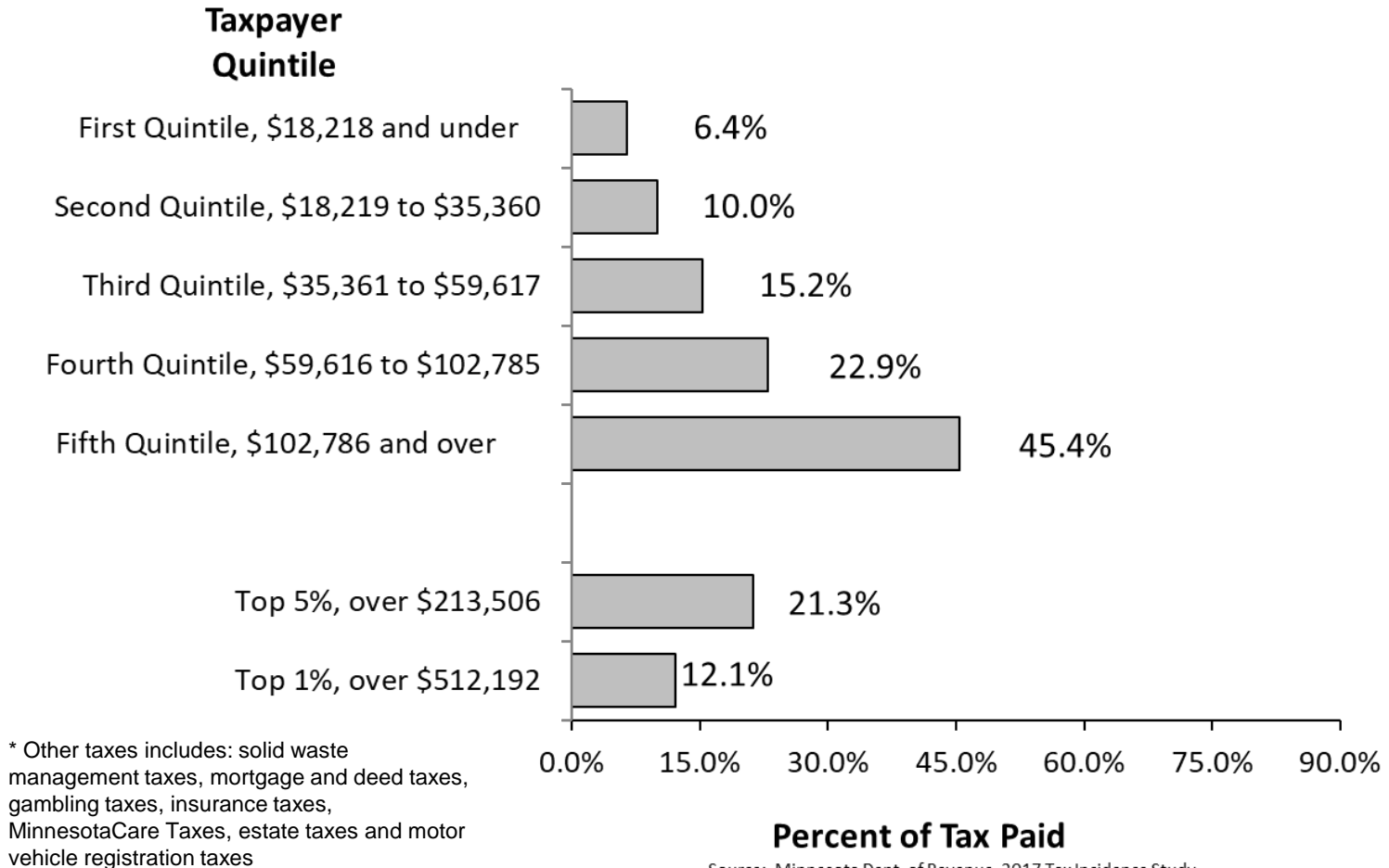


# Other State Tax: Effective rates



Source: Minnesota Dept. of Revenue, 2017 Tax Incidence Study

# Other State Taxes: Who Pays



# Motor Vehicle License Tax

- 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 10 years old or older

# Motor Vehicle License Tax

- Revenues are dedicated to highway user trust fund
- \$795.3 million in FY 2019
- Local governments receive a share of the revenues under county and municipal state aid street funds

# 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 and Medical Assistance programs
- Tax sunsets 1/1/2020
- \$692 million in FY 2019

# 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
- \$507 million in FY 2019
- Portions of the tax are dedicated –  
MinnesotaCare; police and fire pension aid
- Insurance companies that pay are exempt from corporate franchise tax

# 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 \$2.4 million for 2018 deaths, \$3 million for 2020 and later
  - Exemptions for qualified small business and farm properties (maximum is \$2.6 million in 2018; \$2 million in 2020)
- Tax rates range from 13% to 16%, beginning in 2018

# Estate Tax

- \$129.3 million in FY 2019
- Very volatile tax (\$216 million in FY 2006; \$54 million in FY 2001)
- 33 states (including ND, SD, WI) have no taxes for decedents dying in 2019
- Effect on domicile decisions?
- Progressive: Suits index of 0.84

# 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 2019 revenue: \$114.9 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 2019 revenue: \$143 million

# Lawful Gambling Taxes

- Tax imposed on gross receipts minus prizes paid
- The rate for paper bingo, raffles, and paddlewheels is 8.5%
- For pull-tabs, linked bingo, and tipboards, the rate starts at 9% and increases up to 36%
- FY 2019 revenue: \$76.8 million