

Background Briefing on Minnesota Taxes

Minnesota House Research Department and Fiscal Analysis Department

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Presentation Outline

This presentation covers:

- Committee orientation: roles of nonpartisan staff in committee and important committee documents
- Basic tax concepts and practices
- Major state taxes
 - Individual income tax
 - Income taxes on business
 - Sales and use taxes
 - Property taxes
- Evaluative criteria for considering tax proposals
- Constitutional issues in state taxation

Nonpartisan Staff Roles

House Research

- Draft bills and amendments
- Write bill summaries
- Provide background research and overviews
- Answer questions on bill content and legal consequences
- Modeling

House Fiscal

- Track revenue and budget effect of executive and legislative policy goals
- Interpret and analyze revenue estimates and fiscal notes
- Offer confidential fiscal analysis of spending, revenue, and policy proposals

Our departments' services are confidential and available to all House Members.

Important Resources

Committee Documents

- Bill summaries
- Revenue estimates & fiscal notes
- Spreadsheets
- Partisan briefs
- Testifier letters and information

Basic Tax Concepts and Practices

Defining Tax Base

Each tax has a base. The base of a tax is the income, property, consumption, or other economic activity subject to the tax. A tax base can be broad or narrow.

A broad tax base encompasses most of the economic activity that could fall under the tax. A narrow tax base excludes most of the economic activity that could fall under the tax.

Defining Tax Rate

Each tax has a rate or rates. The rate sets the amount of the base which will be paid in taxes.

Some taxes have a flat, per-unit rate.

Many taxes have rates set as percentages of the base.

Calculating Tax Liability

Roughly, $\text{Base} \times \text{Rate} = \text{Tax Liability}$

But

- the base may be reduced by deductions, exclusions, exemptions, and subtractions; and
- the product of multiplying the base times the rate may be reduced by tax credits

Calculating Tax Revenues

The tax revenues for a tax equals the sum of all taxpayers' tax liabilities for the tax, minus the tax gap (the amount that goes unpaid)

Total revenue from all state and local taxes equals the sum of all taxpayers' tax liabilities across all state and local tax types, minus any tax gap

Modifying Tax Revenues

In isolation, a tax provision could raise revenues by:

- Broadening a tax base
- Increasing a tax rate
- Limiting an existing deduction, credit, etc.
- Repealing an existing deduction, credit, etc.
- Increasing tax enforcement to reduce the tax gap
- Enacting a new tax

In isolation, a tax provision could lower revenues by:

- Narrowing a tax base
- Decreasing a tax rate
- Expanding an existing deduction, credit, etc.
- Enacting a new tax deduction, credit, etc.
- Decreasing tax enforcement
- Repealing a tax

Spending in Tax Laws

In many budget years, the tax-writing committee has a budget and may choose to spend its budget.

Expenditures within tax laws are often structured differently from the expenditures of finance and appropriation committees.

These expenditures often take the form of:

- Standing appropriations that endure beyond the current biennium
- Open appropriations of unspecified dollar amounts
- Earmarking (or dedication) of tax revenues for specific purposes or programs
- Tax expenditures

Spending in Tax Laws: Defining Tax Expenditures

Tax expenditures are special provisions of the tax code (such as special deductions and credits) that reduce taxpayers' tax liability. Not all credits or deductions are considered tax expenditures.

Tax expenditures provide financial assistance for specific activities, entities, or groups of people.

Tax expenditures are considered analogous to direct spending programs because, like direct spending programs, tax expenditures:

- impact the state budget;
- pursue the same purposes as direct spending programs; and
- impact the economy in some of the same ways as direct spending programs by influencing how people work, spend, and invest.

Spending in Tax Laws: Categories of Spending

Agriculture

- Property tax credit and preferential valuation of metropolitan agricultural preserves land
- Credit for sale of agricultural assets
- Sales tax exemption for farm machinery

Capital Investment

- Sales tax exemptions for certain government construction projects
- Income tax exclusion for interest on state and local government bonds

Education

- Exclusion for contributions to qualified tuition plans
- Sales tax exemptions for textbooks and school computers
- Credit and subtraction for contributions to college savings plans
- Credit for K-12 education expenses

Energy

- Income tax exclusion for certain energy conservation subsidies
- Sales tax exemptions for residential heating fuels, wind energy conversion systems and solar energy systems

Environment and Natural Resources

- Legacy sales tax revenues dedication
- Soil and water conservation districts

Housing

- Housing TIF districts
- Earmarked metro sales tax revenues
- Home mortgage rate interest deduction
- Statewide housing aid
- Housing contribution credit

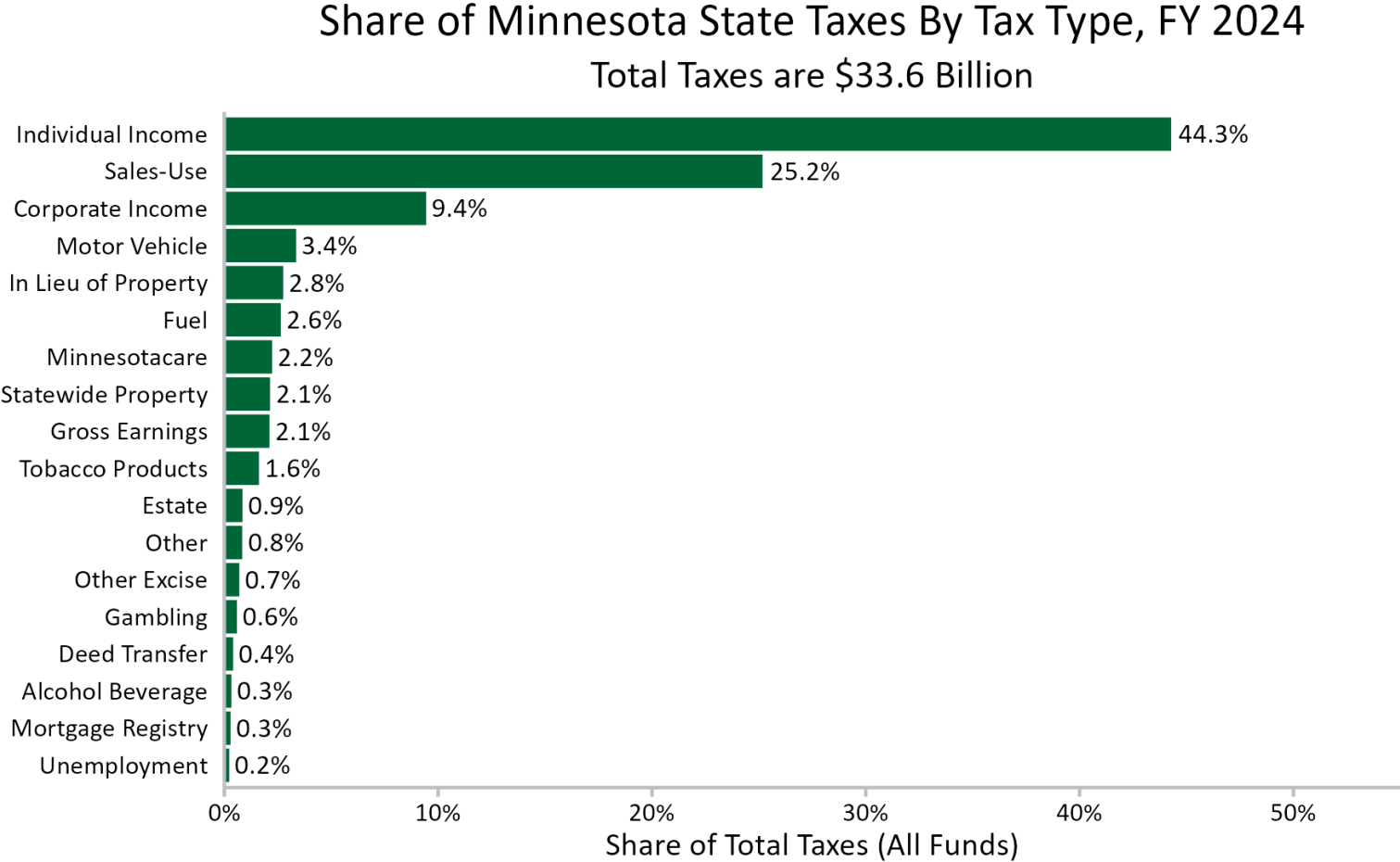
Veterans and Military Affairs

- Homestead exclusion for veterans with a disability
- Income tax exclusion for veterans' benefits and military disability pensions
- Subtraction of compensation for active-duty military

Major Taxes in Minnesota

Income Tax

Individual Income Tax is the Largest State Tax



Graphic by MN House Research
Data from Minnesota Management and Budget. November 2024 Consolidated Fund Statement.

Income Tax Collection; Use of Funds

- Individual income tax is paid to the state in three ways:
 - Minnesota withholding tax:
 - Employers withhold state tax from an employee's paycheck and remit to the state
 - Quarterly payments of estimated tax:
 - Required for income not subject to withholding
 - Final payment (or refund) at the time of filing (January – April)
- Income tax revenues deposited in the state general fund. Use of general fund dollars is determined by appropriations of the legislature.
- No local income taxes in Minnesota. There is a general law that prohibits local governments from imposing them.

Income Tax Base: Minnesota Taxable Income

$$\begin{aligned} &\text{Federal Adjusted Gross Income (FAGI)} \\ &+ \text{Minnesota Additions} \\ &- \text{Minnesota Dependent Exemption} \\ &- \text{Standard or Itemized Deductions} \\ &- \text{Other Minnesota Subtractions} \\ \hline &= \text{Minnesota Taxable Income (MTI)} \end{aligned}$$

Income Tax Collection; Use of Funds, Continued

Standard Deduction

Married Joint	Single	Head of Household
\$29,900	\$14,950	\$22,500

Dependent Exemption

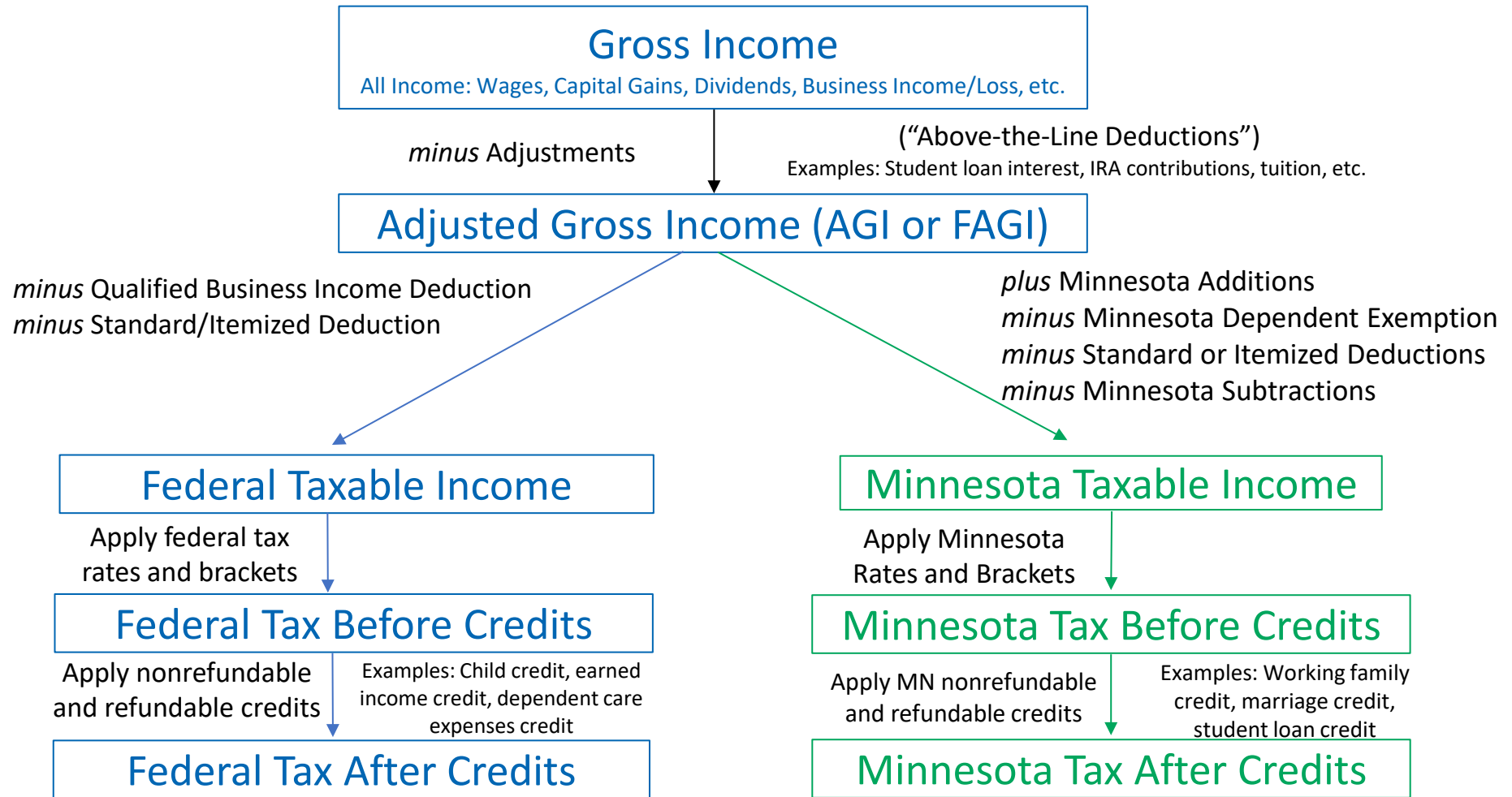
All filing statuses
\$5,200 per dependent

Additions

Subtractions

Tax year 2025 amounts shown for the standard deduction and dependent exemption.

Minnesota's Income Tax Base is Tied to Federal Law



Minnesota's Income Tax Base is Tied to Federal Law,

- Minnesota's tax system is built on the federal system.
- Federal laws and rules that affect FAGI also affect Minnesota liability. Most rules for calculating business income affect FAGI.
- Changes in federal rules are not automatically adopted; Minnesota is a "static date" conformity state. We have adopted the Internal Revenue Code, as amended through May 1, 2023.
- Many federal provisions of the 2017 Tax Cuts and Jobs Act are expiring. If Congress extends or modifies the federal code to deal with that expiration, the state will eventually need to respond.

Income Tax Rates and Brackets, Tax Year 2025

Married Joint	Single	Head of Household	Rate
\$0 to \$47,620	\$0 to \$32,570	\$0 to \$40,100	5.35%
\$47,621 to \$189,180	\$32,571 to \$106,990	\$40,101 to \$161,130	6.80%
\$189,181 to \$330,410	\$106,991 to \$198,630	\$160,131 to \$264,050	7.85%
\$330,411 and above	\$198,631 and above	\$264,051 and above	9.85%

Income Tax Credits

- After calculation of tax base and application of rates, taxpayers apply credits.
- Credits reduce tax liability dollar for dollar; \$1 credit means \$1 reduction in tax.
- As compared to deductions/subtractions, credits are more valuable. A \$100 subtraction reduces tax liability by \$9.85 at most ($\$100 * 9.85\%$). For lower-income taxpayers, deductions do not change liability. A \$100 credit saves taxpayer \$100 in tax.
- **Nonrefundable credits:** reduce liability to \$0 at most.
- **Refundable credits:** reduce liability below \$0, resulting in a refund to the taxpayer.

Individual Income Tax Expenditures

- Some of the largest state tax expenditures are part of the individual income tax

Tax Expenditure	FY 24 Estimated Cost
Child credit and working family credit	\$712.7 million
Social Security subtraction	\$312.6 million
Nonitemizer charitable contribution subtraction	\$113.7 million
Marriage penalty credit	\$98.1 million
Mortgage interest deduction	\$73.5 million
Marriage penalty credit	\$98.1 Million
Standard deduction for the elderly and blind	\$53.8 million
Charitable contribution itemized deduction	\$44.7 million
Deduction for real estate taxes	\$36.6 million

Source: Minnesota Department of Revenue, 2024 Tax Expenditure Budget

State Income Tax on Business (1/5)

- C corporations (usually large, publicly traded companies) pay the corporate franchise tax at the entity level
- The starting point for the state corporate franchise tax is FTI
- Dividends may also be taxed

State Income Tax on Business (2/5)

- Pass-throughs, typically smaller with fewer owners, pay tax on income under the individual income tax, not at the entity level
- Owners receive a share of income, deductions, and credits
- Profits only taxed once under the income tax

State Income Tax on Business (3/5)

- Conformity to most federal deductions (e.g. business expenses)
- Exceptions – additions/subtractions (e.g. bonus depreciation)
- State tax credits are allowed to corporations and pass-throughs

State Income Tax on Business (4/5)

- Corporate income is apportioned to Minnesota based on sales
- Also applies to nonresident partnerships

State Income Tax on Business (5/5)

- Minnesota has "unitary taxation" (e.g., parents and subsidiaries)
- Intercompany transactions are eliminated
- Group income is apportioned based on group sales
- Prevents transfers from reducing Minnesota tax liability

Sales and Use Tax

Sales and Use Tax

- Tax rate – 6.875%
 - 6.5% general rate
 - 0.375% legacy amendment (sunsetting in 2032)
- Tax base
 - Goods (TPP and some intangibles) unless specifically exempted by law
 - Some services (i.e. – dry cleaning, car washes, lawn care)
- Imposed at retail (in-person and online)
- Collected by seller and remitted to state annually, quarterly, or monthly
- Revenue allocation
 - Proceeds from the 6.5% rate – general fund
 - Proceeds from the 0.375% – various legacy funds

Major Exemptions

For Individuals

- Food
- Clothing
- Home heating fuels
- Drugs for human consumption
- Newspaper & magazine subscriptions
- Cigarettes (in lieu sales tax)

For Businesses/Entities

- Capital equipment
- Farm machinery
- Certain direct inputs to agricultural and industrial production
- Certain purchases by data centers

Others

- Most sales to federal and local governments
- Many sales to nonprofit charitable, religious, educational, and youth organizations
- Certain sales by nonprofits

Streamlined Agreement

- Minnesota is a member state
- Provides for the facilitation of tax collection
- Restricts certain legislative actions
 - Same rate must apply to entire base
 - Certain definitions are standardized
- Changes to the agreement may require legislative action

Local Sales Taxes - Overview

- General prohibition on local sales and income taxes
- Some statutes preempt or notwithstanding the prohibition
 - Minn. Stat. § 297A.99 - general local sales taxes
 - Minn. Stat. § 469.190 - local lodging taxes
 - Minn. Stat. § 297A.993 - county transportation taxes

Local Sales Taxes - General

- General – apply to the same base as state sales tax
- Fund capital projects
- Collected and administered by DOR
 - Proceeds remitted to locality quarterly
- Expire after a certain number of years or a certain amount is collected
- Require legislative approval via special law
- Require voter approval after legislative approval
- Current moratorium ends June 1, 2025

County Transportation Taxes

- General – apply to the same base as state sales tax
- Collected and administered by DOR
 - Proceeds remitted to locality quarterly
- Proceeds used to fund county transportation and transit projects
- Do not require legislative or voter approval
 - Statutory authority in section 297A.993
- Rate is capped at 0.50%
- Do not expire

Local Sales Taxes – Special

Special – only imposed on certain transactions

Lodging	Food and Beverage	Entertainment, Amusement, Admissions
<ul style="list-style-type: none">• Imposed on lodging under 30 days• Collected by DOR or locality• Fund tourism promotion in locality• Up to 3 percent rate• Do not expire• Statutory authority – voter approval not required	<ul style="list-style-type: none">• Imposed on prepared food, beverage, and alcohol• Collected by DOR or locality• Require special law• Voter approval not usually required• Fund a capital project usually recreation related including operational costs	<ul style="list-style-type: none">• Imposed on admissions to events or recreation activities• Collected by DOR or locality• Require special law• Voter approval not usually required• Fund a capital project usually recreation related, including operational costs

State and Local Sales Tax Rates

- For in-person sales, location of transaction rate applies
- For online sales, destination rate applies to the transaction
- State rate and local rates combine into one larger rate that applies to the entire transaction
 - May be itemized or may be combined
- General sales taxes will apply to all transactions
- Special sales taxes will apply to only certain transactions, but will also include general sales taxes

Property Tax

Property Tax

- Primarily a local tax
 - Counties, cities/townships, school districts, and special taxing districts (e.g., watershed districts)
 - Collected locally, distributed directly to local jurisdictions
- State general levy
 - Raises \$758.7 million in CY 2024
 - General fund
- Tomorrow's presentation will have more information on property tax system, relief mechanisms, and state aids to local governments

Other Taxes

Other State Taxes (1/3)

Estate Tax

- Based on estate's value
- \$3 million exclusion

Taconite Production Tax

- In lieu property tax on taconite mining
- Revenues are distributed on the Iron Range

Occupation Tax

- Income tax for mining companies
- Base/rate differences

Gross Proceeds Tax

- Tax on mining of nonferrous minerals
- No taxpayers currently subject to the tax

Other State Taxes (2/3)

Cigarettes and Small Cigars	Tobacco Products	Cannabis	Alcoholic Beverages	Lawful Gambling
<ul style="list-style-type: none">• \$3.04/pack +• \$0.63 in lieu sales tax	<ul style="list-style-type: none">• 95% wholesale price	<ul style="list-style-type: none">• 10% gross receipts tax	<ul style="list-style-type: none">• \$5.03/gallon distilled spirits• \$0.30/gallon wine• \$0.15/gallon beer• \$0.08/gallon 3.2 beer• 2.5% gross receipts tax	<ul style="list-style-type: none">• 8.5% net receipts of bingo, raffles, and paddlewheels• 9% - 36% net receipts of pull tabs, tipboards, and e-bingo

Other State Taxes (3/3)

Mortgage Registry Tax

- 0.23% of principal debt

Deed Transfer Tax

- 0.33% of consideration

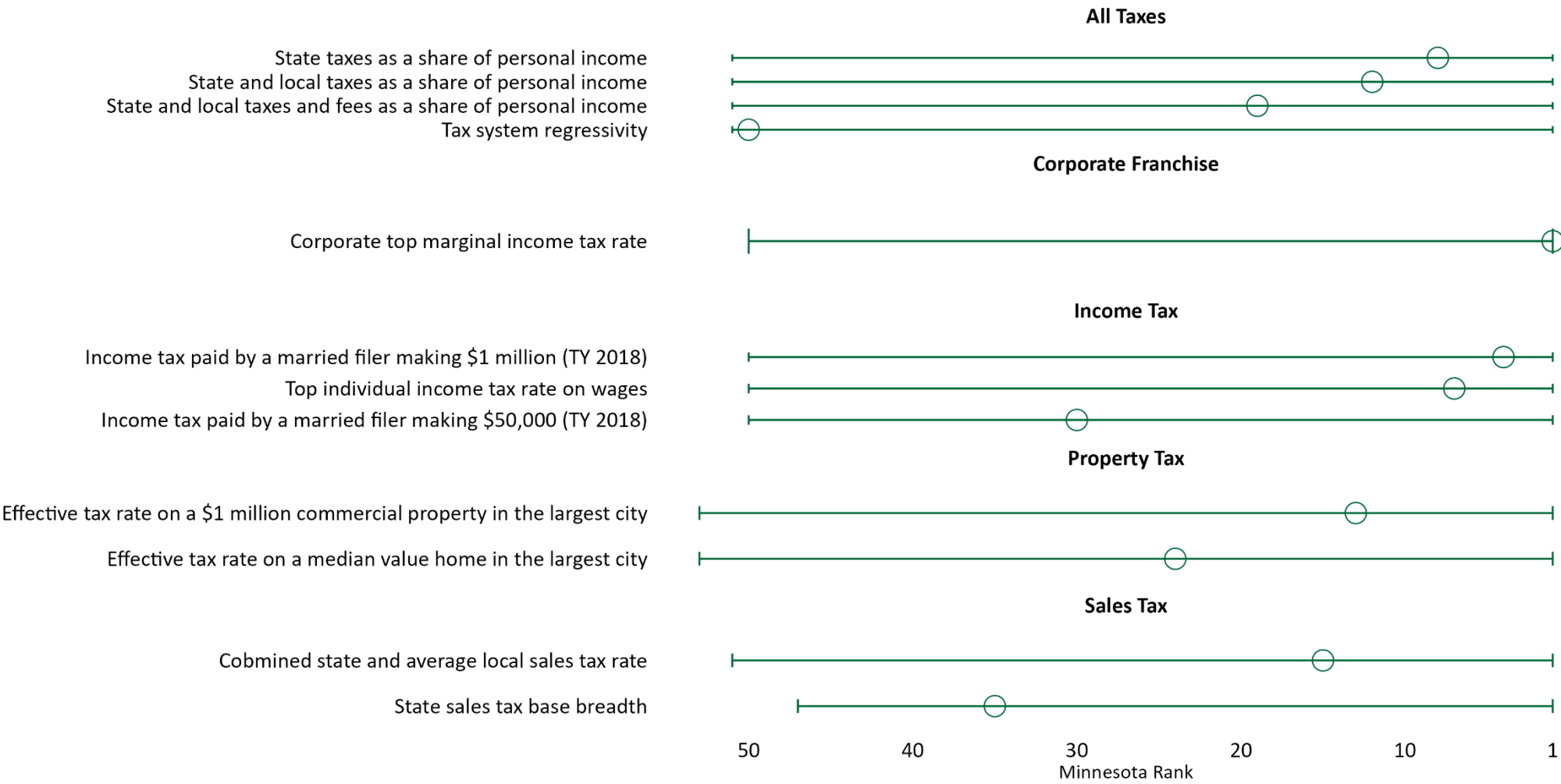
MinnesotaCare Taxes

- 1.8% gross revenue of health care providers

Insurance Premium Tax

- 2% of gross premiums
- 1.5% for life insurance
- 1% for HMOs

Minnesota State Tax Rankings



Graphic by House Research Department.

Tax Rankings Sources

State/local taxes and fees as a share of personal income:

House Research analysis of state and local tax and fee collections from the U.S. Census Bureau, 2022 Census of Governments: Finance.

State personal income data:

House Research analysis of United States Bureau of Economic Analysis, 2022 personal income data.

Corporate income tax rate:

House Research analysis of 2023 Federation of Tax Administrators, “Range of Corporate Income Tax Rates.” <https://taxadmin.org/2023-state-corporate-income-tax-rates/>

Income tax rates:

House Research analysis of Tax Foundation, State Individual income Tax Rates and Brackets, 2024. <https://taxadmin.org/2023-state-corporate-income-tax-rates/>

Income tax paid by married joint filer earning \$50,000:

Minnesota Center for Fiscal Excellence. “Comparison of Individual Income Tax Burdens by State.” 2021 analysis based on tax year 2018 data. https://cdn.ymaws.com/fiscalexcellence.site-ym.com/resource/resmgr/blog_posts_from_old_site/new_report_comparison_of_in.pdf

Property tax rankings:

Lincoln Institute of Land Policy and Minnesota Center for Fiscal Excellence. 2024. *50-State Property Tax Comparison Study: For Taxes Paid in 2023*. <https://www.lincolninst.edu/publications/other/50-state-property-tax-comparison-study-2023/>

Sales tax rankings:

Tax Foundation. State Sales Tax Breadth and Reliance, Fiscal Year 2022. Published July 23, 2024. <https://taxfoundation.org/data/all/state/sales-tax-revenue-reliance-breadth/>

Progressivity of Minnesota State Taxes

As Measured by Suits Index, Tax Year 2021



Data from the DOR 2024 Tax Incidence Study. Graphic by House Research Department.

GAO Criteria for Evaluating Tax Systems

- **Equity:** Horizontal and vertical:
 - **Horizontal equity:** same tax applies to individuals with same ability to pay
 - **Vertical equity:** taxpayers with greater ability to pay should pay more tax
- **Economic efficiency:** Reduce economic distortion caused by the tax system. Distortions reduce well-being by directing resources away from the highest value uses.
- **Simplicity, transparency, administrability:**
 - Simplicity makes the system more understandable, reduces compliance costs for taxpayers, reduces administrative costs.
 - Transparent systems reduce taxpayer uncertainty, which allows for better decision-making.
 - Administrative costs fall on both private and public actors.
- **Economic distortion and compliance costs are “dead-weight losses”**

Source: Government Accountability Office (GAO). “Understanding the tax reform debate.” September 2005.

GAO Criteria for Evaluating Tax Systems, Continued

- **Competitiveness:** Does the tax system disadvantage the state in competing for investment and business?
- **Revenue sufficiency:** Does the tax system raise enough revenue to fund state government?
- **Certainty:** Can taxpayers adequately predict the future tax climate?
- **Compliance/tax gap:** Reducing the difference between taxes paid and taxes owed.
- Property tax revenue estimates score bills based on 6 benchmarks:
(1) Transparency, Understandability, Simplicity & Accountability; (2) Efficiency & Compliance; (3) Equity (Vertical & Horizontal); (4) Stability & Predictability; (5) Competitiveness for Businesses; (6) Responsiveness to Economic Conditions

Source: Government Accountability Office (GAO). "Understanding the tax reform debate." September 2005.

Tax Incidence

- Tax incidence is a way of describing how the burden of a tax falls across the income distribution.
- Economists classify taxes as **proportional, regressive, or progressive**, depending on the effective tax rates paid at different income levels.
- **Effective tax rate:** the amount of tax paid by a group or individual, divided by that group or individual's income.

Source: Government Accountability Office (GAO). "Understanding the tax reform debate." September 2005.

Tax Incidence, Continued

- Department of Revenue Tax Incidence Study: released every two years (most recently March 2024)
- Most state taxes in Minnesota are regressive, meaning lower-income taxpayers pay a higher share of their total income in tax
- Income tax and the estate tax are the only progressive taxes

Constitutional Issues in State Taxation (1/4)

Commerce Clause

Privileges and immunities clause

Equal protection clause

Constitutional Issues in State Taxation (2/4)

- Nonpartisan staff will flag these issues
- It is an art, not a science
- Is about risks and trade-offs, not "dead" bills
- Laws may knowingly violate the constitution (e.g., *Wayfair*)

Constitutional Issues in State Taxation (3/4)

- Commerce clause is the most significant issue
 - States may not burden interstate commerce
 - "Dormant" commerce clause doctrine (special tax rules)
 - Big issue in taxes - discrimination against interstate commerce
 - Also "nexus" issues

Constitutional Issues in State Taxation (4/4)

- Privileges and immunities clause
 - Bars discrimination against nonresidents (along with commerce, EPC)
- Equal protection clause
 - Regulates discrimination among classes or groups
 - Invidious discrimination largely prohibited, but other forms of discrimination usually not prohibited (standards of review)
 - Minnesota uniformity clause
- Direct spending programs (commerce clause)
 - More flexibility