Agenda #1

Senators Ortman, Day, Senjem and Ruud introduced--

S.F. No. 753: Referred to the Committee on Taxes.

A bill for an act

relating to taxes; changing income, franchise, withholding, sales and use, gross revenues, insurance, property, and solid waste management taxes; providing a dairy investment credit; increasing the sales factor percentage in apportioning net income to this state; changing property tax refund provisions; providing for taxation of cigarettes and liquor; conforming provisions to changes in the Internal Revenue Code; providing for designation of an international economic development zone; changing disposition of certain general fund balance; requiring state contracts be with vendors that have registered to collect use taxes; changing provisions relating to the state elections campaign fund; changing certain city aid payments; authorizing tax credits for purposes of biotechnology and health sciences industry zone; appropriating money; amending Minnesota Statutes 2004, sections 10A.31, subdivisions 1, 3, 4; 16C.03, by adding a subdivision; 270A.03, subdivision 7; 272.02, by adding a subdivision; 273.1384, subdivision 1; 289A.02, subdivision 7; 289A.20, subdivision 2; 289A.50, subdivision 1; 290.01, subdivisions 6, 6b, 19, 19a, 19b, 19c, 19d, 29, 31; 290.032, subdivisions 1, 2; 290.06, subdivision 2c, by adding subdivisions; 290.067, subdivisions 1, 2a; 290.0671, subdivision 1; 290.0672, subdivisions 1, 2; 290.0675, subdivision 1; 290.091, subdivision 2; 290.0921, subdivision 3; 290.0922, subdivisions 2, 3; 290.191, subdivisions 2, 3; 290.92, by adding a subdivision; 290A.03, subdivisions 3, 11, 15; 295.53, subdivision 1; 297A.61, subdivisions 4, 7; 297A.67, by adding a subdivision; 297A.68, subdivisions 2, 5, by adding a subdivision; 297F.14, subdivision 4; 297H.13, subdivision 2; 297I.01, by adding a subdivision; 469.335; 473.843, subdivision 2; Laws 2001, First Special Session chapter 5, article 12, section 95; proposing coding for new law in Minnesota Statutes, chapters 295; 297A; 297F; 469; repealing Minnesota Statutes 2004, sections 10A.322, subdivision 4; 16A.1522, subdivision 4; 290.06, subdivision 23.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

ARTICLE 1

INCOME AND CORPORATE FRANCHISE TAXES

Section 1. Minnesota Statutes 2004, section 289A.20, subdivision 2, is amended to read:

Subd. 2. [WITHHOLDING FROM WAGES, ENTERTAINER WITHHOLDING, WITHHOLDING FROM PAYMENTS TO OUT-OF-STATE CONTRACTORS, AND WITHHOLDING BY PARTNERSHIPS AND SMALL BUSINESS CORPORATIONS.] (a) A tax required to be deducted and withheld during the quarterly period must be paid on or before the last day of the month following the close of the quarterly period, unless an earlier time for payment is provided. A tax required to be deducted and withheld from compensation of an entertainer and from a payment to an out-of-state contractor must be paid on or before the date the return for such tax must be filed under section 289A.18, subdivision 2. Taxes required to be deducted and withheld by partnerships ~~and~~, S corporations, and trusts must be paid on ~~or before the date the return must be filed under section 289A.18, subdivision 2~~ a quarterly basis as estimated taxes under section 289A.25 for partnerships and trusts and under section 289A.26 for S corporations.

(b) An employer who, during the previous quarter, withheld more than $1,500 of tax under section 290.92, subdivision 2a or 3, or 290.923, subdivision 2, must deposit tax withheld under those sections with the commissioner within the time allowed to deposit the employer's federal withheld employment taxes under Code of Federal Regulations, title 26, section 31.6302-1, as amended through December 31, 2001, without regard to the safe harbor or de minimis rules in subparagraph (f) or the one-day rule in subsection (c), clause (3). Taxpayers must submit a copy of their federal notice of deposit status to the commissioner upon request by the commissioner.

(c) The commissioner may prescribe by rule other return periods or deposit requirements. In prescribing the reporting period, the commissioner may classify payors according to the amount of their tax liability and may adopt an appropriate reporting period for the class that the commissioner judges to be consistent with efficient tax collection. In no event will the duration of the reporting period be more than one year.

(d) If less than the correct amount of tax is paid to the commissioner, proper adjustments with respect to both the tax and the amount to be deducted must be made, without interest, in the manner and at the times the commissioner prescribes. If the underpayment cannot be adjusted, the amount of the underpayment will be assessed and collected in the manner and at the times the commissioner prescribes.

(e) If the aggregate amount of the tax withheld during a fiscal year ending June 30 under section 290.92, subdivision 2a or 3, is equal to or exceeds the amounts established for remitting federal withheld taxes pursuant to the regulations promulgated under section 6302(h) of the Internal Revenue Code, the employer must remit each required deposit for wages paid in the subsequent calendar year by electronic means.

(f) A third-party bulk filer as defined in section 290.92, subdivision 30, paragraph (a), clause (2), who remits withholding deposits must remit all deposits by electronic means as provided in paragraph (e), regardless of the aggregate amount of tax withheld during a fiscal year for all of the employers.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2005.

Sec. 2. Minnesota Statutes 2004, section 290.01, subdivision 6b, is amended to read:

Subd. 6b. [FOREIGN OPERATING CORPORATION.] The term "foreign operating corporation," when applied to a corporation, means a domestic corporation with the following characteristics:

(1) it is part of a unitary business at least one member of which is taxable in this state;

(2) it is not a foreign sales corporation under section 922 of the Internal Revenue Code, as amended through December 31, 1999, for the taxable year; ~~and~~

(3) ~~either~~ (i) the average of the percentages of its property and payrolls, including the pro rata share of its unitary partnerships' property and payrolls, assigned to locations ~~inside~~ outside the United States ~~and the District of~~

~~Columbia,-excluding-the-commonwealth-of-Puerto-Rico-and possessions-of-the-United-States~~, where the United States includes the District of Columbia and excludes the commonwealth of Puerto Rico and possessions of the United States, as determined under section 290.191 or 290.20, is ~~20~~ 80 percent or ~~less~~ more; or (ii) it has in effect a valid election under section 936 of the Internal Revenue Code; and

(4) it has $1,000,000 of payroll and $2,000,000 of property, as determined under section 290.191 or 290.20, that are located outside the United States. If the domestic corporation does not have payroll as determined under section 290.191 or 290.20, but it or its partnerships have paid $1,000,000 for work, performed directly for the domestic corporation or the partnerships, outside the United States, then paragraph (3)(i) shall not require payrolls to be included in the average calculation.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 3. Minnesota Statutes 2002, section 290.06, is amended by adding a subdivision to read:

Subd. 29. [DAIRY INVESTMENT CREDIT.] (a) A dairy investment credit is allowed against the tax due under this chapter equal to ten percent of the amount paid or incurred by the taxpayer, on the first $300,000 of qualifying expenditures made in the qualifying period.

(b) "Qualifying expenditures" means for purposes of this subdivision the amount spent for the acquisition, construction, or improvement of buildings or facilities, or the acquisition of equipment, for dairy animal housing, confinement, animal feeding, milk production, and waste management, including the following, if related to dairy animals:

(1) freestall barns;

(2) fences;

(3) watering facilities;

(4) feed storage and handling equipment;

(5) milking parlors;

(6) robotic equipment;

(7) scales;

(8) milk storage and cooling facilities;

(9) bulk tanks;

(10) manure pumping and storage facilities;

(11) digesters; and

(12) equipment used to produce energy.

Qualified expenditures only include amounts that are capitalized and deducted under either section 167 or 179 of the Internal Revenue Code in computing federal taxable income.

(c) The credit is limited to the liability for tax, as computed under this chapter for the taxable year. If the amount of the credit determined under this section for any taxable year exceeds this limitation, the excess is a dairy investment credit carryover to each of the 15 succeeding taxable years. The entire amount of the excess unused credit for the taxable year is carried first to the earliest of the taxable years to which the credit may be carried and then to each successive year to which the credit may be carried. The amount of the unused credit which may be added under this paragraph shall not exceed the taxpayer's liability for tax less the dairy investment credit for the taxable year.

(d) The qualifying period is that time after December 31, 2005, and before January 1, 2012.

(e) The $30,000 maximum credit applies at the entity level for partnerships, S corporations, trusts, and estates as well as at the individual level. In the case of married individuals, the credit is limited to $30,000 for a married couple.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2005.

Sec. 4. Minnesota Statutes 2004, section 290.0672, subdivision 1, is amended to read:

Subdivision 1. [DEFINITIONS.] (a) For purposes of this section, the following terms have the meanings given.

(b) "Long-term care insurance" means a policy that:

(1) qualifies for a deduction under section 213 of the

Internal Revenue Code, disregarding the 7.5 percent income test; or meets the requirements given in section 62A.46; or provides similar coverage issued under the laws of another jurisdiction; and

(2) has a lifetime long-term care benefit limit of not less than $100,000; and

(3) has been offered in compliance with the inflation protection requirements of section 62S.23.

(c) "Qualified beneficiary" means the taxpayer or the taxpayer's spouse.

~~(d)-"Premiums-deducted-in-determining-federal-taxable income"-means-the-lesser-of-(1)-long-term-care-insurance premiums-that-qualify-as-deductions-under-section-213-of-the Internal-Revenue-Code;-and-(2)-the-total-amount-deductible-for medical-care-under-section-213-of-the-Internal-Revenue-Code.~~

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 5. Minnesota Statutes 2004, section 290.0672, subdivision 2, is amended to read:

Subd. 2. [CREDIT.] A taxpayer is allowed a credit against the tax imposed by this chapter for long-term care insurance policy premiums paid during the tax year. The credit for each policy equals 25 percent of premiums paid ~~to-the-extent-not deducted-in-determining-federal-taxable-income~~. A taxpayer may claim a credit for only one policy for each qualified beneficiary. A maximum of $100 applies to each qualified beneficiary. The maximum total credit allowed per year is $200 for married couples filing joint returns and $100 for all other filers. For a nonresident or part-year resident, the credit determined under this section must be allocated based on the percentage calculated under section 290.06, subdivision 2c, paragraph (e).

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 6. Minnesota Statutes 2004, section 290.191, subdivision 2, is amended to read:

Subd. 2. [APPORTIONMENT FORMULA OF GENERAL APPLICATION.] (a) Except for those trades or businesses required to use a different formula under subdivision 3 or section 290.36, and for those trades or businesses that receive permission to use some other method under section 290.20 or under subdivision 4, a trade or business required to apportion its net income must apportion its income to this state on the basis of the percentage obtained by taking the sum of:

(1) ~~75~~ the percent for the sales factor under paragraph (b) of the percentage which the sales made within this state in connection with the trade or business during the tax period are of the total sales wherever made in connection with the trade or business during the tax period;

(2) ~~12.5~~ the percent for the property factor under paragraph (b) of the percentage which the total tangible property used by the taxpayer in this state in connection with the trade or business during the tax period is of the total tangible property, wherever located, used by the taxpayer in connection with the trade or business during the tax period; and

(3) ~~12.5~~ the percent for the payroll factor under paragraph (b) of the percentage which the taxpayer's total payrolls paid or incurred in this state or paid in respect to labor performed in this state in connection with the trade or business during the tax period are of the taxpayer's total payrolls paid or incurred in connection with the trade or business during the tax period.

(b) For purposes of paragraph (a) and subdivision 3, the following percentages apply for the taxable years specified:

Taxable years beginning during calendar year	Sales factor percent	Property factor percent	Payroll factor percent
2007	78	11	11
2008	81	9.5	9.5
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 and later calendar years	100	0	0

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 7. Minnesota Statutes 2004, section 290.191, subdivision 3, is amended to read:

Subd. 3. [APPORTIONMENT FORMULA FOR FINANCIAL INSTITUTIONS.] Except for an investment company required to apportion its income under section 290.36, a financial institution that is required to apportion its net income must apportion its net income to this state on the basis of the percentage obtained by taking the sum of:

(1) ~~75~~ the percent for the sales factor under subdivision 2, paragraph (b), of the percentage which the receipts from within this state in connection with the trade or business during the tax period are of the total receipts in connection with the trade or business during the tax period, from wherever derived;

(2) ~~12.5~~ the percent for the property factor under subdivision 2, paragraph (b), of the percentage which the sum of the total tangible property used by the taxpayer in this state and the intangible property owned by the taxpayer and attributed to this state in connection with the trade or business during the tax period is of the sum of the total tangible property, wherever located, used by the taxpayer and the intangible property owned by the taxpayer and attributed to all states in connection with the trade or business during the tax period; and

(3) ~~12.5~~ the percent for the payroll factor under subdivision 2, paragraph (b), of the percentage which the taxpayer's total payrolls paid or incurred in this state or paid in respect to labor performed in this state in connection with the trade or business during the tax period are of the taxpayer's total payrolls paid or incurred in connection with

the trade or business during the tax period.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 8. Minnesota Statutes 2004, section 290.92, is amended by adding a subdivision to read:

Subd. 31. [PAYMENTS TO PERSONS WHO ARE NOT EMPLOYEES; WITHHOLDING.] Any person engaged in a trade or business who in the course of such trade or business makes payments to an individual, who is not an employee of the person, for work described in industry code numbers 23 through 238990 of the North American Industry Classification System, shall deduct from the payment and withhold two percent of the amount as Minnesota withholding tax when the amount paid to that individual by the same person during the calendar year exceeds $600. For purposes of this section, a payment to any person that is subject to withholding under this subdivision must be treated as if the payment was a wage paid by an employer to an employee. Every individual who is to receive a payment that is subject to withholding under this subdivision shall furnish the contracting person with a statement, containing the name, address, and Social Security account number of the person receiving the payment.

[EFFECTIVE DATE.] This section is effective for payments made after July 31, 2005.

ARTICLE 2

FEDERAL UPDATE

Section 1. Minnesota Statutes 2004, section 289A.02, subdivision 7, is amended to read:

Subd. 7. [INTERNAL REVENUE CODE.] Unless specifically defined otherwise, "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through ~~June 15, 2003~~ December 31, 2004.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 2. Minnesota Statutes 2004, section 290.01, subdivision 19, is amended to read:

Subd. 19. [NET INCOME.] The term "net income" means the federal taxable income, as defined in section 63 of the Internal Revenue Code of 1986, as amended through the date named in this subdivision, incorporating <u>the federal effective dates of changes to the Internal Revenue Code and</u> any elections made by the taxpayer in accordance with the Internal Revenue Code in determining federal taxable income for federal income tax purposes, and with the modifications provided in subdivisions 19a to 19f.

In the case of a regulated investment company or a fund thereof, as defined in section 851(a) or 851(g) of the Internal Revenue Code, federal taxable income means investment company taxable income as defined in section 852(b)(2) of the Internal Revenue Code, except that:

(1) the exclusion of net capital gain provided in section 852(b)(2)(A) of the Internal Revenue Code does not apply;

(2) the deduction for dividends paid under section 852(b)(2)(D) of the Internal Revenue Code must be applied by allowing a deduction for capital gain dividends and exempt-interest dividends as defined in sections 852(b)(3)(C) and 852(b)(5) of the Internal Revenue Code; and

(3) the deduction for dividends paid must also be applied in the amount of any undistributed capital gains which the regulated investment company elects to have treated as provided in section 852(b)(3)(D) of the Internal Revenue Code.

The net income of a real estate investment trust as defined and limited by section 856(a), (b), and (c) of the Internal Revenue Code means the real estate investment trust taxable income as defined in section 857(b)(2) of the Internal Revenue Code.

The net income of a designated settlement fund as defined in section 468B(d) of the Internal Revenue Code means the gross income as defined in section 468B(b) of the Internal Revenue Code.

~~The provisions of sections 1113(a), 1117, 1206(a), 1313(a), 1402(a), 1403(a), 1443, 1450, 1501(a), 1605, 1611(a), 1612,~~

~~1616,-1617,-1704(l),-and-1704(m)-of-the-Small-Business-Job Protection-Act,-Public-Law-104-188,-the-provisions-of-Public-Law 104-117,-the-provisions-of-sections-313(a)-and-(b)(1),-602(a), 913(b),-941,-961,-971,-1001(a)-and-(b),-1002,-1003,-1012,-1013, 1014,-1061,-1062,-1081,-1084(b),-1086,-1087,-1111(a),-1131(b) and-(c),-1211(b),-1213,-1530(c)(2),-1601(f)(5)-and-(h),-and 1604(d)(1)-of-the-Taxpayer-Relief-Act-of-1997,-Public-Law 105-34,-the-provisions-of-section-6010-of-the-Internal-Revenue Service-Restructuring-and-Reform-Act-of-1998,-Public-Law 105-206,-the-provisions-of-section-4003-of-the-Omnibus Consolidated-and-Emergency-Supplemental-Appropriations-Act, 1999,-Public-Law-105-277,-and-the-provisions-of-section-318-of the-Consolidated-Appropriation-Act-of-2001,-Public-Law-106-554, shall-become-effective-at-the-time-they-become-effective-for federal-purposes.~~

The Internal Revenue Code of 1986, as amended through December 31, ~~1996~~ 2004, shall be in effect for taxable years beginning after December 31, 1996. The provisions of Public Law 109-1, shall be effective for tax years beginning after December 31, 2003.

~~The-provisions-of-sections-202(a)-and-(b),-221(a),-225, 312,-313,-913(a),-934,-962,-1004,-1005,-1052,-1063,-1084(a)-and (c),-1089,-1112,-1171,-1204,-1271(a)-and-(b),-1305(a),-1306, 1307,-1308,-1309,-1501(b),-1502(b),-1504(a),-1505,-1527,-1528, 1530,-1601(d),-(e),-(f),-and-(i)-and-1602(a),-(b),-(c),-and-(e) of-the-Taxpayer-Relief-Act-of-1997,-Public-Law-105-34,-the provisions-of-sections-6004,-6005,-6012,-6013,-6015,-6016,-7002, and-7003-of-the-Internal-Revenue-Service-Restructuring-and Reform-Act-of-1998,-Public-Law-105-206,-the-provisions-of section-3001-of-the-Omnibus-Consolidated-and-Emergency Supplemental-Appropriations-Act,-1999,-Public-Law-105-277,-the provisions-of-section-3001-of-the-Miscellaneous-Trade-and Technical-Corrections-Act-of-1999,-Public-Law-106-36,-and-the provisions-of-section-316-of-the-Consolidated-Appropriation-Act of-2001,-Public-Law-106-554,-shall-become-effective-at-the-time they-become-effective-for-federal-purposes.~~

~~The-Internal-Revenue-Code-of-1986,-as-amended-through-December-31,-1997,-shall-be-in-effect-for-taxable-years-beginning-after-December-31,-1997.~~

~~The-provisions-of-sections-5002,-6009,-6011,-and-7001-of-the-Internal-Revenue-Service-Restructuring-and-Reform-Act-of-1998,-Public-Law-105-206,-the-provisions-of-section-9010-of-the-Transportation-Equity-Act-for-the-21st-Century,-Public-Law-105-178,-the-provisions-of-sections-1004,-4002,-and-5301-of-the-Omnibus-Consolidation-and-Emergency-Supplemental-Appropriations-Act,-1999,-Public-Law-105-277,-the-provision-of-section-303-of-the-Ricky-Ray-Hemophilia-Relief-Fund-Act-of-1998,-Public-Law-105-369,-the-provisions-of-sections-532,-534,-536,-537,-and-538-of-the-Ticket-to-Work-and-Work-Incentives-Improvement-Act-of-1999,-Public-Law-106-170,-the-provisions-of-the-Installment-Tax-Correction-Act-of-2000,-Public-Law-106-573,-and-the-provisions-of-section-309-of-the-Consolidated-Appropriation-Act-of-2001,-Public-Law-106-554,-shall-become-effective-at-the-time-they-become-effective-for-federal-purposes.~~

~~The-Internal-Revenue-Code-of-1986,-as-amended-through-December-31,-1998,-shall-be-in-effect-for-taxable-years-beginning-after-December-31,-1998.~~

~~The-provisions-of-the-FSC-Repeal-and-Extraterritorial-Income-Exclusion-Act-of-2000,-Public-Law-106-519,-and-the-provision-of-section-412-of-the-Job-Creation-and-Worker-Assistance-Act-of-2002,-Public-Law-107-147,-shall-become-effective-at-the-time-it-became-effective-for-federal-purposes.~~

~~The-Internal-Revenue-Code-of-1986,-as-amended-through-December-31,-1999,-shall-be-in-effect-for-taxable-years-beginning-after-December-31,-1999.--The-provisions-of-sections-306-and-401-of-the-Consolidated-Appropriation-Act-of-2001,-Public-Law-106-554,-and-the-provision-of-section-632(b)(2)(A)-of-the-Economic-Growth-and-Tax-Relief-Reconciliation-Act-of-2001,-Public-Law-107-16,-and-provisions-of-sections-101-and-402-of-the-Job-Creation-and-Worker-Assistance-Act-of-2002,-Public-Law-107-147,-shall-become-effective-at-the-same-time-it-became-effective-for-federal-purposes.~~

~~The Internal Revenue Code of 1986, as amended through December 31, 2000, shall be in effect for taxable years beginning after December 31, 2000. The provisions of sections 659a and 671 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, the provisions of sections 104, 105, and 111 of the Victims of Terrorism Tax Relief Act of 2001, Public Law 107-134, and the provisions of sections 201, 403, 413, and 606 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147, shall become effective at the same time it became effective for federal purposes.~~

~~The Internal Revenue Code of 1986, as amended through March 15, 2002, shall be in effect for taxable years beginning after December 31, 2001.~~

~~The provisions of sections 101 and 102 of the Victims of Terrorism Tax Relief Act of 2001, Public Law 107-134, shall become effective at the same time it becomes effective for federal purposes.~~

~~The Internal Revenue Code of 1986, as amended through June 15, 2003, shall be in effect for taxable years beginning after December 31, 2002. The provisions of section 201 of the Jobs and Growth Tax Relief and Reconciliation Act of 2003, H.R. 2, if it is enacted into law, are effective at the same time it became effective for federal purposes.~~

Except as otherwise provided, references to the Internal Revenue Code in subdivisions ~~19a~~ 19 to ~~19g~~ 19f mean the code in effect for purposes of determining net income for the applicable year.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 3. Minnesota Statutes 2004, section 290.01, subdivision 19a, is amended to read:

Subd. 19a. [ADDITIONS TO FEDERAL TAXABLE INCOME.] For individuals, estates, and trusts, there shall be added to federal taxable income:

(1)(i) interest income on obligations of any state other than Minnesota or a political or governmental subdivision, municipality, or governmental agency or instrumentality of any state other than Minnesota exempt from federal income taxes under the Internal Revenue Code or any other federal statute; and

(ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code, except the portion of the exempt-interest dividends derived from interest income on obligations of the state of Minnesota or its political or governmental subdivisions, municipalities, governmental agencies or instrumentalities, but only if the portion of the exempt-interest dividends from such Minnesota sources paid to all shareholders represents 95 percent or more of the exempt-interest dividends that are paid by the regulated investment company as defined in section 851(a) of the Internal Revenue Code, or the fund of the regulated investment company as defined in section 851(g) of the Internal Revenue Code, making the payment; and

(iii) for the purposes of items (i) and (ii), interest on obligations of an Indian tribal government described in section 7871(c) of the Internal Revenue Code shall be treated as interest income on obligations of the state in which the tribe is located;

(2) the amount of income <u>or sales and use</u> taxes paid or accrued within the taxable year under this chapter and income <u>or sales and use</u> taxes paid to any other state or to any province or territory of Canada, to the extent allowed as a deduction under section 63(d) of the Internal Revenue Code, but the addition may not be more than the amount by which the itemized deductions as allowed under section 63(d) of the Internal Revenue Code exceeds the amount of the standard deduction as defined in section 63(c) of the Internal Revenue Code <u>of 1986, as amended through June 15, 2003</u>. For the purpose of this paragraph, the disallowance of itemized deductions under section 68 of the Internal Revenue Code of 1986, income <u>or sales and use</u> tax is the last itemized deduction disallowed;

(3) the capital gain amount of a lump sum distribution to which the special tax under section 1122(h)(3)(B)(ii) of the Tax Reform Act of 1986, Public Law 99-514, applies;

(4) the amount of income taxes paid or accrued within the taxable year under this chapter and income taxes paid to any other state or any province or territory of Canada, to the extent allowed as a deduction in determining federal adjusted gross income. For the purpose of this paragraph, income taxes do not include the taxes imposed by sections 290.0922, subdivision 1, paragraph (b), 290.9727, 290.9728, and 290.9729;

(5) the amount of expense, interest, or taxes disallowed pursuant to section 290.10;

(6) the amount of a partner's pro rata share of net income which does not flow through to the partner because the partnership elected to pay the tax on the income under section 6242(a)(2) of the Internal Revenue Code; ~~and~~

(7) 80 percent of the depreciation deduction allowed under section 168(k) of the Internal Revenue Code. For purposes of this clause, if the taxpayer has an activity that in the taxable year generates a deduction for depreciation under section 168(k) and the activity generates a loss for the taxable year that the taxpayer is not allowed to claim for the taxable year, "the depreciation allowed under section 168(k)" for the taxable year is limited to excess of the depreciation claimed by the activity under section 168(k) over the amount of the loss from the activity that is not allowed in the taxable year. In succeeding taxable years when the losses not allowed in the taxable year are allowed, the depreciation under section 168(k) is allowed;

(8) 80 percent of the amount by which the deduction allowed by section 179 of the Internal Revenue Code exceeds the deduction allowable by section 179 of the Internal Revenue Code of 1986, as amended through December 31, 2003;

(9) to the extent deducted in computing federal taxable income, the amount of the deduction allowable under section 199 of the Internal Revenue Code; and

(10) to the extent deducted in computing federal taxable

income, the amount by which the standard deduction allowed under section 63(c) of the Internal Revenue Code exceeds the standard deduction allowable under section 63(c) of the Internal Revenue Code of 1986, as amended through December 31, 2003.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004, except the changes in clause (2) are effective for tax years beginning after December 31, 2003.

Sec. 4. Minnesota Statutes 2004, section 290.01, subdivision 19b, is amended to read:

Subd. 19b. [SUBTRACTIONS FROM FEDERAL TAXABLE INCOME.] For individuals, estates, and trusts, there shall be subtracted from federal taxable income:

(1) interest income on obligations of any authority, commission, or instrumentality of the United States to the extent includable in taxable income for federal income tax purposes but exempt from state income tax under the laws of the United States;

(2) if included in federal taxable income, the amount of any overpayment of income tax to Minnesota or to any other state, for any previous taxable year, whether the amount is received as a refund or as a credit to another taxable year's income tax liability;

(3) the amount paid to others, less the amount used to claim the credit allowed under section 290.0674, not to exceed $1,625 for each qualifying child in grades kindergarten to 6 and $2,500 for each qualifying child in grades 7 to 12, for tuition, textbooks, and transportation of each qualifying child in attending an elementary or secondary school situated in Minnesota, North Dakota, South Dakota, Iowa, or Wisconsin, wherein a resident of this state may legally fulfill the state's compulsory attendance laws, which is not operated for profit, and which adheres to the provisions of the Civil Rights Act of 1964 and chapter 363A. For the purposes of this clause, "tuition" includes fees or tuition as defined in section 290.0674, subdivision 1, clause (1). As used in this clause,

"textbooks" includes books and other instructional materials and equipment purchased or leased for use in elementary and secondary schools in teaching only those subjects legally and commonly taught in public elementary and secondary schools in this state. Equipment expenses qualifying for deduction includes expenses as defined and limited in section 290.0674, subdivision 1, clause (3). "Textbooks" does not include instructional books and materials used in the teaching of religious tenets, doctrines, or worship, the purpose of which is to instill such tenets, doctrines, or worship, nor does it include books or materials for, or transportation to, extracurricular activities including sporting events, musical or dramatic events, speech activities, driver's education, or similar programs. For purposes of the subtraction provided by this clause, "qualifying child" has the meaning given in section 32(c)(3) of the Internal Revenue Code;

(4) income as provided under section 290.0802;

(5) to the extent included in federal adjusted gross income, income realized on disposition of property exempt from tax under section 290.491;

(6) to the extent included in federal taxable income, postservice benefits for youth community service under section 124D.42 for volunteer service under United States Code, title 42, sections 12601 to 12604;

(7) to the extent not deducted in determining federal taxable income by an individual who does not itemize deductions for federal income tax purposes for the taxable year, an amount equal to 50 percent of the excess of charitable contributions over $500 allowable as a deduction for the taxable year under section 170(a) of the Internal Revenue Code ~~over $500~~ and under the provisions of Public Law 109-1;

(8) for taxable years beginning before January 1, 2008, the amount of the federal small ethanol producer credit allowed under section 40(a)(3) of the Internal Revenue Code which is included in gross income under section 87 of the Internal Revenue Code;

(9) for individuals who are allowed a federal foreign tax credit for taxes that do not qualify for a credit under section 290.06, subdivision 22, an amount equal to the carryover of subnational foreign taxes for the taxable year, but not to exceed the total subnational foreign taxes reported in claiming the foreign tax credit. For purposes of this clause, "federal foreign tax credit" means the credit allowed under section 27 of the Internal Revenue Code, and "carryover of subnational foreign taxes" equals the carryover allowed under section 904(c) of the Internal Revenue Code minus national level foreign taxes to the extent they exceed the federal foreign tax credit;

(10) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (7), an amount equal to one-fifth of the delayed depreciation. For purposes of this clause, "delayed depreciation" means the amount of the addition made by the taxpayer under subdivision 19a, clause (7), minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. The resulting delayed depreciation cannot be less than zero; ~~and~~

(11) job opportunity building zone income as provided under section 469.316~~.~~;

(12) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (8), or 19c, clause (17), in the case of a shareholder of a corporation that is an S corporation, an amount equal to one-fifth of the addition made by the taxpayer under subdivision 19a, clause (8), or 19c, clause (17), in the case of a shareholder of a corporation that is an S corporation, minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. If the net operating loss exceeds the addition for the tax year, a subtraction is not allowed under this clause; and

(13) to the extent included in federal taxable income,

compensation paid to a service member as defined in United States Code, title 10, section 101(a)(5), for military service as defined in the Service Member Civil Relief Act, Public Law 108-189, section 101(2), and compensation paid for state active service as defined in section 190.05, subdivision 5a, clauses (1) and (3), or federally funded state active service as defined in section 190.05, subdivision 5b. This subtraction does not apply to retirement income as defined in section 290.17, subdivision 2, paragraph (a), clause (3).

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004, except the change to clause (7) is effective for tax years beginning after December 31, 2003.

Sec. 5. Minnesota Statutes 2004, section 290.01, subdivision 19c, is amended to read:

Subd. 19c. [CORPORATIONS; ADDITIONS TO FEDERAL TAXABLE INCOME.] For corporations, there shall be added to federal taxable income:

(1) the amount of any deduction taken for federal income tax purposes for income, excise, or franchise taxes based on net income or related minimum taxes, including but not limited to the tax imposed under section 290.0922, paid by the corporation to Minnesota, another state, a political subdivision of another state, the District of Columbia, or any foreign country or possession of the United States;

(2) interest not subject to federal tax upon obligations of: the United States, its possessions, its agencies, or its instrumentalities; the state of Minnesota or any other state, any of its political or governmental subdivisions, any of its municipalities, or any of its governmental agencies or instrumentalities; the District of Columbia; or Indian tribal governments;

(3) exempt-interest dividends received as defined in section 852(b)(5) of the Internal Revenue Code;

(4) the amount of any net operating loss deduction taken for federal income tax purposes under section 172 or 832(c)(10) of the Internal Revenue Code or operations loss deduction under

section 810 of the Internal Revenue Code;

(5) the amount of any special deductions taken for federal income tax purposes under sections 241 to 247 of the Internal Revenue Code;

(6) losses from the business of mining, as defined in section 290.05, subdivision 1, clause (a), that are not subject to Minnesota income tax;

(7) the amount of any capital losses deducted for federal income tax purposes under sections 1211 and 1212 of the Internal Revenue Code;

(8) the exempt foreign trade income of a foreign sales corporation under sections 921(a) and 291 of the Internal Revenue Code;

(9) the amount of percentage depletion deducted under sections 611 through 614 and 291 of the Internal Revenue Code;

(10) for certified pollution control facilities placed in service in a taxable year beginning before December 31, 1986, and for which amortization deductions were elected under section 169 of the Internal Revenue Code of 1954, as amended through December 31, 1985, the amount of the amortization deduction allowed in computing federal taxable income for those facilities;

(11) the amount of any deemed dividend from a foreign operating corporation determined pursuant to section 290.17, subdivision 4, paragraph (g);

(12) the amount of any environmental tax paid under section 59(a) of the Internal Revenue Code;

(13) the amount of a partner's pro rata share of net income which does not flow through to the partner because the partnership elected to pay the tax on the income under section 6242(a)(2) of the Internal Revenue Code;

(14) the amount of net income excluded under section 114 of the Internal Revenue Code;

(15) any increase in subpart F income, as defined in section 952(a) of the Internal Revenue Code, for the taxable year when subpart F income is calculated without regard to the

provisions of section 614 of Public Law 107-147; ~~and~~

(16) 80 percent of the depreciation deduction allowed under section 168(k) of the Internal Revenue Code. For purposes of this clause, if the taxpayer has an activity that in the taxable year generates a deduction for depreciation under section 168(k) and the activity generates a loss for the taxable year that the taxpayer is not allowed to claim for the taxable year, "the depreciation allowed under section 168(k)" for the taxable year is limited to excess of the depreciation claimed by the activity under section 168(k) over the amount of the loss from the activity that is not allowed in the taxable year. In succeeding taxable years when the losses not allowed in the taxable year are allowed, the depreciation under section 168(k) is allowed;

(17) 80 percent of the amount by which the deduction allowed by section 179 of the Internal Revenue Code exceeds the deduction allowable by section 179 of the Internal Revenue Code of 1986, as amended through December 31, 2003; and

(18) to the extent deducted in computing federal taxable income, the amount of the deduction allowable under section 199 of the Internal Revenue Code.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 6. Minnesota Statutes 2004, section 290.01, subdivision 19d, is amended to read:

Subd. 19d. [CORPORATIONS; MODIFICATIONS DECREASING FEDERAL TAXABLE INCOME.] For corporations, there shall be subtracted from federal taxable income after the increases provided in subdivision 19c:

(1) the amount of foreign dividend gross-up added to gross income for federal income tax purposes under section 78 of the Internal Revenue Code;

(2) the amount of salary expense not allowed for federal income tax purposes due to claiming the federal jobs credit under section 51 of the Internal Revenue Code;

(3) any dividend (not including any distribution in liquidation) paid within the taxable year by a national or state

bank to the United States, or to any instrumentality of the United States exempt from federal income taxes, on the preferred stock of the bank owned by the United States or the instrumentality;

(4) amounts disallowed for intangible drilling costs due to differences between this chapter and the Internal Revenue Code in taxable years beginning before January 1, 1987, as follows:

(i) to the extent the disallowed costs are represented by physical property, an amount equal to the allowance for depreciation under Minnesota Statutes 1986, section 290.09, subdivision 7, subject to the modifications contained in subdivision 19e; and

(ii) to the extent the disallowed costs are not represented by physical property, an amount equal to the allowance for cost depletion under Minnesota Statutes 1986, section 290.09, subdivision 8;

(5) the deduction for capital losses pursuant to sections 1211 and 1212 of the Internal Revenue Code, except that:

(i) for capital losses incurred in taxable years beginning after December 31, 1986, capital loss carrybacks shall not be allowed;

(ii) for capital losses incurred in taxable years beginning after December 31, 1986, a capital loss carryover to each of the 15 taxable years succeeding the loss year shall be allowed;

(iii) for capital losses incurred in taxable years beginning before January 1, 1987, a capital loss carryback to each of the three taxable years preceding the loss year, subject to the provisions of Minnesota Statutes 1986, section 290.16, shall be allowed; and

(iv) for capital losses incurred in taxable years beginning before January 1, 1987, a capital loss carryover to each of the five taxable years succeeding the loss year to the extent such loss was not used in a prior taxable year and subject to the provisions of Minnesota Statutes 1986, section 290.16, shall be allowed;

(6) an amount for interest and expenses relating to income

not taxable for federal income tax purposes, if (i) the income is taxable under this chapter and (ii) the interest and expenses were disallowed as deductions under the provisions of section 171(a)(2), 265 or 291 of the Internal Revenue Code in computing federal taxable income;

(7) in the case of mines, oil and gas wells, other natural deposits, and timber for which percentage depletion was disallowed pursuant to subdivision 19c, clause (11), a reasonable allowance for depletion based on actual cost. In the case of leases the deduction must be apportioned between the lessor and lessee in accordance with rules prescribed by the commissioner. In the case of property held in trust, the allowable deduction must be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the trust, or if there is no provision in the instrument, on the basis of the trust's income allocable to each;

(8) for certified pollution control facilities placed in service in a taxable year beginning before December 31, 1986, and for which amortization deductions were elected under section 169 of the Internal Revenue Code of 1954, as amended through December 31, 1985, an amount equal to the allowance for depreciation under Minnesota Statutes 1986, section 290.09, subdivision 7;

(9) amounts included in federal taxable income that are due to refunds of income, excise, or franchise taxes based on net income or related minimum taxes paid by the corporation to Minnesota, another state, a political subdivision of another state, the District of Columbia, or a foreign country or possession of the United States to the extent that the taxes were added to federal taxable income under section 290.01, subdivision 19c, clause (1), in a prior taxable year;

(10) 80 percent of royalties, fees, or other like income accrued or received from a foreign operating corporation or a foreign corporation which is part of the same unitary business as the receiving corporation;

(11) income or gains from the business of mining as defined in section 290.05, subdivision 1, clause (a), that are not subject to Minnesota franchise tax;

(12) the amount of handicap access expenditures in the taxable year which are not allowed to be deducted or capitalized under section 44(d)(7) of the Internal Revenue Code;

(13) the amount of qualified research expenses not allowed for federal income tax purposes under section 280C(c) of the Internal Revenue Code, but only to the extent that the amount exceeds the amount of the credit allowed under section 290.068;

(14) the amount of salary expenses not allowed for federal income tax purposes due to claiming the Indian employment credit under section 45A(a) of the Internal Revenue Code;

(15) the amount of any refund of environmental taxes paid under section 59A of the Internal Revenue Code;

(16) for taxable years beginning before January 1, 2008, the amount of the federal small ethanol producer credit allowed under section 40(a)(3) of the Internal Revenue Code which is included in gross income under section 87 of the Internal Revenue Code;

(17) for a corporation whose foreign sales corporation, as defined in section 922 of the Internal Revenue Code, constituted a foreign operating corporation during any taxable year ending before January 1, 1995, and a return was filed by August 15, 1996, claiming the deduction under section 290.21, subdivision 4, for income received from the foreign operating corporation, an amount equal to 1.23 multiplied by the amount of income excluded under section 114 of the Internal Revenue Code, provided the income is not income of a foreign operating company;

(18) any decrease in subpart F income, as defined in section 952(a) of the Internal Revenue Code, for the taxable year when subpart F income is calculated without regard to the provisions of section 614 of Public Law 107-147; ~~and~~

(19) in each of the five tax years immediately following the tax year in which an addition is required under subdivision

19c, clause (16), an amount equal to one-fifth of the delayed depreciation. For purposes of this clause, "delayed depreciation" means the amount of the addition made by the taxpayer under subdivision 19c, clause (16). The resulting delayed depreciation cannot be less than zero; and

(20) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19c, clause (17), an amount equal to one-fifth of the amount of the addition.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 7. Minnesota Statutes 2004, section 290.01, subdivision 31, is amended to read:

Subd. 31. [INTERNAL REVENUE CODE.] Unless specifically defined otherwise, "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through ~~June-15,-2003~~ December 31, 2004.

[EFFECTIVE DATE.] This section is effective the day following final enactment except the changes incorporated by federal changes are effective at the same times as the changes were effective for federal purposes.

Sec. 8. Minnesota Statutes 2004, section 290.032, subdivision 1, is amended to read:

Subdivision 1. [IMPOSITION.] There is hereby imposed as an addition to the annual income tax for a taxable year of a taxpayer in the classes described in section 290.03 a tax with respect to any distribution received by such taxpayer that is treated as a lump sum distribution under section ~~402(d)-of-the Internal-Revenue-Code~~ 1401(c)(2) of the Small Business Job Protection Act, Public Law 104-188 and that is subject to tax for such taxable year under section ~~402(d)-of-the-Internal Revenue-Code~~ 1401(c)(2) of the Small Business Job Protection Act, Public Law 104-188.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 1999.

Sec. 9. Minnesota Statutes 2004, section 290.032,

subdivision 2, is amended to read:

Subd. 2. [COMPUTATION.] The amount of tax imposed by subdivision 1 shall be computed in the same way as the tax imposed under section 402(d) of the Internal Revenue Code <u>of 1986, as amended through December 31, 1995</u>, except that the initial separate tax shall be an amount equal to five times the tax which would be imposed by section 290.06, subdivision 2c, if the recipient was an unmarried individual, and the taxable net income was an amount equal to one-fifth of the excess of

(i) the total taxable amount of the lump sum distribution for the year, over

(ii) the minimum distribution allowance, and except that references in section 402(d) of the Internal Revenue Code <u>of 1986, as amended through December 31, 1995,</u> to paragraph (1)(A) thereof shall instead be references to subdivision 1, and the excess, if any, of the subtraction base amount over federal taxable income for a qualified individual as provided under section 290.0802, subdivision 2.

[EFFECTIVE DATE.] <u>This section is effective for tax years beginning after December 31, 1999.</u>

Sec. 10. Minnesota Statutes 2004, section 290.06, subdivision 2c, is amended to read:

Subd. 2c. [SCHEDULES OF RATES FOR INDIVIDUALS, ESTATES, AND TRUSTS.] (a) The income taxes imposed by this chapter upon married individuals filing joint returns and surviving spouses as defined in section 2(a) of the Internal Revenue Code must be computed by applying to their taxable net income the following schedule of rates:

(1) On the first $25,680, 5.35 percent;

(2) On all over $25,680, but not over $102,030, 7.05 percent;

(3) On all over $102,030, 7.85 percent.

Married individuals filing separate returns, estates, and trusts must compute their income tax by applying the above rates to their taxable income, except that the income brackets will be one-half of the above amounts.

(b) The income taxes imposed by this chapter upon unmarried individuals must be computed by applying to taxable net income the following schedule of rates:

(1) On the first $17,570, 5.35 percent;

(2) On all over $17,570, but not over $57,710, 7.05 percent;

(3) On all over $57,710, 7.85 percent.

(c) The income taxes imposed by this chapter upon unmarried individuals qualifying as a head of household as defined in section 2(b) of the Internal Revenue Code must be computed by applying to taxable net income the following schedule of rates:

(1) On the first $21,630, 5.35 percent;

(2) On all over $21,630, but not over $86,910, 7.05 percent;

(3) On all over $86,910, 7.85 percent.

(d) In lieu of a tax computed according to the rates set forth in this subdivision, the tax of any individual taxpayer whose taxable net income for the taxable year is less than an amount determined by the commissioner must be computed in accordance with tables prepared and issued by the commissioner of revenue based on income brackets of not more than $100. The amount of tax for each bracket shall be computed at the rates set forth in this subdivision, provided that the commissioner may disregard a fractional part of a dollar unless it amounts to 50 cents or more, in which case it may be increased to $1.

(e) An individual who is not a Minnesota resident for the entire year must compute the individual's Minnesota income tax as provided in this subdivision. After the application of the nonrefundable credits provided in this chapter, the tax liability must then be multiplied by a fraction in which:

(1) the numerator is the individual's Minnesota source federal adjusted gross income as defined in section 62 of the Internal Revenue Code and increased by the additions required under section 290.01, subdivision 19a, clauses (1), (5), ~~and~~ (6), (7), (8), and (9), and reduced by the subtraction under section 290.01, subdivision 19b, clause (11), and the Minnesota

assignable portion of the subtraction for United States government interest under section 290.01, subdivision 19b, clause (1), and the subtractions under clauses (10), (11), (12), and (13), after applying the allocation and assignability provisions of section 290.081, clause (a), or 290.17; and

(2) the denominator is the individual's federal adjusted gross income as defined in section 62 of the Internal Revenue Code of 1986, increased by the amounts specified in section 290.01, subdivision 19a, clauses (1), (5), ~~and~~ (6), (7), (8), and (9), and reduced by the amounts specified in section 290.01, subdivision 19b, clauses (1) ~~and~~, (10), (11), (12), and (13).

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 11. Minnesota Statutes 2004, section 290.067, subdivision 2a, is amended to read:

Subd. 2a. [INCOME.] (a) For purposes of this section, "income" means the sum of the following:

(1) federal adjusted gross income as defined in section 62 of the Internal Revenue Code; and

(2) the sum of the following amounts to the extent not included in clause (1):

(i) all nontaxable income;

(ii) the amount of a passive activity loss that is not disallowed as a result of section 469, paragraph (i) or (m) of the Internal Revenue Code and the amount of passive activity loss carryover allowed under section 469(b) of the Internal Revenue Code;

(iii) an amount equal to the total of any discharge of qualified farm indebtedness of a solvent individual excluded from gross income under section 108(g) of the Internal Revenue Code;

(iv) cash public assistance and relief;

(v) any pension or annuity (including railroad retirement benefits, all payments received under the federal Social Security Act, supplemental security income, and veterans benefits), which was not exclusively funded by the claimant or spouse, or which was funded exclusively by the claimant or spouse and which funding payments were excluded from federal adjusted gross income in the years when the payments were made;

(vi) interest received from the federal or a state government or any instrumentality or political subdivision thereof;

(vii) workers' compensation;

(viii) nontaxable strike benefits;

(ix) the gross amounts of payments received in the nature of disability income or sick pay as a result of accident, sickness, or other disability, whether funded through insurance or otherwise;

(x) a lump sum distribution under section 402(e)(3) of the Internal Revenue Code of 1986, as amended through December 31, 1995;

(xi) contributions made by the claimant to an individual retirement account, including a qualified voluntary employee contribution; simplified employee pension plan; self-employed retirement plan; cash or deferred arrangement plan under section 401(k) of the Internal Revenue Code; or deferred compensation plan under section 457 of the Internal Revenue Code; ~~and~~

(xii) nontaxable scholarship or fellowship grants;

(xiii) the amount of deduction allowed under section 199 of the Internal Revenue Code; and

(xiv) the amount of deduction allowed under section 220 or 223 of the Internal Revenue Code.

In the case of an individual who files an income tax return on a fiscal year basis, the term "federal adjusted gross income" means federal adjusted gross income reflected in the fiscal year ending in the next calendar year. Federal adjusted gross income may not be reduced by the amount of a net operating loss carryback or carryforward or a capital loss carryback or carryforward allowed for the year.

(b) "Income" does not include:

(1) amounts excluded pursuant to the Internal Revenue Code, sections 101(a) and 102;

(2) amounts of any pension or annuity that were exclusively funded by the claimant or spouse if the funding payments were not excluded from federal adjusted gross income in the years when the payments were made;

(3) surplus food or other relief in kind supplied by a governmental agency;

(4) relief granted under chapter 290A;

(5) child support payments received under a temporary or final decree of dissolution or legal separation; and

(6) restitution payments received by eligible individuals and excludable interest as defined in section 803 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2003.

Sec. 12. Minnesota Statutes 2004, section 290.0675, subdivision 1, is amended to read:

Subdivision 1. [DEFINITIONS.] (a) For purposes of this section the following terms have the meanings given.

(b) "Earned income" means the sum of the following, to the extent included in Minnesota taxable income:

(1) earned income as defined in section 32(c)(2) of the Internal Revenue Code;

(2) income received from a retirement pension, profit-sharing, stock bonus, or annuity plan; and

(3) Social Security benefits as defined in section 86(d)(1) of the Internal Revenue Code.

(c) "Taxable income" means net income as defined in section 290.01, subdivision 19.

(d) "Earned income of lesser-earning spouse" means the earned income of the spouse with the lesser amount of earned income as defined in paragraph (b) for the taxable year minus the sum of (i) the amount for one exemption under section 151(d) of the Internal Revenue Code and (ii) one-half the amount of the standard deduction under section 63(c)(2)(A) and (4) of the Internal Revenue Code of 1986, as amended through December 31,

<u>2003</u>.

[EFFECTIVE DATE.] <u>This section is effective for tax years beginning after December 31, 2004.</u>

Sec. 13. Minnesota Statutes 2004, section 290.091, subdivision 2, is amended to read:

Subd. 2. [DEFINITIONS.] For purposes of the tax imposed by this section, the following terms have the meanings given:

(a) "Alternative minimum taxable income" means the sum of the following for the taxable year:

(1) the taxpayer's federal alternative minimum taxable income as defined in section 55(b)(2) of the Internal Revenue Code;

(2) the taxpayer's itemized deductions allowed in computing federal alternative minimum taxable income, but excluding:

(i) the charitable contribution deduction under section 170 of the Internal Revenue Code to the extent that the deduction exceeds 1.0 percent of adjusted gross income, as defined in section 62 of the Internal Revenue Code;

(ii) the medical expense deduction;

(iii) the casualty, theft, and disaster loss deduction; and

(iv) the impairment-related work expenses of a disabled person;

(3) for depletion allowances computed under section 613A(c) of the Internal Revenue Code, with respect to each property (as defined in section 614 of the Internal Revenue Code), to the extent not included in federal alternative minimum taxable income, the excess of the deduction for depletion allowable under section 611 of the Internal Revenue Code for the taxable year over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year);

(4) to the extent not included in federal alternative minimum taxable income, the amount of the tax preference for intangible drilling cost under section 57(a)(2) of the Internal Revenue Code determined without regard to subparagraph (E);

(5) to the extent not included in federal alternative

minimum taxable income, the amount of interest income as provided by section 290.01, subdivision 19a, clause (1); and

(6) the amount of addition required by section 290.01, subdivision 19a, ~~clause~~ clauses (7), (8), and (9);

less the sum of the amounts determined under the following:

(1) interest income as defined in section 290.01, subdivision 19b, clause (1);

(2) an overpayment of state income tax as provided by section 290.01, subdivision 19b, clause (2), to the extent included in federal alternative minimum taxable income;

(3) the amount of investment interest paid or accrued within the taxable year on indebtedness to the extent that the amount does not exceed net investment income, as defined in section 163(d)(4) of the Internal Revenue Code. Interest does not include amounts deducted in computing federal adjusted gross income; and

(4) amounts subtracted from federal taxable income as provided by section 290.01, subdivision 19b, clauses (10) ~~and~~, (11), (12), and (13).

In the case of an estate or trust, alternative minimum taxable income must be computed as provided in section 59(c) of the Internal Revenue Code.

(b) "Investment interest" means investment interest as defined in section 163(d)(3) of the Internal Revenue Code.

(c) "Tentative minimum tax" equals 6.4 percent of alternative minimum taxable income after subtracting the exemption amount determined under subdivision 3.

(d) "Regular tax" means the tax that would be imposed under this chapter (without regard to this section and section 290.032), reduced by the sum of the nonrefundable credits allowed under this chapter.

(e) "Net minimum tax" means the minimum tax imposed by this section.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 14. Minnesota Statutes 2004, section 290A.03,

subdivision 3, is amended to read:

Subd. 3. [INCOME.] (1) "Income" means the sum of the following:

(a) federal adjusted gross income as defined in the Internal Revenue Code; and

(b) the sum of the following amounts to the extent not included in clause (a):

(i) all nontaxable income;

(ii) the amount of a passive activity loss that is not disallowed as a result of section 469, paragraph (i) or (m) of the Internal Revenue Code and the amount of passive activity loss carryover allowed under section 469(b) of the Internal Revenue Code;

(iii) an amount equal to the total of any discharge of qualified farm indebtedness of a solvent individual excluded from gross income under section 108(g) of the Internal Revenue Code;

(iv) cash public assistance and relief;

(v) any pension or annuity (including railroad retirement benefits, all payments received under the federal Social Security Act, supplemental security income, and veterans benefits), which was not exclusively funded by the claimant or spouse, or which was funded exclusively by the claimant or spouse and which funding payments were excluded from federal adjusted gross income in the years when the payments were made;

(vi) interest received from the federal or a state government or any instrumentality or political subdivision thereof;

(vii) workers' compensation;

(viii) nontaxable strike benefits;

(ix) the gross amounts of payments received in the nature of disability income or sick pay as a result of accident, sickness, or other disability, whether funded through insurance or otherwise;

(x) a lump sum distribution under section 402(e)(3) of the Internal Revenue Code <u>of 1986, as amended through December 31,</u>

1995;

(xi) contributions made by the claimant to an individual retirement account, including a qualified voluntary employee contribution; simplified employee pension plan; self-employed retirement plan; cash or deferred arrangement plan under section 401(k) of the Internal Revenue Code; or deferred compensation plan under section 457 of the Internal Revenue Code; ~~and~~

(xii) nontaxable scholarship or fellowship grants;

(xiii) the amount of deduction allowed under section 199 of the Internal Revenue Code; and

(xiv) the amount of deduction allowed under section 220 or 223 of the Internal Revenue Code.

In the case of an individual who files an income tax return on a fiscal year basis, the term "federal adjusted gross income" shall mean federal adjusted gross income reflected in the fiscal year ending in the calendar year. Federal adjusted gross income shall not be reduced by the amount of a net operating loss carryback or carryforward or a capital loss carryback or carryforward allowed for the year.

(2) "Income" does not include:

(a) amounts excluded pursuant to the Internal Revenue Code, sections 101(a) and 102;

(b) amounts of any pension or annuity which was exclusively funded by the claimant or spouse and which funding payments were not excluded from federal adjusted gross income in the years when the payments were made;

(c) surplus food or other relief in kind supplied by a governmental agency;

(d) relief granted under this chapter;

(e) child support payments received under a temporary or final decree of dissolution or legal separation; or

(f) restitution payments received by eligible individuals and excludable interest as defined in section 803 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16.

(3) The sum of the following amounts may be subtracted from

income:

(a) for the claimant's first dependent, the exemption amount multiplied by 1.4;

(b) for the claimant's second dependent, the exemption amount multiplied by 1.3;

(c) for the claimant's third dependent, the exemption amount multiplied by 1.2;

(d) for the claimant's fourth dependent, the exemption amount multiplied by 1.1;

(e) for the claimant's fifth dependent, the exemption amount; and

(f) if the claimant or claimant's spouse was disabled or attained the age of 65 on or before December 31 of the year for which the taxes were levied or rent paid, the exemption amount.

For purposes of this subdivision, the "exemption amount" means the exemption amount under section 151(d) of the Internal Revenue Code for the taxable year for which the income is reported.

[EFFECTIVE DATE.] This section is effective for property tax refunds based on household income for 2004 and thereafter.

Sec. 15. Minnesota Statutes 2004, section 290A.03, subdivision 15, is amended to read:

Subd. 15. [INTERNAL REVENUE CODE.] "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through ~~June 15, 2003~~ December 31, 2004.

[EFFECTIVE DATE.] This section is effective for property tax refunds based on property taxes payable on or after December 31, 2004, and rent paid on or after December 31, 2003.

ARTICLE 3

SALES, USE, AND SPECIAL TAXES

Section 1. Minnesota Statutes 2004, section 16C.03, is amended by adding a subdivision to read:

Subd. 18. [CONTRACTS WITH FOREIGN VENDORS.] (a) The commissioner and other agencies to which this section applies and the legislative branch of government shall, subject to paragraph (d), cancel a contract for goods or services from a vendor or an affiliate of a vendor or suspend or debar a vendor or an affiliate of a vendor from future contracts upon notification from the commissioner of revenue that the vendor or an affiliate of the vendor has not registered to collect the sales and use tax imposed under chapter 297A on its sales in Minnesota or to a destination in Minnesota. This subdivision shall not apply to state colleges and universities, the courts, and any agency in the judicial branch of government. For purposes of this subdivision, the term "affiliate" means any person or entity that is controlled by, or is under common control of, a vendor through stock ownership or other affiliation.

(b) Beginning January 1, 2006, each vendor or affiliate of a vendor selling goods or services, subject to tax under chapter 297A, to an agency or the legislature must provide its Minnesota sales and use tax business identification number, upon request, to show that the vendor is registered to collect Minnesota sales or use tax.

(c) The commissioner of revenue shall periodically provide to the commissioner and the legislative branch a list of vendors who have not registered to collect Minnesota sales and use tax and who are subject to being suspended or debarred as vendors or having their contracts canceled.

(d) The provisions of this subdivision may be waived by the commissioner or the legislative branch when the vendor is the single source of such goods or services, in the event of an emergency, or when it is in the best interests of the state as determined by the commissioner in consultation with the commissioner of revenue. Such consultation is not a disclosure violation under chapter 270B.

[EFFECTIVE DATE.] This section is effective for all contracts entered into after December 31, 2005.

Sec. 2. Minnesota Statutes 2004, section 295.53, subdivision 1, is amended to read:

Subdivision 1. [EXEMPTIONS.] (a) The following payments are excluded from the gross revenues subject to the hospital, surgical center, or health care provider taxes under sections 295.50 to 295.59:

(1) payments received for services provided under the Medicare program, including payments received from the government, and organizations governed by sections 1833 and 1876 of title XVIII of the federal Social Security Act, United States Code, title 42, section 1395, and enrollee deductibles, coinsurance, and co-payments, whether paid by the Medicare enrollee or by a Medicare supplemental coverage as defined in section 62A.011, subdivision 3, clause (10), or by Medicaid payments under title XIX of the federal Social Security Act. Payments for services not covered by Medicare are taxable;

(2) payments received for home health care services;

(3) payments received from hospitals or surgical centers for goods and services on which liability for tax is imposed under section 295.52 or the source of funds for the payment is exempt under clause (1), (7), (10), or (14);

(4) payments received from health care providers for goods and services on which liability for tax is imposed under this chapter or the source of funds for the payment is exempt under clause (1), (7), (10), or (14);

(5) amounts paid for legend drugs, other than nutritional products, to a wholesale drug distributor who is subject to tax under section 295.52, subdivision 3, reduced by reimbursements received for legend drugs otherwise exempt under this chapter;

(6) payments received by a health care provider or the wholly owned subsidiary of a health care provider for care provided outside Minnesota;

(7) payments received from the chemical dependency fund under chapter 254B;

(8) payments received in the nature of charitable donations that are not designated for providing patient services to a specific individual or group;

(9) payments received for providing patient services incurred through a formal program of health care research conducted in conformity with federal regulations governing

research on human subjects. Payments received from patients or from other persons paying on behalf of the patients are subject to tax;

(10) payments received from any governmental agency for services benefiting the public, not including payments made by the government in its capacity as an employer or insurer or payments made by the government for services provided under general assistance medical care, the MinnesotaCare program, or the medical assistance program governed by title XIX of the federal Social Security Act, United States Code, title 42, sections 1396 to 1396v;

(11) government payments received by the commissioner of human services for state-operated services;

(12) payments received by a health care provider for hearing aids and related equipment or prescription eyewear delivered outside of Minnesota;

(13) payments received by an educational institution from student tuition, student activity fees, health care service fees, government appropriations, donations, or grants, and for services identified in and provided under an individualized education plan as defined in section 256B.0625 or Code of Federal Regulations, chapter 34, section 300.340(a). Fee for service payments and payments for extended coverage are taxable; ~~and~~

(14) payments received under the federal Employees Health Benefits Act, United States Code, title 5, section 8909(f), as amended by the Omnibus Reconciliation Act of 1990; and

(15) payments received under the federal Tricare program, Code of Federal Regulations, title 32, section 199.17(a)(7). Enrollee deductibles, coinsurance, and co-payments are subject to tax.

(b) Payments received by wholesale drug distributors for legend drugs sold directly to veterinarians or veterinary bulk purchasing organizations are excluded from the gross revenues subject to the wholesale drug distributor tax under sections 295.50 to 295.59.

[EFFECTIVE DATE.] This section is effective for gross revenues received under the federal Tricare program after December 31, 2004.

Sec. 3. [295.75] [LIQUOR GROSS RECEIPTS TAX.]

Subdivision 1. [DEFINITIONS.] (a) For purposes of this section, the following terms have the meanings given.

(b) "Commissioner" means the commissioner of revenue.

(c) "Gross receipts" means the total amount received, in money or by barter or exchange, for all liquor sales at retail as measured by the sales price, but does not include any taxes imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the purchaser.

(d) "Liquor" means:

(1) intoxicating liquor, as defined in section 340A.101, subdivision 14;

(2) beverage containing intoxicating liquor; and

(3) 3.2 percent malt liquor, as defined in section 340A.101, subdivision 19, when sold at an on-sale or off-sale municipal liquor store or other establishment licensed to sell any type of intoxicating liquor.

(e) "Liquor retailer" means a retailer that sells liquor.

(f) "Retail sale" has the meaning given in section 297A.61, subdivision 4.

Subd. 2. [GROSS RECEIPTS TAX IMPOSED.] A tax is imposed on each liquor retailer equal to 2.5 percent of gross receipts from retail sales in Minnesota of liquor.

Subd. 3. [USE TAX IMPOSED; CREDIT FOR TAXES PAID.] (a) A person that receives liquor for use or storage in Minnesota, other than from a liquor retailer that paid the tax under subdivision 2, is subject to tax at the rate imposed under subdivision 2. Liability for the tax is incurred when the person has possession of the liquor in Minnesota. The tax must be remitted to the commissioner in the same manner prescribed for the taxes imposed under chapter 297A.

(b) A person that has paid taxes to another jurisdiction on the same transaction and is subject to tax under this section is entitled to a credit for the tax legally due and paid to another jurisdiction to the extent of the lesser of (1) the tax actually paid to the other jurisdiction, or (2) the amount of tax imposed by Minnesota on the transaction subject to tax in the other jurisdiction.

Subd. 4. [TAX COLLECTION REQUIRED.] A liquor retailer with nexus in Minnesota, who is not subject to tax under subdivision 2, is required to collect the tax imposed under subdivision 3 from the purchaser of the liquor and give the purchaser a receipt for the tax paid. The tax collected must be remitted to the commissioner in the same manner prescribed for the taxes imposed under chapter 297A.

Subd. 5. [TAXES PAID TO ANOTHER JURISDICTION; CREDIT.] A liquor retailer that has paid taxes to another jurisdiction measured by gross receipts and is subject to tax under this section on the same gross receipts is entitled to a credit for the tax legally due and paid to another jurisdiction to the extent of the lesser of (1) the tax actually paid to the other jurisdiction, or (2) the amount of tax imposed by Minnesota on the gross receipts subject to tax in the other taxing jurisdictions.

Subd. 6. [EXEMPTIONS.] All of the exemptions applicable to the taxes imposed under chapter 297A are applicable to the taxes imposed under this section.

Subd. 7. [SOURCING OF SALES.] All of the provisions of section 297A.668 apply to the taxes imposed by this section.

Subd. 8. [PAYMENT; REPORTING.] A liquor retailer shall report the tax on a return prescribed by the commissioner of revenue, and shall remit the tax with the return. The return and the tax must be filed and paid using the filing cycle and due dates provided for taxes imposed under chapter 297A.

Subd. 9. [ADMINISTRATION.] Unless specifically provided otherwise by this section, the audit, assessment, refund, penalty, interest, enforcement, collection remedies, appeal, and administrative provisions of chapters 270 and 289A that are applicable to taxes imposed under chapter 297A apply to taxes imposed under this section.

Subd. 10. [INTEREST ON OVERPAYMENTS.] Interest must be paid on an overpayment refunded or credited to the taxpayer from the date of payment of the tax until the date the refund is paid or credited. For purposes of this subdivision, the date of payment is the due date of the return or the date of actual payment of the tax, whichever is later.

Subd. 11. [DEPOSIT OF REVENUES.] The commissioner shall deposit all revenues, including penalties and interest, derived from the tax imposed by this section in the general fund.

[EFFECTIVE DATE.] This section is effective for sales and purchases occurring on or after January 1, 2006.

Sec. 4. Minnesota Statutes 2004, section 297A.61, subdivision 4, is amended to read:

Subd. 4. [RETAIL SALE.] (a) A "retail sale" means any sale, lease, or rental for any purpose other than resale, sublease, or subrent.

(b) A sale of property used by the owner only by leasing it to others or by holding it in an effort to lease it, and put to no use by the owner other than resale after the lease or effort to lease, is a sale of property for resale.

(c) A sale of master computer software that is purchased and used to make copies for sale or lease is a sale of property for resale.

(d) A sale of building materials, supplies, and equipment to owners, contractors, subcontractors, or builders for the erection of buildings or the alteration, repair, or improvement of real property is a retail sale in whatever quantity sold, whether the sale is for purposes of resale in the form of real property or otherwise.

(e) A sale of carpeting, linoleum, or similar floor covering to a person who provides for installation of the floor covering is a retail sale and not a sale for resale since a sale of floor covering which includes installation is a contract for the improvement of real property.

(f) A sale of shrubbery, plants, sod, trees, and similar items to a person who provides for installation of the items is a retail sale and not a sale for resale since a sale of shrubbery, plants, sod, trees, and similar items that includes installation is a contract for the improvement of real property.

(g) A sale of tangible personal property that is awarded as prizes is a retail sale and is not considered a sale of property for resale.

(h) A sale of tangible personal property utilized or employed in the furnishing or providing of services under subdivision 3, paragraph (g), clause (1), including, but not limited to, property given as promotional items, is a retail sale and is not considered a sale of property for resale.

(i) A sale of tangible personal property used in conducting lawful gambling under chapter 349 or the state lottery under chapter 349A, including, but not limited to, property given as promotional items, is a retail sale and is not considered a sale of property for resale.

(j) A sale of machines, equipment, or devices that are used to furnish, provide, or dispense goods or services, including, but not limited to, coin-operated devices, is a retail sale and is not considered a sale of property for resale.

(k) In the case of a lease, a retail sale occurs (1) when an obligation to make a lease payment becomes due under the terms of the agreement or the trade practices of the lessor or (2) in the case of a lease of a motor vehicle, as defined in section 297B.01, subdivision 5, but excluding vehicles with a manufacturer's gross vehicle weight rating greater than 10,000 pounds and rentals of vehicles for not more than 28 days, at the time the lease is executed.

(l) In the case of a conditional sales contract, a retail sale occurs upon the transfer of title or possession of the tangible personal property.

[EFFECTIVE DATE.] This section is effective for leases entered into after June 30, 2005.

Sec. 5. Minnesota Statutes 2004, section 297A.61,

subdivision 7, is amended to read:

Subd. 7. [SALES PRICE.] (a) "Sales price" means the measure subject to sales tax, and means the total amount of consideration, including cash, credit, personal property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following:

(1) the seller's cost of the property sold;

(2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expenses of the seller;

(3) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;

(4) delivery charges;

(5) installation charges; and

(6) the value of exempt property given to the purchaser when taxable and exempt personal property have been bundled together and sold by the seller as a single product or piece of merchandise.

(b) Sales price does not include:

(1) discounts, including cash, terms, or coupons, that are not reimbursed by a third party and that are allowed by the seller and taken by a purchaser on a sale;

(2) interest, financing, and carrying charges from credit extended on the sale of personal property or services, if the amount is separately stated on the invoice, bill of sale, or similar document given to the purchaser; and

(3) any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the purchaser.

(c) In the case of a lease of a motor vehicle, as defined in subdivision 4, paragraph (k), clause (2), that is taxable under this chapter, "sales price" means the total amount to be paid by the lessee under the lease agreement at the time the lease is executed. If the total amount of the consideration for the lease includes amounts that are not calculated at the time the lease is executed, "sales price" includes these amounts at the time the amounts are billed to the lessee. In the case of an open-ended lease, "sales price" means the total amount to be paid during the initial term of the lease, and then, for each subsequent renewal period, the total amount to be paid during the subsequent terms of the lease.

[EFFECTIVE DATE.] This section is effective for leases entered into after June 30, 2005.

Sec. 6. Minnesota Statutes 2004, section 297A.67, is amended by adding a subdivision to read:

Subd. 32. [CIGARETTES.] Cigarettes upon which a tax has been imposed under section 297F.25 are exempt.

[EFFECTIVE DATE.] This section is effective for sales and purchases made after July 31, 2005.

Sec. 7. Minnesota Statutes 2004, section 297A.68, subdivision 2, is amended to read:

Subd. 2. [MATERIALS CONSUMED IN INDUSTRIAL PRODUCTION.] (a) Materials stored, used, or consumed in industrial production of personal property intended to be sold ultimately at retail are exempt, whether or not the item so used becomes an ingredient or constituent part of the property produced. Materials that qualify for this exemption include, but are not limited to, the following:

(1) chemicals, including chemicals used for cleaning food processing machinery and equipment;

(2) materials, including chemicals, fuels, and electricity purchased by persons engaged in industrial production to treat waste generated as a result of the production process;

(3) fuels, electricity, gas, and steam used or consumed in the production process, except that electricity, gas, or steam used for space heating, cooling, or lighting is exempt if (i) it is in excess of the average climate control or lighting for the production area, and (ii) it is necessary to produce that particular product;

(4) petroleum products and lubricants;

(5) packaging materials, including returnable containers used in packaging food and beverage products;

(6) accessory tools, equipment, and other items that are separate detachable units with an ordinary useful life of less than 12 months used in producing a direct effect upon the product; and

(7) the following materials, tools, and equipment used in metalcasting: crucibles, thermocouple protection sheaths and tubes, stalk tubes, refractory materials, molten metal filters and filter boxes, degassing lances, and base blocks.

(b) This exemption does not include:

(1) machinery, equipment, implements, tools, accessories, appliances, contrivances and furniture and fixtures, except those listed in paragraph (a), clause (6); and

(2) petroleum and special fuels used in producing or generating power for propelling ready-mixed concrete trucks on the public highways of this state.

(c) Industrial production includes, but is not limited to, research, development, design or production of any tangible personal property, manufacturing, processing (other than by restaurants and consumers) of agricultural products (whether vegetable or animal), commercial fishing, refining, smelting, reducing, brewing, distilling, printing, mining, quarrying, lumbering, generating electricity, the production of road building materials, and the research, development, design, or production of computer software. Industrial production does not include painting, cleaning, repairing or similar processing of property except as part of the original manufacturing process. Industrial production does not include the transportation, transmission, or distribution of petroleum, liquefied gas, natural gas, water, or steam, in, by, or through pipes, lines, tanks, mains, or other means of transporting those products. For purposes of this paragraph, "transportation, transmission, or distribution" does not include blending of petroleum or biodiesel fuel as defined in section 239.77.

[EFFECTIVE DATE.] This section is effective for sales and purchases made after June 30, 2005.

Sec. 8. Minnesota Statutes 2004, section 297A.68, subdivision 5, is amended to read:

Subd. 5. [CAPITAL EQUIPMENT.] (a) Capital equipment is exempt. The tax must be imposed and collected as if the rate under section 297A.62, subdivision 1, applied, and then refunded in the manner provided in section 297A.75.

"Capital equipment" means machinery and equipment purchased or leased, and used in this state by the purchaser or lessee primarily for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail if the machinery and equipment are essential to the integrated production process of manufacturing, fabricating, mining, or refining. Capital equipment also includes machinery and equipment used to electronically transmit results retrieved by a customer of an on-line computerized data retrieval system.

(b) Capital equipment includes, but is not limited to:

(1) machinery and equipment used to operate, control, or regulate the production equipment;

(2) machinery and equipment used for research and development, design, quality control, and testing activities;

(3) environmental control devices that are used to maintain conditions such as temperature, humidity, light, or air pressure when those conditions are essential to and are part of the production process;

(4) materials and supplies used to construct and install machinery or equipment;

(5) repair and replacement parts, including accessories, whether purchased as spare parts, repair parts, or as upgrades or modifications to machinery or equipment;

(6) materials used for foundations that support machinery or equipment;

(7) materials used to construct and install special purpose buildings used in the production process;

(8) ready-mixed concrete equipment in which the ready-mixed concrete is mixed as part of the delivery process regardless if

mounted on a chassis and leases of ready-mixed concrete trucks; and

(9) machinery or equipment used for research, development, design, or production of computer software.

(c) Capital equipment does not include the following:

(1) motor vehicles taxed under chapter 297B;

(2) machinery or equipment used to receive or store raw materials;

(3) building materials, except for materials included in paragraph (b), clauses (6) and (7);

(4) machinery or equipment used for nonproduction purposes, including, but not limited to, the following: plant security, fire prevention, first aid, and hospital stations; support operations or administration; pollution control; and plant cleaning, disposal of scrap and waste, plant communications, space heating, cooling, lighting, or safety;

(5) farm machinery and aquaculture production equipment as defined by section 297A.61, subdivisions 12 and 13;

(6) machinery or equipment purchased and installed by a contractor as part of an improvement to real property; ~~or~~

(7) machinery or equipment used in the transportation, transmission, or distribution of petroleum, liquefied gas, natural gas, water, or steam, in, by, or through pipes, lines, tanks, mains, or other means of transporting those products. This clause does not apply to machinery or equipment used to blend petroleum or biodiesel fuel as defined in section 239.77; or

(8) any other item that is not essential to the integrated process of manufacturing, fabricating, mining, or refining.

(d) For purposes of this subdivision:

(1) "Equipment" means independent devices or tools separate from machinery but essential to an integrated production process, including computers and computer software, used in operating, controlling, or regulating machinery and equipment; and any subunit or assembly comprising a component of any machinery or accessory or attachment parts of machinery, such as

tools, dies, jigs, patterns, and molds.

(2) "Fabricating" means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(3) "Integrated production process" means a process or series of operations through which tangible personal property is manufactured, fabricated, mined, or refined. For purposes of this clause, (i) manufacturing begins with the removal of raw materials from inventory and ends when the last process prior to loading for shipment has been completed; (ii) fabricating begins with the removal from storage or inventory of the property to be assembled, processed, altered, or modified and ends with the creation or production of the new or changed product; (iii) mining begins with the removal of overburden from the site of the ores, minerals, stone, peat deposit, or surface materials and ends when the last process before stockpiling is completed; and (iv) refining begins with the removal from inventory or storage of a natural resource and ends with the conversion of the item to its completed form.

(4) "Machinery" means mechanical, electronic, or electrical devices, including computers and computer software, that are purchased or constructed to be used for the activities set forth in paragraph (a), beginning with the removal of raw materials from inventory through completion of the product, including packaging of the product.

(5) "Machinery and equipment used for pollution control" means machinery and equipment used solely to eliminate, prevent, or reduce pollution resulting from an activity described in paragraph (a).

(6) "Manufacturing" means an operation or series of operations where raw materials are changed in form, composition, or condition by machinery and equipment and which results in the production of a new article of tangible personal property. For purposes of this subdivision, "manufacturing" includes the generation of electricity or steam to be sold at retail.

(7) "Mining" means the extraction of minerals, ores, stone,

or peat.

(8) "On-line data retrieval system" means a system whose cumulation of information is equally available and accessible to all its customers.

(9) "Primarily" means machinery and equipment used 50 percent or more of the time in an activity described in paragraph (a).

(10) "Refining" means the process of converting a natural resource to an intermediate or finished product, including the treatment of water to be sold at retail.

[EFFECTIVE DATE.] This section is effective for sales and purchases made after June 30, 2005.

Sec. 9. [297A.82] [MOTOR VEHICLE LEASES.]

Subdivision 1. [MOTOR VEHICLE LEASE PRICE; PAYMENT.] (a) In the case of a lease of a motor vehicle as provided in section 297A.61, subdivision 4, paragraph (k), clause (2), the tax is imposed on the total amount to be paid by the lessee under the lease agreement. The lessor shall collect the tax in full at the time the lease is executed or, if the tax is included in the lease and the lease is assigned, the tax is due from the original lessor at the time the lease is assigned. The total amount to be paid by the lessee under the lease agreement equals the agreed-upon value of the vehicle less manufacturer's rebates, the stated residual value of the leased vehicle, and the total value allowed for a vehicle owned by the lessee taken in trade by the lessor, plus the price of any taxable goods and services included in the lease and the rent charge as provided by Code of Federal Regulations, title 12, section 213.4, excluding any rent charge related to the capitalization of the tax.

(b) If the total amount paid by the lessee for use of the leased vehicle includes amounts that are not calculated at the time the lease is executed, the tax is imposed and must be collected by the lessor at the time the amounts are paid by the lessee. In the case of a lease which by its terms may be renewed, the sales tax is due and payable on the total amount to be paid during the initial term of the lease, and then for each subsequent renewal period on the total amount to be paid during the renewal period.

(c) If a lease is canceled or rescinded on or before 90 days of its execution or if a vehicle is returned to the manufacturer under section 325F.665, the lessor may file a claim for a refund of the total tax paid minus the amount of tax due for the period the vehicle is used by the lessee.

Subd. 2. [LEASE OF MOTOR VEHICLES.] When the lease of a motor vehicle as defined in section 297A.61, subdivision 4, paragraph (k), clause (2), originates in another state, the sales tax under subdivision 1 shall be calculated by the lessor on the total amount that is due under the lease agreement after the vehicle is required to be registered in Minnesota. If the total amount to be paid by the lessee under the lease agreement has already been subjected to tax by another state, a credit for taxes paid in the other state is allowed as provided in section 297A.80.

[EFFECTIVE DATE.] Subdivision 1 of this section is effective for leases entered into after June 30, 2005. Subdivision 2 of this section is effective for vehicles registering in Minnesota after June 30, 2005.

Sec. 10. Minnesota Statutes 2004, section 297F.14, subdivision 4, is amended to read:

Subd. 4. [BAD DEBT.] ~~The commissioner may adopt rules providing a refund of the tax paid under this chapter if the tax paid qualifies as a bad debt under section 166(a) of the Internal Revenue Code.~~ For any reporting period, a taxpayer may offset against taxes payable under this chapter the amount of taxes previously paid under this chapter that is attributable to a bad debt. The taxes must have been included in a transaction the consideration for which was a debt owed to the taxpayer and which became uncollectible, but only in proportion to the portion of debt that became uncollectible. To qualify for offset under this subdivision, the debt must have qualified as a bad debt under section 166(a) of the Internal Revenue Code. The taxpayer may claim the offset within the time period prescribed in section 297F.17, subdivision 6. If the taxpayer is no longer liable for taxes imposed under this chapter, the commissioner shall refund to the taxpayer the amount of the taxes attributable to the bad debt. Any recovery of the tax claimed as a refund or credit must be reported to the commissioner on the tax return for the month in which the recovery is made. If the taxpayer is no longer required to file returns under this chapter, the taxpayer must reimburse the commissioner for tax recovered in the month following the recovery.

[EFFECTIVE DATE.] This section is effective for claims filed on or after July 1, 2005.

Sec. 11. [297F.25] [CIGARETTE SALES TAX.]

Subdivision 1. [IMPOSITION.] A tax is imposed on distributors on the sale of cigarettes by a cigarette distributor to a retailer or cigarette subjobber for resale in this state. The tax is equal to 6.5 percent of the weighted average retail price. The weighted average retail price must be expressed in cents per pack when rounded to the nearest one-tenth of a cent. The weighted average retail price must be determined annually, with new rates published by May 1, and effective for sales on or after July 1. The weighted average retail price must be established by surveying cigarette retailers statewide in a manner and time determined by the commissioner. The determination of the commissioner pursuant to this subdivision is not a "rule" and is not subject to the Administrative Procedure Act contained in chapter 14. As of August 1, 2005, the tax is 21 cents per pack of 20 cigarettes. For packs of cigarettes with other than 20 cigarettes, the tax must be adjusted proportionally.

Subd. 2. [PAYMENT.] Each taxpayer must remit payments of the taxes to the commissioner on the same dates prescribed under section 297F.09, subdivision 1, for cigarette tax returns, including the accelerated remittance of the June liability.

Subd. 3. [RETURN.] A taxpayer must file a return with the commissioner on the same dates prescribed under section 297F.09, subdivision 1, for cigarette tax returns. Notwithstanding any other provisions of this chapter, the tax due on the return is based upon actual stamps purchased during the reporting period.

Subd. 4. [FORM OF RETURN.] The return must contain the information and be in the form prescribed by the commissioner.

Subd. 5. [TAX AS DEBT.] The tax that is required to be paid by the distributor is a debt from the retailer or cigarette subjobber to the distributor recoverable at law in the same manner as other debts. A cigarette retailer or subjobber must pay the tax imposed under subdivision 1 to the distributor before the 12th day of the month following the month in which the cigarettes were purchased from the distributor.

Subd. 6. [SALES TAX STAMP.] Payment of the tax imposed under section 297F.05 and by this section must be evidenced by a dual-purpose single stamp affixed to each package.

Subd. 7. [ADMINISTRATION.] The stamping, audit, assessment, interest, penalty, appeal, refund, and collection provisions applicable to the taxes imposed under this chapter apply to taxes imposed under this section.

Subd. 8. [DEPOSIT OF REVENUES.] Notwithstanding the provisions of section 297F.10, the commissioner shall deposit all revenues, including penalties and interest, derived from the tax imposed by this section, in the general fund.

[EFFECTIVE DATE.] This section is effective for all sales made on or after August 1, 2005.

Sec. 12. Minnesota Statutes 2004, section 297H.13, subdivision 2, is amended to read:

Subd. 2. [ALLOCATION OF REVENUES.] (a) The commissioner of revenue shall deduct from the proceeds of the taxes imposed under this chapter an amount that equals the direct and indirect costs of the Department of Revenue to administer this chapter. This amount is annually appropriated to the commissioner of revenue.

(b) ~~$22,000,000~~ $33,760,000, or ~~50~~ 70 percent, whichever is greater, of the balance of the amounts remitted under this chapter must be credited to the environmental fund established in section 16A.531, subdivision 1.

~~(b)~~ (c) The remainder must be deposited into the general fund.

[EFFECTIVE DATE.] This section is effective for amounts remitted on or after July 1, 2005.

Sec. 13. Minnesota Statutes 2004, section 297I.01, is amended by adding a subdivision to read:

Subd. 6a. [DIRECT BUSINESS.] (a) "Direct business" means all insurance provided by an insurance company or its agents, and specifically includes stop-loss insurance purchased in connection with a self-insurance plan for employee health benefits or for other purposes, but excludes:

(1) reinsurance in which an insurance company assumes the liability of another insurance company; and

(2) self-insurance.

(b) For purposes of this subdivision, an insurance company includes a nonprofit health service corporation, health maintenance organization, and community integrated service network.

[EFFECTIVE DATE.] This section is effective for insurance premiums received after December 31, 2005.

Sec. 14. Minnesota Statutes 2004, section 473.843, subdivision 2, is amended to read:

Subd. 2. [DISPOSITION OF PROCEEDS.] (a) The commissioner of revenue shall deduct from the proceeds of the fees imposed under this section an amount that equals the direct and indirect costs of the Department of Revenue to administer this section. This amount is annually appropriated to the commissioner of revenue.

(b) The remainder of the proceeds of the fees imposed under this section, including interest and penalties, must be deposited as follows:

(1) three-fourths of the proceeds must be deposited in the environmental fund for metropolitan landfill abatement for the purposes described in section 473.844; and

(2) one-fourth of the proceeds must be deposited in the

metropolitan landfill contingency action trust account in the remediation fund established in sections 116.155 and 473.845.

[EFFECTIVE DATE.] This section is effective for amounts remitted on or after July 1, 2005.

Sec. 15. Laws 2001, First Special Session chapter 5, article 12, section 95, is amended to read:

Sec. 95. [REPEALER.]

(a) Minnesota Statutes 2000, sections 297A.61, subdivision 16; 297A.68, subdivision 21; and 297A.71, subdivisions 2 and 16, are repealed effective for sales and purchases occurring after June 30, 2001, except that the repeal of section 297A.61, subdivision 16, paragraph (d), is effective for sales and purchases occurring after July 31, 2001.

(b) Minnesota Statutes 2000, ~~sections~~ section 297A.62, subdivision 2, ~~and 297A.64, subdivision 1, are~~ is repealed effective for sales and purchases made after December 31, 2005.

(c) Minnesota Statutes 2000, section 297A.71, subdivision 15, is repealed effective for sales and purchases made after June 30, 2002.

(d) Minnesota Statutes 2000, section 289A.60, subdivision 15, is repealed effective for liabilities after January 1, 2003.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 16. [FLOOR STOCKS TAX.]

Subdivision 1. [CIGARETTES.] A floor stocks cigarette sales tax is imposed on every person engaged in the business in this state as a distributor, retailer, subjobber, vendor, manufacturer, or manufacturer's representative of cigarettes, on the stamped cigarettes and unaffixed stamps in the person's possession or under the person's control at 12:01 a.m. on August 1, 2005. The tax is imposed at the rate of 21 cents per pack of 20 cigarettes. For packs of cigarettes with other than 20 cigarettes, the tax shall be adjusted proportionally.

Each distributor, by August 10, 2005, shall file a return with the commissioner, in the form the commissioner prescribes, showing the stamped cigarettes and unaffixed stamps on hand at

12:01 a.m. on August 1, 2005, and the amount of tax due on the cigarettes and unaffixed stamps. The tax imposed by this section is due and payable by September 7, 2005, and after that date bears interest at the rate of one percent a month.

Each retailer, subjobber, vendor, manufacturer, or manufacturer's representative, by August 10, 2005, shall file a return with the commissioner, in the form the commissioner prescribes, showing the cigarettes on hand at 12:01 a.m. on August 1, 2005, and the amount of tax due on the cigarettes. The tax imposed by this section is due and payable by September 7, 2005, and after that date bears interest at the rate of one percent a month.

Subd. 2. [AUDIT AND ENFORCEMENT.] The tax imposed by this section is subject to the audit, assessment, penalty, and collection provisions applicable to the taxes imposed under Minnesota Statutes, chapter 297F. The commissioner may require a distributor to receive and maintain copies of floor stocks tax returns filed by all persons requesting a credit for returned cigarettes.

Subd. 3. [DEPOSIT OF PROCEEDS.] The revenue from the tax imposed under this section shall be deposited by the commissioner in the state treasury and credited to the general fund.

[EFFECTIVE DATE.] This section is effective August 1, 2005.

ARTICLE 4

INTERNATIONAL ECONOMIC DEVELOPMENT ZONE

Section 1. Minnesota Statutes 2004, section 272.02, is amended by adding a subdivision to read:

Subd. 68. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONE PROPERTY.] (a) Improvements to real property, and personal property, classified under section 273.13, subdivision 24, and located within the international economic development zone designated under section 469.322, are exempt from ad valorem taxes levied under chapter 275, if the improvements are:

(1) part of a regional distribution center as defined in section 469.321; or

(2) occupied by a qualified business as defined in section 469.321, that uses the improvements primarily in freight forwarding operations.

(b) The exemption applies beginning for the first assessment year after designation of the international economic development zone. The exemption applies to each assessment year that begins during the duration of the international economic development zone. To be exempt under paragraph (a), clause (2), the property must be occupied by July 1 of the assessment year by a qualified business that has signed the business subsidy agreement by July 1 of the assessment year.

[EFFECTIVE DATE.] This section is effective beginning for property taxes payable in 2008.

Sec. 2. Minnesota Statutes 2004, section 290.01, subdivision 19b, is amended to read:

Subd. 19b. [SUBTRACTIONS FROM FEDERAL TAXABLE INCOME.] For individuals, estates, and trusts, there shall be subtracted from federal taxable income:

(1) interest income on obligations of any authority, commission, or instrumentality of the United States to the extent includable in taxable income for federal income tax purposes but exempt from state income tax under the laws of the United States;

(2) if included in federal taxable income, the amount of any overpayment of income tax to Minnesota or to any other state, for any previous taxable year, whether the amount is received as a refund or as a credit to another taxable year's income tax liability;

(3) the amount paid to others, less the amount used to claim the credit allowed under section 290.0674, not to exceed $1,625 for each qualifying child in grades kindergarten to 6 and $2,500 for each qualifying child in grades 7 to 12, for tuition, textbooks, and transportation of each qualifying child in attending an elementary or secondary school situated in Minnesota, North Dakota, South Dakota, Iowa, or Wisconsin, wherein a resident of this state may legally fulfill the state's

compulsory attendance laws, which is not operated for profit, and which adheres to the provisions of the Civil Rights Act of 1964 and chapter 363A. For the purposes of this clause, "tuition" includes fees or tuition as defined in section 290.0674, subdivision 1, clause (1). As used in this clause, "textbooks" includes books and other instructional materials and equipment purchased or leased for use in elementary and secondary schools in teaching only those subjects legally and commonly taught in public elementary and secondary schools in this state. Equipment expenses qualifying for deduction includes expenses as defined and limited in section 290.0674, subdivision 1, clause (3). "Textbooks" does not include instructional books and materials used in the teaching of religious tenets, doctrines, or worship, the purpose of which is to instill such tenets, doctrines, or worship, nor does it include books or materials for, or transportation to, extracurricular activities including sporting events, musical or dramatic events, speech activities, driver's education, or similar programs. For purposes of the subtraction provided by this clause, "qualifying child" has the meaning given in section 32(c)(3) of the Internal Revenue Code;

(4) income as provided under section 290.0802;

(5) to the extent included in federal adjusted gross income, income realized on disposition of property exempt from tax under section 290.491;

(6) to the extent included in federal taxable income, postservice benefits for youth community service under section 124D.42 for volunteer service under United States Code, title 42, sections 12601 to 12604;

(7) to the extent not deducted in determining federal taxable income by an individual who does not itemize deductions for federal income tax purposes for the taxable year, an amount equal to 50 percent of the excess of charitable contributions allowable as a deduction for the taxable year under section 170(a) of the Internal Revenue Code over $500;

(8) for taxable years beginning before January 1, 2008, the

amount of the federal small ethanol producer credit allowed under section 40(a)(3) of the Internal Revenue Code which is included in gross income under section 87 of the Internal Revenue Code;

(9) for individuals who are allowed a federal foreign tax credit for taxes that do not qualify for a credit under section 290.06, subdivision 22, an amount equal to the carryover of subnational foreign taxes for the taxable year, but not to exceed the total subnational foreign taxes reported in claiming the foreign tax credit. For purposes of this clause, "federal foreign tax credit" means the credit allowed under section 27 of the Internal Revenue Code, and "carryover of subnational foreign taxes" equals the carryover allowed under section 904(c) of the Internal Revenue Code minus national level foreign taxes to the extent they exceed the federal foreign tax credit;

(10) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (7), an amount equal to one-fifth of the delayed depreciation. For purposes of this clause, "delayed depreciation" means the amount of the addition made by the taxpayer under subdivision 19a, clause (7), minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. The resulting delayed depreciation cannot be less than zero; ~~and~~

(11) job opportunity building zone income as provided under section 469.316; and

(12) international economic development zone income as provided under section 469.325.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 3. Minnesota Statutes 2004, section 290.01, subdivision 29, is amended to read:

Subd. 29. [TAXABLE INCOME.] The term "taxable income" means:

(1) for individuals, estates, and trusts, the same as

taxable net income;

(2) for corporations, the taxable net income less

(i) the net operating loss deduction under section 290.095;

(ii) the dividends received deduction under section 290.21, subdivision 4;

(iii) the exemption for operating in a job opportunity building zone under section 469.317; ~~and~~

(iv) the exemption for operating in a biotechnology and health sciences industry zone under section 469.337; and

(v) the exemption for operating in an international economic development zone under section 469.326.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 4. Minnesota Statutes 2004, section 290.06, subdivision 2c, is amended to read:

Subd. 2c. [SCHEDULES OF RATES FOR INDIVIDUALS, ESTATES, AND TRUSTS.] (a) The income taxes imposed by this chapter upon married individuals filing joint returns and surviving spouses as defined in section 2(a) of the Internal Revenue Code must be computed by applying to their taxable net income the following schedule of rates:

(1) On the first $25,680, 5.35 percent;

(2) On all over $25,680, but not over $102,030, 7.05 percent;

(3) On all over $102,030, 7.85 percent.

Married individuals filing separate returns, estates, and trusts must compute their income tax by applying the above rates to their taxable income, except that the income brackets will be one-half of the above amounts.

(b) The income taxes imposed by this chapter upon unmarried individuals must be computed by applying to taxable net income the following schedule of rates:

(1) On the first $17,570, 5.35 percent;

(2) On all over $17,570, but not over $57,710, 7.05 percent;

(3) On all over $57,710, 7.85 percent.

(c) The income taxes imposed by this chapter upon unmarried individuals qualifying as a head of household as defined in section 2(b) of the Internal Revenue Code must be computed by applying to taxable net income the following schedule of rates:

(1) On the first $21,630, 5.35 percent;

(2) On all over $21,630, but not over $86,910, 7.05 percent;

(3) On all over $86,910, 7.85 percent.

(d) In lieu of a tax computed according to the rates set forth in this subdivision, the tax of any individual taxpayer whose taxable net income for the taxable year is less than an amount determined by the commissioner must be computed in accordance with tables prepared and issued by the commissioner of revenue based on income brackets of not more than $100. The amount of tax for each bracket shall be computed at the rates set forth in this subdivision, provided that the commissioner may disregard a fractional part of a dollar unless it amounts to 50 cents or more, in which case it may be increased to $1.

(e) An individual who is not a Minnesota resident for the entire year must compute the individual's Minnesota income tax as provided in this subdivision. After the application of the nonrefundable credits provided in this chapter, the tax liability must then be multiplied by a fraction in which:

(1) the numerator is the individual's Minnesota source federal adjusted gross income as defined in section 62 of the Internal Revenue Code and increased by the additions required under section 290.01, subdivision 19a, clauses (1), (5), and (6), and reduced by the subtraction under section 290.01, subdivision 19b, ~~clause~~ clauses (11) and (12), and the Minnesota assignable portion of the subtraction for United States government interest under section 290.01, subdivision 19b, clause (1), after applying the allocation and assignability provisions of section 290.081, clause (a), or 290.17; and

(2) the denominator is the individual's federal adjusted gross income as defined in section 62 of the Internal Revenue Code of 1986, increased by the amounts specified in section

290.01, subdivision 19a, clauses (1), (5), and (6), and reduced by the amounts specified in section 290.01, subdivision 19b, clauses (1) ~~and~~, (11), and (12).

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 5. Minnesota Statutes 2004, section 290.06, is amended by adding a subdivision to read:

Subd. 32. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONE JOB CREDIT.] A taxpayer that is a qualified business, as defined in section 469.321, subdivision 6, is allowed a credit as determined under section 469.327 against the tax imposed by this chapter.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 6. Minnesota Statutes 2004, section 290.067, subdivision 1, is amended to read:

Subdivision 1. [AMOUNT OF CREDIT.] (a) A taxpayer may take as a credit against the tax due from the taxpayer and a spouse, if any, under this chapter an amount equal to the dependent care credit for which the taxpayer is eligible pursuant to the provisions of section 21 of the Internal Revenue Code subject to the limitations provided in subdivision 2 except that in determining whether the child qualified as a dependent, income received as a Minnesota family investment program grant or allowance to or on behalf of the child must not be taken into account in determining whether the child received more than half of the child's support from the taxpayer, and the provisions of section 32(b)(1)(D) of the Internal Revenue Code do not apply.

(b) If a child who has not attained the age of six years at the close of the taxable year is cared for at a licensed family day care home operated by the child's parent, the taxpayer is deemed to have paid employment-related expenses. If the child is 16 months old or younger at the close of the taxable year, the amount of expenses deemed to have been paid equals the maximum limit for one qualified individual under section 21(c) and (d) of the Internal Revenue Code. If the child is older than 16 months of age but has not attained the age of six years at the close of the taxable year, the amount of expenses deemed to have been paid equals the amount the licensee would charge for the care of a child of the same age for the same number of hours of care.

(c) If a married couple:

(1) has a child who has not attained the age of one year at the close of the taxable year;

(2) files a joint tax return for the taxable year; and

(3) does not participate in a dependent care assistance program as defined in section 129 of the Internal Revenue Code, in lieu of the actual employment related expenses paid for that child under paragraph (a) or the deemed amount under paragraph (b), the lesser of (i) the combined earned income of the couple or (ii) the amount of the maximum limit for one qualified individual under section 21(c) and (d) of the Internal Revenue Code will be deemed to be the employment related expense paid for that child. The earned income limitation of section 21(d) of the Internal Revenue Code shall not apply to this deemed amount. These deemed amounts apply regardless of whether any employment-related expenses have been paid.

(d) If the taxpayer is not required and does not file a federal individual income tax return for the tax year, no credit is allowed for any amount paid to any person unless:

(1) the name, address, and taxpayer identification number of the person are included on the return claiming the credit; or

(2) if the person is an organization described in section 501(c)(3) of the Internal Revenue Code and exempt from tax under section 501(a) of the Internal Revenue Code, the name and address of the person are included on the return claiming the credit.

In the case of a failure to provide the information required under the preceding sentence, the preceding sentence does not apply if it is shown that the taxpayer exercised due diligence in attempting to provide the information required.

In the case of a nonresident, part-year resident, or a person who has earned income not subject to tax under this chapter including earned income excluded pursuant to section 290.01, subdivision 19b, ~~clause~~ clauses (11) and (12), the credit determined under section 21 of the Internal Revenue Code must be allocated based on the ratio by which the earned income of the claimant and the claimant's spouse from Minnesota sources bears to the total earned income of the claimant and the claimant's spouse.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 7. Minnesota Statutes 2004, section 290.0671, subdivision 1, is amended to read:

Subdivision 1. [CREDIT ALLOWED.] (a) An individual is allowed a credit against the tax imposed by this chapter equal to a percentage of earned income. To receive a credit, a taxpayer must be eligible for a credit under section 32 of the Internal Revenue Code.

(b) For individuals with no qualifying children, the credit equals 1.9125 percent of the first $4,620 of earned income. The credit is reduced by 1.9125 percent of earned income or modified adjusted gross income, whichever is greater, in excess of $5,770, but in no case is the credit less than zero.

(c) For individuals with one qualifying child, the credit equals 8.5 percent of the first $6,920 of earned income and 8.5 percent of earned income over $12,080 but less than $13,450. The credit is reduced by 5.73 percent of earned income or modified adjusted gross income, whichever is greater, in excess of $15,080, but in no case is the credit less than zero.

(d) For individuals with two or more qualifying children, the credit equals ten percent of the first $9,720 of earned income and 20 percent of earned income over $14,860 but less than $16,800. The credit is reduced by 10.3 percent of earned income or modified adjusted gross income, whichever is greater, in excess of $17,890, but in no case is the credit less than zero.

(e) For a nonresident or part-year resident, the credit must be allocated based on the percentage calculated under section 290.06, subdivision 2c, paragraph (e).

(f) For a person who was a resident for the entire tax year and has earned income not subject to tax under this chapter, including income excluded under section 290.01, subdivision 19b, clause (11) <u>or (12)</u>, the credit must be allocated based on the ratio of federal adjusted gross income reduced by the earned income not subject to tax under this chapter over federal adjusted gross income.

(g) For tax years beginning after December 31, 2001, and before December 31, 2004, the $5,770 in paragraph (b), the $15,080 in paragraph (c), and the $17,890 in paragraph (d), after being adjusted for inflation under subdivision 7, are each increased by $1,000 for married taxpayers filing joint returns.

(h) For tax years beginning after December 31, 2004, and before December 31, 2007, the $5,770 in paragraph (b), the $15,080 in paragraph (c), and the $17,890 in paragraph (d), after being adjusted for inflation under subdivision 7, are each increased by $2,000 for married taxpayers filing joint returns.

(i) For tax years beginning after December 31, 2007, and before December 31, 2010, the $5,770 in paragraph (b), the $15,080 in paragraph (c), and the $17,890 in paragraph (d), after being adjusted for inflation under subdivision 7, are each increased by $3,000 for married taxpayers filing joint returns. For tax years beginning after December 31, 2008, the $3,000 is adjusted annually for inflation under subdivision 7.

(j) The commissioner shall construct tables showing the amount of the credit at various income levels and make them available to taxpayers. The tables shall follow the schedule contained in this subdivision, except that the commissioner may graduate the transition between income brackets.

[EFFECTIVE DATE.] <u>This section is effective for tax years beginning after December 31, 2006.</u>

Sec. 8. Minnesota Statutes 2004, section 290.091, subdivision 2, is amended to read:

Subd. 2. [DEFINITIONS.] For purposes of the tax imposed by this section, the following terms have the meanings given:

(a) "Alternative minimum taxable income" means the sum of the following for the taxable year:

(1) the taxpayer's federal alternative minimum taxable income as defined in section 55(b)(2) of the Internal Revenue Code;

(2) the taxpayer's itemized deductions allowed in computing federal alternative minimum taxable income, but excluding:

(i) the charitable contribution deduction under section 170 of the Internal Revenue Code to the extent that the deduction exceeds 1.0 percent of adjusted gross income, as defined in section 62 of the Internal Revenue Code;

(ii) the medical expense deduction;

(iii) the casualty, theft, and disaster loss deduction; and

(iv) the impairment-related work expenses of a disabled person;

(3) for depletion allowances computed under section 613A(c) of the Internal Revenue Code, with respect to each property (as defined in section 614 of the Internal Revenue Code), to the extent not included in federal alternative minimum taxable income, the excess of the deduction for depletion allowable under section 611 of the Internal Revenue Code for the taxable year over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year);

(4) to the extent not included in federal alternative minimum taxable income, the amount of the tax preference for intangible drilling cost under section 57(a)(2) of the Internal Revenue Code determined without regard to subparagraph (E);

(5) to the extent not included in federal alternative minimum taxable income, the amount of interest income as provided by section 290.01, subdivision 19a, clause (1); and

(6) the amount of addition required by section 290.01, subdivision 19a, clause (7);

less the sum of the amounts determined under the following:

(1) interest income as defined in section 290.01,

subdivision 19b, clause (1);

(2) an overpayment of state income tax as provided by section 290.01, subdivision 19b, clause (2), to the extent included in federal alternative minimum taxable income;

(3) the amount of investment interest paid or accrued within the taxable year on indebtedness to the extent that the amount does not exceed net investment income, as defined in section 163(d)(4) of the Internal Revenue Code. Interest does not include amounts deducted in computing federal adjusted gross income; and

(4) amounts subtracted from federal taxable income as provided by section 290.01, subdivision 19b, clauses (10) ~~and~~, (11), and (12).

In the case of an estate or trust, alternative minimum taxable income must be computed as provided in section 59(c) of the Internal Revenue Code.

(b) "Investment interest" means investment interest as defined in section 163(d)(3) of the Internal Revenue Code.

(c) "Tentative minimum tax" equals 6.4 percent of alternative minimum taxable income after subtracting the exemption amount determined under subdivision 3.

(d) "Regular tax" means the tax that would be imposed under this chapter (without regard to this section and section 290.032), reduced by the sum of the nonrefundable credits allowed under this chapter.

(e) "Net minimum tax" means the minimum tax imposed by this section.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 9. Minnesota Statutes 2004, section 290.0921, subdivision 3, is amended to read:

Subd. 3. [ALTERNATIVE MINIMUM TAXABLE INCOME.] "Alternative minimum taxable income" is Minnesota net income as defined in section 290.01, subdivision 19, and includes the adjustments and tax preference items in sections 56, 57, 58, and 59(d), (e), (f), and (h) of the Internal Revenue Code. If a corporation files a separate company Minnesota tax return, the minimum tax must be computed on a separate company basis. If a corporation is part of a tax group filing a unitary return, the minimum tax must be computed on a unitary basis. The following adjustments must be made.

(1) For purposes of the depreciation adjustments under section 56(a)(1) and 56(g)(4)(A) of the Internal Revenue Code, the basis for depreciable property placed in service in a taxable year beginning before January 1, 1990, is the adjusted basis for federal income tax purposes, including any modification made in a taxable year under section 290.01, subdivision 19e, or Minnesota Statutes 1986, section 290.09, subdivision 7, paragraph (c).

For taxable years beginning after December 31, 2000, the amount of any remaining modification made under section 290.01, subdivision 19e, or Minnesota Statutes 1986, section 290.09, subdivision 7, paragraph (c), not previously deducted is a depreciation allowance in the first taxable year after December 31, 2000.

(2) The portion of the depreciation deduction allowed for federal income tax purposes under section 168(k) of the Internal Revenue Code that is required as an addition under section 290.01, subdivision 19c, clause (16), is disallowed in determining alternative minimum taxable income.

(3) The subtraction for depreciation allowed under section 290.01, subdivision 19d, clause (19), is allowed as a depreciation deduction in determining alternative minimum taxable income.

(4) The alternative tax net operating loss deduction under sections 56(a)(4) and 56(d) of the Internal Revenue Code does not apply.

(5) The special rule for certain dividends under section 56(g)(4)(C)(ii) of the Internal Revenue Code does not apply.

(6) The special rule for dividends from section 936 companies under section 56(g)(4)(C)(iii) does not apply.

(7) The tax preference for depletion under section 57(a)(1)

of the Internal Revenue Code does not apply.

(8) The tax preference for intangible drilling costs under section 57(a)(2) of the Internal Revenue Code must be calculated without regard to subparagraph (E) and the subtraction under section 290.01, subdivision 19d, clause (4).

(9) The tax preference for tax exempt interest under section 57(a)(5) of the Internal Revenue Code does not apply.

(10) The tax preference for charitable contributions of appreciated property under section 57(a)(6) of the Internal Revenue Code does not apply.

(11) For purposes of calculating the tax preference for accelerated depreciation or amortization on certain property placed in service before January 1, 1987, under section 57(a)(7) of the Internal Revenue Code, the deduction allowable for the taxable year is the deduction allowed under section 290.01, subdivision 19e.

For taxable years beginning after December 31, 2000, the amount of any remaining modification made under section 290.01, subdivision 19e, not previously deducted is a depreciation or amortization allowance in the first taxable year after December 31, 2004.

(12) For purposes of calculating the adjustment for adjusted current earnings in section 56(g) of the Internal Revenue Code, the term "alternative minimum taxable income" as it is used in section 56(g) of the Internal Revenue Code, means alternative minimum taxable income as defined in this subdivision, determined without regard to the adjustment for adjusted current earnings in section 56(g) of the Internal Revenue Code.

(13) For purposes of determining the amount of adjusted current earnings under section 56(g)(3) of the Internal Revenue Code, no adjustment shall be made under section 56(g)(4) of the Internal Revenue Code with respect to (i) the amount of foreign dividend gross-up subtracted as provided in section 290.01, subdivision 19d, clause (1), (ii) the amount of refunds of income, excise, or franchise taxes subtracted as provided in

section 290.01, subdivision 19d, clause (10), or (iii) the amount of royalties, fees or other like income subtracted as provided in section 290.01, subdivision 19d, clause (11).

(14) Alternative minimum taxable income excludes the income from operating in a job opportunity building zone as provided under section 469.317.

(15) Alternative minimum taxable income excludes the income from operating in a biotechnology and health sciences industry zone as provided under section 469.337.

(16) Alternative minimum taxable income excludes the income from operating in an international economic development zone as provided under section 469.326.

Items of tax preference must not be reduced below zero as a result of the modifications in this subdivision.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 10. Minnesota Statutes 2004, section 290.0922, subdivision 2, is amended to read:

Subd. 2. [EXEMPTIONS.] The following entities are exempt from the tax imposed by this section:

(1) corporations exempt from tax under section 290.05;

(2) real estate investment trusts;

(3) regulated investment companies or a fund thereof; and

(4) entities having a valid election in effect under section 860D(b) of the Internal Revenue Code;

(5) town and farmers' mutual insurance companies;

(6) cooperatives organized under chapter 308A that provide housing exclusively to persons age 55 and over and are classified as homesteads under section 273.124, subdivision 3; ~~and~~

(7) an entity, if for the taxable year all of its property is located in a job opportunity building zone designated under section 469.314 and all of its payroll is a job opportunity building zone payroll under section 469.310; and

(8) an entity, if for the taxable year all of its property is located in an international economic development zone

designated under section 469.322, and all of its payroll is international economic development zone payroll under section 469.321.

Entities not specifically exempted by this subdivision are subject to tax under this section, notwithstanding section 290.05.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 11. Minnesota Statutes 2004, section 290.0922, subdivision 3, is amended to read:

Subd. 3. [DEFINITIONS.] (a) "Minnesota sales or receipts" means the total sales apportioned to Minnesota pursuant to section 290.191, subdivision 5, the total receipts attributed to Minnesota pursuant to section 290.191, subdivisions 6 to 8, and/or the total sales or receipts apportioned or attributed to Minnesota pursuant to any other apportionment formula applicable to the taxpayer.

(b) "Minnesota property" means total Minnesota tangible property as provided in section 290.191, subdivisions 9 to 11, any other tangible property located in Minnesota, but does not include property located in a job opportunity building zone designated under section 469.314, or property of a qualified business located in a biotechnology and health sciences industry zone designated under section 469.334, or property of a qualified business located in the international economic development zone designated under section 469.322. Intangible property shall not be included in Minnesota property for purposes of this section. Taxpayers who do not utilize tangible property to apportion income shall nevertheless include Minnesota property for purposes of this section. On a return for a short taxable year, the amount of Minnesota property owned, as determined under section 290.191, shall be included in Minnesota property based on a fraction in which the numerator is the number of days in the short taxable year and the denominator is 365.

(c) "Minnesota payrolls" means total Minnesota payrolls as provided in section 290.191, subdivision 12, but does not include job opportunity building zone payrolls under section 469.310, subdivision 8, or biotechnology and health sciences industry zone ~~payroll~~ payrolls under section 469.330, subdivision 8, or international economic development zone payrolls under section 469.321, subdivision 9. Taxpayers who do not utilize payrolls to apportion income shall nevertheless include Minnesota payrolls for purposes of this section.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 12. Minnesota Statutes 2004, section 297A.68, is amended by adding a subdivision to read:

Subd. 40. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONES.] (a) Purchases of tangible personal property or taxable services by a qualified business, as defined in section 469.321, are exempt if the property or services are primarily used or consumed in the international economic development zone designated under section 469.322.

(b) Purchase and use of construction materials, supplies, and equipment incorporated into the construction of improvements to real property in the international economic development zone are exempt if the improvements after completion of construction are to be used as a regional distribution center as defined in section 469.321 or otherwise used in the conduct of freight forwarding activities of a qualified business as defined in section 469.321. This exemption applies regardless of whether the purchases are made by the business or a contractor.

(c) The exemptions under this subdivision apply to a local sales and use tax, regardless of whether the local tax is imposed on sales taxable under this chapter or in another law, ordinance, or charter provision.

(d) The exemption in paragraph (a) applies to sales during the duration of the zone, if the purchase was made and delivery received after the business signs the business subsidy agreement required under chapter 469. The exemption in paragraph (b) applies to sales made before the end of the duration of the zone, if the purchase and delivery were made after June 30, 2006.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 13. [469.321] [DEFINITIONS.]

Subdivision 1. [SCOPE.] For purposes of sections 469.321 to 469.328, the following terms have the meanings given.

Subd. 2. [FOREIGN TRADE ZONE.] "Foreign trade zone" means a foreign trade zone designated pursuant to United States Code, title 19, section 81a, for the right to use the powers provided in United States Code, title 19, sections 81a to 81u, or a subzone authorized by the foreign trade zone.

Subd. 3. [FOREIGN TRADE ZONE AUTHORITY.] "Foreign trade zone authority" means the Greater Metropolitan Foreign Trade Zone Commission number 119, a joint powers authority created by the county of Hennepin, the cities of Minneapolis and Bloomington, and the Metropolitan Airports Commission, under the authority of section 469.059, 469.101, or 471.59, which includes any other political subdivisions that enter into the authority after its creation.

Subd. 4. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONE OR ZONE.] An "international economic development zone" or "zone" is a zone so designated under section 469.322.

Subd. 5. [PERSON.] "Person" includes an individual, corporation, partnership, limited liability company, association, or any other entity.

Subd. 6. [QUALIFIED BUSINESS.] (a) "Qualified business" means a person who has signed a business subsidy agreement as required under sections 116J.993 to 116J.995 and 469.323, subdivision 4, carrying on a trade or business at a place of business located within the international economic development zone that is:

(1)(i) engaged in the furtherance of international export or import of goods as a freight forwarder; and (ii) certified by the foreign trade zone authority as a trade or business that furthers the purpose of developing international distribution capacity and capability; or

(2) the owner or operator of a regional distribution center.

(b) A qualified business must pay each employee total compensation, including benefits not mandated by law, that on an annualized basis is equal to at least 110 percent of the federal poverty guidelines for a family of four.

Subd. 7. [REGIONAL DISTRIBUTION CENTER.] A "regional distribution center" is a distribution center developed within a foreign trade zone. The regional distribution center must have as its primary purpose, the facilitation of the gathering of freight for the purpose of centralizing the functions necessary for the shipment of freight in international commerce, including, but not limited to, security and customs functions.

Subd. 8. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONE PERCENTAGE OR ZONE PERCENTAGE.] "International economic development zone percentage" or "zone percentage" means the following fraction reduced to a percentage:

(1) the numerator of the fraction is:

(i) the ratio of the taxpayer's property factor under section 290.191 located in the zone for the taxable year which is land, buildings, machinery and equipment, inventories, and other tangible personal property that is a regional distribution center or is used in the furtherance of the taxpayer's freight forwarding operations over the property factor numerator determined under section 290.191, plus

(ii) the ratio of the taxpayer's international economic development zone payroll factor under subdivision 9 over the payroll factor numerator determined under section 290.191; and

(2) the denominator of the fraction is two.

When calculating the zone percentage for a business that is part of a unitary business as defined under section 290.17, subdivision 4, the denominator of the payroll and property factors is the Minnesota payroll and property of the unitary business as reported on the combined report under section 290.17, subdivision 4, paragraph (j).

Subd. 9. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONE PAYROLL FACTOR OR INTERNATIONAL ECONOMIC DEVELOPMENT ZONE PAYROLL.]

"International economic development zone payroll factor" or "international economic development zone payroll" is that portion of the payroll factor under section 290.191 used to operate a regional distribution center, or used in the furtherance of the taxpayer's freight forwarding operations that represents:

(1) wages or salaries paid to an individual for services performed in the international economic development zone; or

(2) wages or salaries paid to individuals working from offices within the international economic development zone, if their employment requires them to work outside the zone and the work is incidental to the work performed by the individual within the zone. However, in no case does zone payroll include wages paid for work performed outside the zone of an employee who performs more than ten percent of total services for the employer outside the zone.

Subd. 10. [FREIGHT FORWARDER.] "Freight forwarder" is a business that, for compensation, ensures that goods produced or sold by another business move from point of origin to point of destination.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 14. [469.3215] [APPLICATION FOR DESIGNATION.]

Subdivision 1. [WHO MAY APPLY.] One or more local government units, or a joint powers board under section 471.59, acting on behalf of two or more units, may apply for designation of an area as an international economic development zone. All or part of the area proposed for designation as a zone must be located within the boundaries of each of the governmental units. A local government unit may not submit or have submitted on its behalf more than one application for designation of an international economic development zone.

Subd. 2. [APPLICATION CONTENT.] (a) The application must include:

(1) a resolution or ordinance adopted by each of the cities or towns and the counties in which the zone is located, agreeing

to provide all of the local tax exemptions provided under section 469.315;

(2) an agreement by the applicant to treat incentives provided under the zone designation as business subsidies under sections 116J.993 to 116J.995 and to comply with the requirements of that law; and

(3) supporting evidence to allow the authority to evaluate the application.

(b) Applications must be submitted to the authority no later than December 31, 2005.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 15. [469.322] [DESIGNATION OF INTERNATIONAL ECONOMIC DEVELOPMENT ZONE.]

(a) An area designated as a foreign trade zone may be designated by the foreign trade zone authority as an international economic development zone if within the zone a regional distribution center is being developed pursuant to section 469.323. The zone must consist of contiguous area of not less than 500 acres and not more than 1,000 acres. The designation authority under this section is limited to one zone.

(b) In making the designation, the foreign trade zone authority, in consultation with the Minnesota Department of Transportation, the Minnesota Department of Employment and Economic Development, the Minnesota Department of Revenue, and the Metropolitan Council, shall consider access to major transportation routes, consistency with current state transportation and air cargo planning, adequacy of the size of the site, access to airport facilities, present and future capacity at the designated airport, the capability to meet integrated present and future air cargo, security, and inspection services, and access to other infrastructure and financial incentives to maximize the security, efficiency, and volume of Minnesota's export shipments. The border of the international economic development zone must be no more than 60 miles distant or 90 minutes drive time from the border of the

Minneapolis-St. Paul International Airport.

(c) Prior to a final site designation, the foreign trade zone authority, in consultation with the applicant, must conduct a transportation impact study based on the regional model and utilizing traffic forecasting and assignments. The results must be used to evaluate the effects of the proposed use on the transportation system and identify any needed improvements. If the site is in the metropolitan area the study must also evaluate the effect of the transportation impacts on the Metropolitan Transportation System plan as well as the comprehensive plans of the municipalities that would be affected. The cost of the study must be paid by the applicant.

(d) Final zone designation must be made by June 30, 2006.

(e) Duration of the zone is a 12-year period beginning on January 1, 2007.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 16. [469.323] [FOREIGN TRADE ZONE AUTHORITY POWERS.]

Subdivision 1. [DEVELOPMENT OF REGIONAL DISTRIBUTION CENTER.] The foreign trade zone authority shall be responsible for creating a development plan for the regional distribution center. The regional distribution center must be developed with the purpose of expanding, on a regional basis, international distribution capacity and capability. The foreign trade zone authority shall consult only with municipalities that have indicated to the authority an interest in locating the international economic development zone within their boundaries, as well as interested businesses, potential financiers, and appropriate state and federal agencies.

Subd. 2. [BUSINESS PLAN.] Before designation of an international economic development zone under section 469.322, the governing body of the foreign trade zone authority shall prepare a business plan. The plan must establish performance goals for the zone. These goals must set out, at a minimum, the amount of investment, the number of jobs, and the amount of freight handled expected to be attained at the end of three-, five-, and ten-year periods by the zone. The plan also must include an analysis of the economic feasibility of the regional distribution center once it becomes operational and of the operations of freight forwarders and other businesses that choose to locate within the boundaries of the zone. The analysis must provide profitability models that:

(1) include the benefits of the incentives;

(2) estimate the amount of time needed to achieve profitability; and

(3) analyze the length of time incentives will be necessary to the economic viability of the regional distribution center.

If the governing body of the foreign trade authority determines that the models do not establish the economic feasibility of the project, the regional distribution center does not meet the development requirements of this section and section 469.322.

Subd. 3. [PORT AUTHORITY POWERS.] The governing body of the foreign trade zone authority may establish a port authority that has the same powers as a port authority established under section 469.049. If the foreign trade zone authority establishes a port authority, the governing body of the foreign trade zone authority shall exercise all powers granted to a city by sections 469.048 to 469.068 or other law.

Subd. 4. [BUSINESS SUBSIDY LAW.] Tax exemptions and job credits provided under this section are business subsidies paid by the affected local government for the purpose of sections 116J.871 and 116J.993 to 116J.995.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 17. [469.324] [TAX INCENTIVES IN INTERNATIONAL ECONOMIC DEVELOPMENT ZONE.]

Subdivision 1. [AVAILABILITY.] Qualified businesses that operate in an international economic development zone, individuals who invest in a regional distribution center or qualified businesses that operate in an international economic development zone, and property located in an international economic development zone qualify for:

(1) exemption from individual income taxes as provided under section 469.325;

(2) exemption from corporate franchise taxes as provided under section 469.326;

(3) exemption from the state sales and use tax and any local sales and use taxes on qualifying purchases as provided in section 297A.68, subdivision 40;

(4) exemption from the property tax as provided in section 272.02, subdivision 68; and

(5) the jobs credit allowed under section 469.327.

Sec. 18. [469.325] [INDIVIDUAL INCOME TAX EXEMPTION.]

Subdivision 1. [APPLICATION.] An individual, estate, or trust operating a trade or business in the international economic development zone, and an individual making a qualifying investment in a qualified business operating in the international economic development zone, qualifies for the exemptions from taxes imposed under chapter 290, as provided in this section. The exemptions provided under this section apply only to the extent that the income otherwise would be taxable under chapter 290. Subtractions under this section from federal taxable income, alternative minimum taxable income, or any other base subject to tax are limited to the amount that otherwise would be included in the tax base absent the exemption under this section. This section applies only to tax years beginning during the duration of the zone.

Subd. 2. [RENTS.] An individual, estate, or trust is exempt from the taxes imposed under chapter 290 on net rents derived from real or tangible personal property used by a qualified business and located in the zone for the taxable year in which the zone was designated an international economic development zone. If tangible personal property was used both within and outside of the zone by the qualified business, the exemption amount for the net rental income must be multiplied by a fraction, the numerator of which is the number of days the property was used in the zone and the denominator of which is the total days the property is rented by a qualified business.

Subd. 3. [BUSINESS INCOME.] An individual, estate, or trust is exempt from the taxes imposed under chapter 290 on net income from the operation of a qualified business in the international economic development zone. If the trade or business is carried on within and outside of the zone and the individual is not a resident of Minnesota, the exemption must be apportioned based on the zone percentage for the taxable year. If the trade or business is carried on within or outside of the zone and the individual is a resident of Minnesota, the exemption must be apportioned based on the zone percentage for the taxable year, except the ratios under section 469.321, subdivision 8, clause (1), items (i) and (ii), must use the denominators of the property and payroll factors determined under section 290.191. No subtraction is allowed under this section in excess of 20 percent of the sum of the international economic development zone payroll and the adjusted basis of the property at the time that the property is first used in the international economic development zone by the business.

Subd. 4. [CAPITAL GAINS.] (a) An individual, estate, or trust is exempt from the taxes imposed under chapter 290 on:

(1) net gain derived on a sale or exchange of real property located in the international economic development zone and used by a qualified business. If the property was held by the individual, estate, or trust during a period when the zone was not designated, the gain must be prorated based on the percentage of time, measured in calendar days, that the real property was held by the individual during the period the zone designation was in effect to the total period of time the real property was held by the individual;

(2) net gain derived on a sale or exchange of tangible personal property used by a qualified business in the international economic development zone. If the property was held by the individual, estate, or trust during a period when the zone was not designated, the gain must be prorated based on the percentage of time, measured in calendar days, that the

property was held by the individual during the period the zone designation was in effect to the total period of time the property was held by the individual, estate, or trust. If the tangible personal property was used outside of the zone during the period of the zone's designation, the exemption must be multiplied by a fraction, the numerator of which is the number of days the property was used in the zone during the time of the designation and the denominator of which is the total days the property was held during the time of the designation; and

(3) net gain derived on a sale of an ownership interest in a qualified business operating in the international economic development zone, meeting the requirements of paragraph (b). The exemption on the gain must be multiplied by the zone percentage of the business for the taxable year prior to the sale.

(b) A qualified business meets the requirements of paragraph (a), clause (3), if it is a corporation, an S corporation, or a partnership, and for the taxable year its international economic development zone percentage exceeds 25 percent. For purposes of paragraph (a), clause (3), the zone percentage must be calculated by modifying the ratios under section 469.321, subdivision 8, clause (1), items (i) and (ii), to use the denominators of the property and payroll factors determined under section 290.191. Upon the request of an individual, estate, or trust holding an ownership interest in the entity, the entity must certify to the owner, in writing, the international economic development zone percentage needed to determine the exemption.

[**EFFECTIVE DATE.**] This section is effective for tax years beginning after December 31, 2006.

Sec. 19. [469.326] [CORPORATE FRANCHISE TAX EXEMPTION.]

(a) A qualified business is exempt from taxation under section 290.02, the alternative minimum tax under section 290.0921, and the minimum fee under section 290.0922, on the portion of its income attributable to operations within the international economic development zone. This exemption is determined as follows:

(1) for purposes of the tax imposed under section 290.02, by multiplying its taxable net income by its zone percentage and subtracting the result in determining taxable income;

(2) for purposes of the alternative minimum tax under section 290.0921, by multiplying its alternative minimum taxable income by its zone percentage and reducing alternative minimum taxable income by this amount; and

(3) for purposes of the minimum fee under section 290.0922, by excluding property and payroll in the zone from the computations of the fee or by exempting the entity under section 290.0922, subdivision 2, clause (8).

(b) No subtraction is allowed under this section in excess of 20 percent of the sum of the corporation's international economic development zone payroll and the adjusted basis of the zone property at the time that the property is first used in the international economic development zone by the corporation.

(c) This section applies only to tax years beginning during the duration of the international economic development zone.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 20. [469.327] [JOBS CREDIT.]

Subdivision 1. [CREDIT ALLOWED.] A qualified business is allowed a credit against the taxes imposed under chapter 290. The credit equals seven percent of the:

(1) lesser of:

(i) zone payroll for the taxable year, less the zone payroll for the base year; or

(ii) total Minnesota payroll for the taxable year, less total Minnesota payroll for the base year; minus

(2) $30,000 multiplied by the number of full-time equivalent employees that the qualified business employs in the international economic development zone for the taxable year, minus the number of full-time equivalent employees the business employed in the zone in the base year, but not less than zero.

Subd. 2. [DEFINITIONS.] (a) For purposes of this section, the following terms have the meanings given.

(b) "Base year" means the taxable year beginning during the calendar year in which the zone designation was made under section 469.322, paragraph (d).

(c) "Full-time equivalent employees" means the equivalent of annualized expected hours of work equal to 2,080 hours.

(d) "Minnesota payroll" means the wages or salaries attributed to Minnesota under section 290.191, subdivision 12, for the qualified business or the unitary business of which the qualified business is a part, whichever is greater.

(e) "Zone payroll" means wages or salaries used to determine the zone payroll factor for the qualified business, less the amount of compensation attributable to any employee that exceeds $100,000.

Subd. 3. [INFLATION ADJUSTMENT.] For taxable years beginning after December 31, 2004, the dollar amounts in subdivisions 1, clause (2); and 2, paragraph (e), are annually adjusted for inflation. The commissioner of revenue shall adjust the amounts by the percentage determined under section 290.06, subdivision 2d, for the taxable year.

Subd. 4. [REFUNDABLE.] If the amount of the credit exceeds the liability for tax under chapter 290, the commissioner of revenue shall refund the excess to the qualified business.

Subd. 5. [APPROPRIATION.] An amount sufficient to pay the refunds authorized by this section is appropriated to the commissioner of revenue from the general fund.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2006.

Sec. 21. [469.328] [REPAYMENT OF TAX BENEFITS.]

Subdivision 1. [REPAYMENT OBLIGATION.] A person must repay the amount of the tax reduction received under section 469.324, subdivision 1, clauses (1) to (5), or credit received under section 469.327, during the two years immediately before it ceased to operate in the zone as a qualified business, if the person ceased to operate its facility located within the zone, ceased to be in compliance with the terms of the business

<u>subsidy agreement, or otherwise ceases to be or is not a qualified business.</u>

<u>Subd. 2.</u> [DISPOSITION OF REPAYMENT.] <u>The repayment must be paid to the state to the extent it represents a state tax reduction and to the county to the extent it represents a property tax reduction. Any amount repaid to the state must be deposited in the general fund. Any amount repaid to the county for the property tax exemption must be distributed to the local governments with authority to levy taxes in the zone in the same manner provided for distribution of payment of delinquent property taxes. Any repayment of local sales or use taxes must be repaid to the jurisdiction imposing the local sales or use tax.</u>

<u>Subd. 3.</u> [REPAYMENT PROCEDURES.] <u>(a) For the repayment of taxes imposed under chapter 290 or 297A or local taxes collected pursuant to section 297A.99, a person must file an amended return with the commissioner of revenue and pay any taxes required to be repaid within 30 days after ceasing to be a qualified business. The amount required to be repaid is determined by calculating the tax for the period for which repayment is required without regard to the tax reductions and credits allowed under section 469.324.</u>

<u>(b) For the repayment of property taxes, the county auditor shall prepare a tax statement for the person, applying the applicable tax extension rates for each payable year and provide a copy to the business. The person must pay the taxes to the county treasurer within 30 days after receipt of the tax statement. The taxpayer may appeal the valuation and determination of the property tax to the tax court within 30 days after receipt of the tax statement.</u>

<u>(c) The provisions of chapters 270 and 289A relating to the commissioner of revenue's authority to audit, assess, and collect the tax and to hear appeals are applicable to the repayment required under paragraphs (a) and (b). The commissioner may impose civil penalties as provided in chapter 289A, and the additional tax and penalties are subject to</u>

interest at the rate provided in section 270.75, from 30 days after ceasing to do business in the zone until the date the tax is paid.

(d) If a property tax is not repaid under paragraph (c), the county treasurer shall add the amount required to be repaid to the property taxes assessed against the property for payment in the year following the year in which the treasurer discovers that the person ceased to operate in the international economic development zone.

(e) For determining the tax required to be repaid, a tax reduction is deemed to have been received on the date that the tax would have been due if the person had not been entitled to the tax reduction.

(f) The commissioner of revenue may assess the repayment of taxes under paragraph (d) at any time within two years after the person ceases to be a qualified business, or within any period of limitations for the assessment of tax under section 289A.38, whichever is later.

Subd. 4. [WAIVER AUTHORITY.] The commissioner of revenue may waive all or part of a repayment, if, in consultation with the foreign trade zone authority and appropriate officials from the state and local government units, including the commissioner of employment and economic development, determines that requiring repayment of the tax is not in the best interest of the state or local government and the business ceased operating as a result of circumstances beyond its control, including, but not limited to:

(1) a natural disaster;

(2) unforeseen industry trends; or

(3) loss of a major supplier or customer.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 22. [469.329] [REPORTING REQUIREMENTS.]

An applicant receiving designation of an international economic development zone under section 469.322 must annually report to the commissioner of employment and economic development on its progress in meeting the zone performance goals under the business plan for the zone and the applicant's compliance with the business subsidy law under sections 116J.993 to 116J.995.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

ARTICLE 5

MISCELLANEOUS

Section 1. Minnesota Statutes 2004, section 10A.31, subdivision 1, is amended to read:

Subdivision 1. [DESIGNATION.] An individual resident of this state who files an income tax return or ~~a-renter-and homeowner~~ property tax refund return with the commissioner of revenue may designate on their original return that ~~$5-be-paid from-the-general-fund-of-the-state~~ $1 to $25, or $1 to $50 if the return is filed jointly, be added to the tax or deducted from the refund that would otherwise be payable by or to the individual and paid into the state elections campaign fund. ~~If a-husband-and-wife-file-a-joint-return,-each-spouse-may designate-that-$5-be-paid.--No-individual-is-allowed-to designate-$5-more-than-once-in-any-year.~~ The taxpayer may designate that the amount be paid into the account of a political party or into the general account. Designations made under this section are not eligible for refund under section 290.06, subdivision 23.

[EFFECTIVE DATE.] This section is effective beginning with designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005.

Sec. 2. Minnesota Statutes 2004, section 10A.31, subdivision 3, is amended to read:

Subd. 3. [FORM.] The commissioner of revenue must provide on ~~the-first-page-of~~ the income tax form and the renter and homeowner property tax refund return a space for the individual to indicate a wish to pay ~~$5-($10~~ $1 to $25, or $1 to $50 if filing a joint return~~)-from-the-general-fund-of-the-state~~, to finance election campaigns. The form must also contain language prepared by the commissioner that permits the individual to direct the ~~state-to-pay-the-$5-(or-$10-if-filing-a-joint-return)~~ designation to: (1) one of the major political parties; (2) any minor political party that qualifies under subdivision 3a; or (3) all qualifying candidates as provided by subdivision 7. ~~The renter-and-homeowner-property-tax-refund-return-must-include instructions-that-the-individual-filing-the-return-may-designate $5-on-the-return-only-if-the-individual-has-not-designated-$5-on the-income-tax-return.~~

[EFFECTIVE DATE.] This section is effective beginning with designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005.

Sec. 3. Minnesota Statutes 2004, section 10A.31, subdivision 4, is amended to read:

Subd. 4. [APPROPRIATION.] ~~(a)~~ The amounts designated by individuals for the state elections campaign fund, less three percent, ~~are-appropriated-from-the-general-fund,~~ must be transferred and credited to the appropriate account in the state elections campaign fund~~,-and-are-annually-appropriated~~ for distribution as set forth in subdivisions 5, 5a, 6, and 7. The remaining three percent must be ~~kept~~ deposited in the general fund for administrative costs.

~~(b)-In-addition-to-the-amounts-in-paragraph-(a),-$1,500,000 for-each-general-election-is-appropriated-from-the-general-fund for-transfer-to-the-general-account-of-the-state-elections campaign-fund.~~

~~Of-this-appropriation,-$65,000-each-fiscal-year-must-be-set aside-to-pay-assessments-made-by-the-Office-of-Administrative Hearings-under-section-211B.37.--Amounts-remaining-after-all assessments-have-been-paid-must-be-canceled-to-the-general account.~~

[EFFECTIVE DATE.] The changes to paragraph (a) are effective beginning with designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005. The changes to paragraph (b) are effective for appropriations for general elections occurring after December 31, 2004.

Sec. 4. Minnesota Statutes 2004, section 270A.03, subdivision 7, is amended to read:

Subd. 7. [REFUND.] "Refund" means an individual income tax refund ~~or political contribution refund, pursuant to chapter 290~~, or a property tax credit or refund, pursuant to chapter 290A, or a sustainable forest tax payment to a claimant under chapter 290C.

For purposes of this chapter, lottery prizes, as set forth in section 349A.08, subdivision 8, and amounts granted to persons by the legislature on the recommendation of the joint senate-house of representatives Subcommittee on Claims shall be treated as refunds.

In the case of a joint property tax refund payable to spouses under chapter 290A, the refund shall be considered as belonging to each spouse in the proportion of the total refund that equals each spouse's proportion of the total income determined under section 290A.03, subdivision 3. In the case of a joint income tax refund under chapter 289A, the refund shall be considered as belonging to each spouse in the proportion of the total refund that equals each spouse's proportion of the total taxable income determined under section 290.01, subdivision 29. The commissioner shall remit the entire refund to the claimant agency, which shall, upon the request of the spouse who does not owe the debt, determine the amount of the refund belonging to that spouse and refund the amount to that spouse. For court fines, fees, and surcharges and court-ordered restitution under section 611A.04, subdivision 2, the notice provided by the commissioner of revenue under section 270A.07, subdivision 2, paragraph (b), serves as the appropriate legal notice to the spouse who does not owe the debt.

[EFFECTIVE DATE.] This section is effective for political contribution refund claims based on contributions made on or after July 1, 2005.

Sec. 5. Minnesota Statutes 2004, section 273.1384, subdivision 1, is amended to read:

Subdivision 1. [RESIDENTIAL HOMESTEAD MARKET VALUE CREDIT.] Each county auditor shall determine a homestead credit for each class 1a, 1b, 1c, and 2a homestead property within the county equal to 0.4 percent of the first $76,000 of market value of the property~~.--The-amount-of-homestead-credit-for-a-homestead may-not-exceed-$304-and-is-reduced-by~~ minus .09 percent of the market value in excess of $76,000. The credit amount may not be less than zero. In the case of an agricultural or resort homestead, only the market value of the house, garage, and immediately surrounding one acre of land is eligible in determining the property's homestead credit. In the case of a property which is classified as part homestead and part nonhomestead, (i) the credit shall apply only to the homestead portion of the property~~.~~, but (ii) if a portion of a property is classified as nonhomestead solely because not all the owners occupy the property, or solely because both spouses do not occupy the property, the credit amount shall be initially computed as if that nonhomestead portion were also in the homestead class and then prorated to the owner-occupant's percentage of ownership or prorated to one-half if both spouses do not occupy the property.

[EFFECTIVE DATE.] This section is effective for taxes payable in 2006 and thereafter.

Sec. 6. Minnesota Statutes 2004, section 289A.50, subdivision 1, is amended to read:

Subdivision 1. [GENERAL RIGHT TO REFUND.] (a) Subject to the requirements of this section and section 289A.40, a taxpayer who has paid a tax in excess of the taxes lawfully due and who files a written claim for refund will be refunded or credited the overpayment of the tax determined by the commissioner to be erroneously paid.

(b) The claim must specify the name of the taxpayer, the date when and the period for which the tax was paid, the kind of tax paid, the amount of the tax that the taxpayer claims was erroneously paid, the grounds on which a refund is claimed, and other information relative to the payment and in the form required by the commissioner. An income tax, estate tax, or corporate franchise tax return, or amended return claiming an overpayment constitutes a claim for refund.

(c) When, in the course of an examination, and within the time for requesting a refund, the commissioner determines that there has been an overpayment of tax, the commissioner shall refund or credit the overpayment to the taxpayer and no demand is necessary. If the overpayment exceeds $1, the amount of the overpayment must be refunded to the taxpayer. If the amount of the overpayment is less than $1, the commissioner is not required to refund. In these situations, the commissioner does not have to make written findings or serve notice by mail to the taxpayer.

(d) If the amount allowable as a credit for withholding, estimated taxes, or dependent care exceeds the tax against which the credit is allowable, the amount of the excess is considered an overpayment. ~~The-refund-allowed-by-section-290.06, subdivision-23,-is-also-considered-an-overpayment.~~ The requirements of section 270.10, subdivision 1, do not apply to the refunding of such an overpayment shown on the original return filed by a taxpayer.

(e) If the entertainment tax withheld at the source exceeds by $1 or more the taxes, penalties, and interest reported in the return of the entertainment entity or imposed by section 290.9201, the excess must be refunded to the entertainment entity. If the excess is less than $1, the commissioner need not refund that amount.

(f) If the surety deposit required for a construction contract exceeds the liability of the out-of-state contractor, the commissioner shall refund the difference to the contractor.

(g) An action of the commissioner in refunding the amount of the overpayment does not constitute a determination of the correctness of the return of the taxpayer.

(h) There is appropriated from the general fund to the commissioner of revenue the amount necessary to pay refunds allowed under this section.

[EFFECTIVE DATE.] This section is effective for political contribution refund claims based on contributions made on or after July 1, 2005.

Sec. 7. Minnesota Statutes 2004, section 290.01, subdivision 6, is amended to read:

Subd. 6. [TAXPAYER.] The term "taxpayer" means any person or corporation subject to a tax imposed by this chapter. ~~For purposes of section 290.06, subdivision 23, the term "taxpayer" means an individual eligible to vote in Minnesota under section 201.014.~~

[EFFECTIVE DATE.] This section is effective for political contribution refund claims based on contributions that are made on or after July 1, 2005.

Sec. 8. Minnesota Statutes 2004, section 290A.03, subdivision 11, is amended to read:

Subd. 11. [RENT CONSTITUTING PROPERTY TAXES.] (a) "Rent constituting property taxes" means ~~19~~ the percent specified in paragraph (b) of the gross rent actually paid in cash, or its equivalent, or the portion of rent paid in lieu of property taxes, in any calendar year by a claimant for the right of occupancy of the claimant's Minnesota homestead in the calendar year, and which rent constitutes the basis, in the succeeding calendar year of a claim for relief under this chapter by the claimant.

(b) For rent paid in 2005, the percent is 16 percent; and for rent paid in 2006, and thereafter, the percent is 15 percent.

[EFFECTIVE DATE.] This section is effective for rent constituting property taxes payable based on rent paid after December 31, 2004.

Sec. 9. Minnesota Statutes 2004, section 469.335, is amended to read:

469.335 [APPLICATION FOR TAX BENEFITS.]

(a) To claim a tax credit or exemption against a state tax under section 469.336, clauses (2) through (5), a business must apply to the commissioner for a tax credit certificate. As a condition of its application, the business must agree to furnish information to the commissioner that is sufficient to verify the eligibility for any credits or exemptions claimed. The total amount of the state tax credits and exemptions allowed for the specified period may not exceed the amount of the tax credit certificates provided by the commissioner to the business. The commissioner must verify to the commissioner of revenue the amount of tax exemptions or credits for which each business is eligible.

(b) A tax credit certificate issued under this section may specify the particular tax exemptions or credits against a state tax that the qualified business is eligible to claim under section 469.336, clauses (2) through (5), and the amount of each exemption or credit allowed.

(c) The commissioner may issue $1,000,000 of tax credits or exemptions in fiscal year 2004. Any tax credits or exemptions not awarded in fiscal year 2004 may be awarded in fiscal year 2005. The commissioner may issue $1,000,000 in tax credits or exemptions in fiscal year 2006. Any tax credits or exemptions not awarded in fiscal year 2006 may be awarded in fiscal year 2007.

(d) A qualified business must use the tax credits or tax exemptions granted under this section by the later of the end of the state fiscal year or the taxpayer's tax year in which the credits or exemptions are granted.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 10. [2005 CITY AID PAYMENTS.]

In 2005 and 2006, market value credit reimbursements for each city payable under Minnesota Statutes, section 273.1384, are reduced by the dollar amount of the 2003 reduction in market value credit reimbursements for that city due to Laws 2003, First Special Session chapter 21, article 5, section 12. No city's 2005 or 2006 market value credit reimbursements are reduced to less than zero under this section. To the extent sufficient information is available on each payment date, the commissioner shall pay the annual 2005 and 2006 market value credit reimbursement amounts, after reduction under this section, to cities in equal installments on the dates specified in Minnesota Statutes, section 273.1384.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

Sec. 11. [REPEALER.]

(a) Minnesota Statutes 2004, section 10A.322, subdivision 4, is repealed effective July 1, 2005.

(b) Minnesota Statutes 2004, section 16A.1522, subdivision 4, is repealed effective the day following final enactment.

(c) Minnesota Statutes 2004, section 290.06, subdivision 23, is repealed effective for contributions made after June 30, 2005.

MINNESOTA · REVENUE

Governor's Tax Bill

February 18, 2005

	Yes	No
Separate Official Fiscal Note Requested		X
Fiscal Impact		
DOR Administrative Costs/Savings		X

Department of Revenue
Analysis of S.F. 753 (Ortman)/ H.F. 660 (Krinkie)

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
	(000's)			
Federal Update				
*Military Family Tax Relief Act of 2003** (retroactive, various dates)	($680)	($330)	($340)	($350)
Medicare Prescription Drug, Improvement, And Modernization Act of 2003				
- Health Savings Accounts (1/1/04)	($6,400)	($3,600)	($3,900)	($4,300)
- Income Exclusion for Federal Subsidies to Employers with Pres. Drug Plans for Retirees (subsidy begins 1/1/06)	($2,900)	($6,200)	($7,100)	($7,800)
Working Families Tax Relief Act of 2004				
- Uniform Definition of Qualifying Child for Various Provisions (1/1/05)	($190)	($160)	($170)	($175)
- Include Combat Pay in Earned Income for Earned Income Credit/Working Family Credit (Tax years 2004 and 2005)	($80)	$0	$0	$0
Extend Expiring Provisions to 2004 and 2005				
- Deduction up to $250 for Teacher Expenses	($2,400)	$0	$0	$0
- Other Provisions*	($1,310)	$90	$55	$45
American Job Creation Act of 2004				
- Increased Expensing with 80% Addback and 5-Year Subtraction (2006 and 2007)	($125)	$1,600	$4,200	$2,175
- All Other Provisions (except Deduction for U.S. Production Activities)*	$8,705	$10,585	$15,420	$15,290
Individual Income Tax				
- Exempt State Active Service by the National Guard (1/1/05)	($42)	($42)	($42)	($42)
- Eliminate Deduction Offset for Long Term Care Insurance Credit (1/1/05)	($300)	($330)	($360)	($400)
- Dairy Investment Credit (1/1/06)	$0	($2,900)	($3,500)	($4,000)
- Change Partnership/S Corporation Withholding Payment from Annual to Quarterly (1/1/06)	$14,200	$900	$950	$1,000

* Detail available upon request.

February 18, 2005

	Fund Impact			
	F.Y. 2006	F.Y. 2007	F.Y. 2008	F.Y. 2009
	(000's)			
Corporate Franchise Tax				
- Change Qualifications for Foreign Operating Corporations (1/1/05)	$1,300	$980	$650	$500
- Single Sales Factor Phased In Over Eight Years (1/1/07)	$0	($1,800)	($7,600)	($15,200)
Sales Tax				
- No MN State Govt. Contracts Unless Vendor Collects MN Sales Tax (1/1/06)	$680	$2,730	$4,300	$4,410
- Up-Front Sales Tax Payment on Motor Vehicle Leases (7/1/05)	$27,100	$15,500	$1,400	$1,100
- Natural Gas Pipelines Taxable (7/1/05)	$1,600	$3,200	$3,200	$3,200
- Cigarettes Exempted from Sales Tax, Subject to a New Tax at the Distributor Level (8/1/05)	$5,800	$0	$0	$0
- Repeal Sunset Date for 6.2% Additional Tax on Car Rentals (1/1/06)	$4,740	$14,580	$15,300	$16,090
- Impose 2.5% Gross Receipts Tax on Alcoholic Beverages (1/1/06)	$24,830	$60,040	$61,870	$63,150
Other Taxes				
- Impose Insurance Premiums Tax on Stop-Loss Insurance (1/1/06)	$1,400	$3,700	$4,500	$5,400
- Change Disposition of Solid Waste Management Taxes (7/1/05)	($12,107)	($12,310)	($12,561)	($12,837)
Property Tax Credits and Aids				
- Property Tax Refund for Renters – Change Percent of Rent from 19% to 16% (1/1/05) then 15% (1/1/06)	$0	$30,400	$41,100	$41,500
- Change Market Value Credit Calculation for Fractional Homesteads (starting pay 2006)	$0	$500	$500	$500
- Reduced Reimbursement of Market Value Credit for Certain Cities (2005 and 2006)	$19,300	$19,000	$0	$0

February 18, 2005

	Fund Impact			
	F.Y. 2006	F.Y. 2007	F.Y. 2008	F.Y. 2009
	(000's)			
Designated Zones				
- Tax Benefits in the Biotechnology and Health Sciences Industry Zone	($1,000)	$0	$0	$0
- International Development Zone	$0	($700)	($1,050)	($1,050)
Other Provisions				
Eliminate:				
- State-Funded Campaign Checkoff and Appropriation (1/1/05)	$160	$5,400	$160	$2,400
- Political Contribution Refund (7/1/05)	$4,000	$6,500	$4,800	$5,100
General Fund Total	$86,281	$147,333	$121,782	$115,706
Health Care Access Fund				
- Impose Insurance Premiums Tax on Stop-Loss Insurance (1/1/06)	$800	$2,300	$2,700	$3,300
- Exempt Tricare Program Payments from MNCare Taxes (1/1/05)	($1,730)	($1,410)	($1,500)	($1,580)
Health Care Access Fund Total	($930)	$890	$1,200	$1,720
Environmental Fund				
- Change Disposition of Solid Waste Management Tax (7/1/105)	$12,107	$12,310	$12,561	$12,837
Environment Fund Total	$12,107	$12,310	$12,561	$12,837
State Elections Campaign Fund				
- Eliminate State-Funded Campaign Checkoff, Establish Taxpayer-Funded Checkoff (1/1/05)				
Change in Fund Revenues	($80)	($1,950)	($80)	($450)
Change in Fund Expenditures	$80	$1,950	$80	$450
State Elections Campaign Fund Total	$0	$0	$0	$0

February 18, 2005

EXPLANATION OF THE BILL

A section-by-section summary of the bill is attached.

REVENUE ANALYSIS DETAIL

Federal Update

- The estimates are based on the estimates for the federal legislation prepared by the Joint Committee on Taxation (JCT).
- If both the individual income and corporate franchise taxes would be affected, the federal estimates were divided between the two taxes based on information related to that provision.
- The federal estimates were apportioned to Minnesota based on a measure related to that provision. Federal and state marginal rates appropriate to each provision were then applied.
- The estimates were converted from federal fiscal years to state fiscal years.
- For the proposal to adopt increased expensing with an 80% addback, which would then be deducted in equal parts over the next five years, additional calculations were required. The increased expensing was extrapolated from the JCT estimates. The increased expensing was divided into categories based on the likely distribution by the class life of the property. The difference between current law and the proposal was then calculated for each category for each tax year affected.

Exempt State Active Service by the National Guard

- Data provided by the State Department of Military Affairs for 1991 through 2003 shows that the amount of wages paid for such service varies greatly from year to year. The average of the wages paid for the last five years was about $700,000.
- An average marginal tax rate of 6% yields a revenue loss of $42,000.
- Because wages paid for such service fluctuate greatly depending on the number of Guard personnel in active service and the duration of that service, and because no trends over time are apparent, the average was used for all years, with no growth assumed.
- An estimated 850 taxpayers would be affected each year.

Eliminate Deduction Offset for Long Term Care Insurance Credit

- Data from the income tax sample for tax year 2002 show that about 4,300 taxpayers both itemized medical expenses and claimed the long term care credit for less than the maximum amount. If those taxpayers had been able to claim the credit at the same average rate as all other filers who claimed the credit, they would have claimed an additional credit amount of about $52 per return, for an additional aggregate credit amount of $225,726.
- Growth of 10% per year is assumed.
- About 5,700 returns would be affected for tax year 2005.

Dairy Investment Credit

- Data sources were an industry survey taken by the Minnesota Department of Agriculture and the 2002 Census of Agriculture published in February and June of 2004.
- Survey participation rate for dairy enterprises is 25%.
- Inflation is assumed to be 1.85% per year.
- Acquisitions of entire farms are assumed not to qualify.
- It was assumed that 33% of the credit generated would be used to offset tax in the first year, with the remainder taken equally in each of the next 12 years.
- Approximately 1,400 farms per year are expected to use this program.

Change Partnership/S Corporation Withholding Payment from Annual to Quarterly

- In calendar year 2003, withholding payments were \$9.3 million from partnerships for nonresident partners and \$12.8 million from S corporations for nonresident shareholders.
- Collection amounts are projected based on individual income tax growth rates from the November 2004 forecast.
- A quarterly payment schedule would shift 50% of the total annual withholding payment to the preceding fiscal year.
- About 1,270 partnerships and 775 S corporations would be affected.

Change Qualifications for Foreign Operating Corporations

- The revenue estimates are based on data from returns filed in calendar year 2003.
- Runs of tax calculation programs against corporate data were used to calculate the revenue impact of the proposal.
- Growth in overall corporate tax collections as projected by the Department of Finance in the November 2004 forecast is used to project future revenue gains.
- It is assumed that the revenue gain would decrease over time as corporations make changes to meet the proposed requirements for an FOC.
- An estimated 20 to 40 companies would be affected by the bill.

Single Sales Factor Phased In Over Eight Years

- The revenue estimate is based on data from returns filed in calendar year 2003.
- A program was run against corporate data to calculate the revenue effect from changing the current law weighting to the series of weightings in the bill, starting with tax year 2007.
- Growth in overall corporate tax collections as projected by the Department of Finance in the November 2004 forecast is used to project future revenue losses.
- This law change also affects the apportionment of income generated by entities other than C corporations, mainly S corporations. The estimate was adjusted to include these businesses.
- The tax liability of about 9,000 corporations would be affected, including both increases and decreases.

No Minnesota State Government Contracts Unless Vendor Collects Minnesota Sales Tax

- The estimate was based on revenue estimates and actual tax receipts from North Carolina and Virginia, states which have a similar requirement. The base year was FY 2003. The numbers from the two states were divided by their respective sales tax rates to arrive at a tax base.
- The two states' tax bases were averaged and multiplied by the 6.5% Minnesota sales tax rate.
- Apportionment to Minnesota was based on state population estimates from the U.S. Census Bureau.
- Annual growth of 2.5% was used. Only new contracts are affected so the impact is phased in.

Up-Front Sales Tax Payment on Motor Vehicle Leases

- The estimate was based on national personal consumption expenditures for motor vehicle leases as provided by the U.S. Bureau of Economic Analysis. The average of the 2002 and 2003 figures was calculated for a FY 2003 base number.
- This amount was increased by 25% to include leases to businesses.
- The adjusted amount was apportioned to Minnesota at 1.7%, the state's portion of national new passenger car and truck registrations, and multiplied by the 6.5% sales tax rate.
- The potential amount of tax was reduced to exclude lease payments for vehicles over 10,000 lb. The adjustment was based on information from a number of sources.
- The potential amount of tax was further reduced by 2.5% to exclude tax currently collected on insurance premiums, service contracts, and vehicle registration tax when these charges are included in periodic lease payments.
- The estimate assumes that the average lease is three years.
- Annual growth was based on the growth of motor vehicle sales tax according to the November 2004 state revenue forecast.

Natural Gas Pipelines Taxable

- The estimate was based on information from the Census Bureau, sales tax refund claims by gas pipeline businesses, and the Minnesota Office of Pipeline Safety.
- The FY 2006 estimate was reduced by one half because capital equipment refunds would be paid in FY 2006 for purchases made before the effective date of July 1, 2005.
- Annual estimates were held steady because basic qualifying activity for the capital equipment exemption is on-going but major outlays appear to be sporadic.
- An estimated seven companies would be affected.

Cigarettes Exempted from Sales Tax, Subject to a New Tax at the Distributor Level

- It is estimated that moving the tax from the retail sale to the purchase by the retailer will accelerate the tax by approximately one month, resulting in a one-time fiscal year shift.
- Based on the November 2004 forecast of the cigarette excise tax, an estimated 324,650,000 packs of cigarettes will be sold in fiscal year 2006, or about 27 million packs per month.
- At a projected average retail price of $3.31 per pack for fiscal year 2006, the sales tax on cigarettes is estimated to be $5,800,000 per month.
- The new tax would be remitted by seventy distributors.

Repeal Sunset Date for 6.2% Additional Tax on Car Rentals

- The Department of Finance provided estimates of the revenue that would be gained by repealing the sunset date for the 6.2% additional sales tax on short-term car rentals. The estimates are consistent with the November 2004 forecast.

Impose 2.5% Gross Receipts Tax on Alcoholic Beverages

- The Department of Finance provided estimates of the revenue that would be gained by repealing the sunset date for the 2.5% additional sales tax on alcoholic beverages. The estimates are consistent with the November 2004 forecast.
- It is assumed that the revenue under the proposed 2.5% gross receipts tax would be the same as under the additional 2.5% sales tax.

Impose Insurance Premiums Tax on Stop-Loss Insurance

- Tax refund claims information resulting from the decision in *BCBSM, Inc. vs. Commissioner of Revenue* and information from insurance company annual statements were used to estimate stop-loss premiums in calendar year 2003.
- Articles by insurance industry experts indicate stop-loss premiums are expected to increase by 20% or more per year. This estimate is based on an annual 20% growth rate from 2003.
- Tax year data were allocated 40/60 to fiscal years.
- An estimated fifteen insurance companies would be affected.

Change Disposition of the Solid Waste Management Taxes

- The estimates are based on the November 2004 forecast.

Property Tax Refund for Renters

- The base year for the estimates was tax year 2003 returns filed in 2004.
- The PTR model was used to develop these estimates.
- The estimates are consistent with the November 2004 forecast.
- For tax year 2005, the estimated number of renter refund claims is estimated to decrease from 275,000 under current law to 262,000 under the proposal.

Change Market Value Credit Calculations for Fractional Homesteads

- This analysis was completed on a county level, using residential homestead values.
- Proposed credits were calculated on a payable 2003 basis, compared to current law, and the difference computed. Current law 2003 was based on the 2002 assessment abstract, and the 2003 tax list abstract.
- Fractional homestead percentages of total homesteads were from county surveys.
- There are about 3,600 fractional homesteads in the state.

Reduced Reimbursement of Market Value Credit for Certain Cities

- The certified 2003 market value credit reduction equaled about $20 million for 103 cities.
- It was estimated that the 2005 market value credit reduction would be approximately $19.3 million. This amount is slightly less than the certified reduction because some cities have market value homestead credit amounts less than their certified reduction amount. Based on a forecasted decrease in total market value credit payments to cities, it was estimated that the actual reduction amount would continue to decrease.
- Calendar year market value homestead credit payments are made in the following fiscal year.

Tax Benefits in the Biotechnology and Health Sciences Industry Zone

- It is expected that the total amount of authorized tax benefits would be used.

International Development Zone

- The estimates are based on the revenue analysis for S.F. 1801/H.F. 2298 from the 2004 Session.

Eliminate State-Funded Campaign Checkoff and Appropriation

- The estimates for eliminating the state-funded checkoff are based on the November 2004 forecast. The estimates include eliminating the $1.5 million appropriation which would occur in fiscal years 2007 and 2009.
- It is assumed that the total amount from a taxpayer-funded checkoff would be about one-half of the state-funded checkoff.

Eliminate Political Contribution Refund

- On average, about 100,000 individuals receive the $50 political contribution refund annually.
- This estimate corresponds to the November 2004 Department of Finance economic forecast.
- The fiscal year 2006 impact was adjusted to reflect the effective date. It is expected that amounts paid for refund claims in process as of July 1, 2005, will be similar to the historical average monthly refund claims paid in a non-election year for the months of July and August and would be about $350,000. An additional $150,000 will be disbursed in fiscal year 2006 for refund claims filed after July 1, 2005, for contributions made from January through June.

Exempt Tricare Program Payments from MinnesotaCare Taxes

- TriWest Healthcare Alliance is the Department of Defense's contractor that administers the Tricare program in Minnesota, along with 15 other states. In FY 2003, TriWest spent $53.75 million on health care for its Minnesota beneficiaries, and this is expected to grow to $79.2 million by 2009.
- Although Minnesota beneficiaries are able to obtain health care in other states, and beneficiaries from other states are able to obtain health care in Minnesota, it is assumed that these are roughly equal.
- Calendar estimates were allocated to fiscal years. Hospitals and surgical centers make their estimated payments monthly, and health care providers make quarterly payments.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy

sf0753(hf0660)_1/ cc et al

2005 GOVERNOR'S BILL SUMMARY

MINNESOTA • REVENUE
Appeals and Legal Services Division
600 North Robert Street
Saint Paul, Minnesota 55146-2220

Bill Date: 02/02/05 (Rev. No. 05-0400)
Summary Date: 02/02/05

ARTICLE 1: INDIVIDUAL INCOME AND CORPORATE FRANCHISE

Section 1. Payment by Partnerships and "S" Corporations of Withholding on Nonresident Income. Amends Minn. Stat. § 289A.20, subd. 2, to require partnerships with nonresident partners to pay the Minnesota withholding on Minnesota source income on a quarterly basis during the year, like all other taxpayers, rather than paying with the entity's return filed after the tax year has ended. Effective for tax years beginning after December 31, 2005.

Section 2. Foreign Operating Corporation. Amends Minn. Stat. § 290.01, subd. 6b, to require a foreign operating corporation to have 80 percent or more of its average of payroll and property, measured as those factors are determined for apportionment of income, outside of the United States. It requires minimum amounts of payroll, $1 million, and property, $2 million, before a corporation can qualify as a foreign operating corporation. It also permits the flow-up of partnership factors, and the aggregation of partnerships, when determining if the payroll threshold is met. Effective for tax years beginning after December 31, 2004.

Section 3. Investment Tax Credit for Dairy Farms. Amends Minn. Stat. § 290.06 to allow a nonrefundable credit against the taxes imposed under Minn. Stat. ch. 290 in the amount of 10% of the amount of purchases of depreciable capital assets, other than farm animals, used in a dairy farm operation. The credit is limited to purchases on or between January 1, 2006 and December 31, 2011. The maximum credit available to any taxpayer over the six year period is $30,000. The $30,000 cap applies at individual, husband and wife, flow-through entities, and corporate levels. Credits that exceed the tax in a year can be carried over to the next year for up to15 years. Effective for tax years beginning after December 31, 2005.

Sections 4 and 5. Long Term Health Insurance Credit. Amends Minn. Stat. § 290.0672, subds. 1 and 2, to provide that taxpayers who use long term health insurance premiums as an itemized deduction in computing federal taxable income can use the same payments to calculate the Minnesota credit similar to a self-employed individual who can only use the payments as a deduction in determining federal adjusted gross income. Effective for tax years beginning after December 31, 2004.

Sections 6 and 7. Apportionment of Income, Single-Factor. Amends Minn. Stat. § 290.191, subds. 2 and 3, to provide for the apportionment of income using a single factor, sales. Amendments to subd. 2 provide for generally applicable single factor apportionment, phased in over eight years. Subdivision 3 is amended to implement single factor apportionment, phased in over eight years, for financial institutions. Effective for tax years beginning after December 31, 2006.

Section 8. Withholding for Individual Independent Contractors Performing Construction Work in Minnesota. Amends Minn. Stat. § 290.92 to require businesses who hire individual independent contractors to perform construction work in Minnesota to withhold and remit to Minnesota 2% of the amount they are paying independent contractors, if the payments are over $600 (level for which payer is required to issue a federal 1099 to the independent contractor) as if the independent contractor were an employee. Effective for payments made after July 31, 2005.

ARTICLE 2: FEDERAL UPDATE

Overview

Minnesota income and franchise tax is based on "federal taxable income" for regular Minnesota tax purposes; "federal alternative minimum taxable income" for Minnesota alternative minimum taxable income; and "federal adjusted gross income" for household income used for the Minnesota dependent care credit, education credit, and property tax refund. The current Minnesota law has adopted these federal concepts as the federal law stood on June 15, 2003. Since June 15, 2003 the federal government has enacted four laws that have changed the concepts.

In late 2003, the Military Family Tax Relief Act of 2003 and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 were enacted. The military act provides a number of new exclusions and deductions for members of the military retroactively effective to the beginning of 2003. The drug act provides for the tax treatment of health savings accounts that were first allowed in 2004.

In late 2004 the Working Families Tax Relief Act of 2004 and American Jobs Creation Act of 2004 were enacted. The Working Families Act extended the sunset dates of a number of expiring tax provisions (teacher material expense, Archer medical accounts, clean fuel vehicle deduction), modified the definitions of "dependent" and "qualifying child" to make them similar, increased the standard deduction available to married couples, and made a number of technical changes. The Jobs Act was a large act that contained a large number of business provisions which limited some business deductions, created some new deductions and closed some perceived loopholes. It also contained provisions allowing the itemized deduction of the greater of state income taxes or state sales taxes and limited the Internal Revenue Code, section 179, expensing of Sport Utility Vehicles (SUV's).

Section 1. Update of Tax Administration Provisions. Amends Minn. Stat. § 289A.02, subd. 7, to adopt federal tax administrative provisions made between June 15, 2003 and December 31, 2004 that Minnesota piggybacks on for state tax administration purposes. None of the four federal acts mentioned in the overview changed federal provisions that Minnesota provisions piggyback upon in Minn. Stat. ch. 289A. Effective the day following final enactment.

Section 2. Update to Federal Definition of Taxable Income. Amends Minn. Stat. § 290.01, subd. 19, to adopt all of the federal changes to taxable income effective at the same time the federal changes were effective. The federal changes of note were:

The Military Family Tax Relief Act of 2003

- Increases the exclusion from income of the death gratuity benefit paid to survivors of members of the military who are killed in the line of duty from $3,000 to $12,000 (also increased the benefit from $6,000 to $12,000). Effective for deaths after September 10, 2001.

- Excludes from taxable income the cost of dependent care assistance provided by the military to a service member. Effective beginning in tax year 2003.

- Excludes from taxable income payments from the Department of Defense Homeowner Assistance program which offset the adverse effects of military base closings on housing values. Effective for payments made after November 11, 2003.

- Suspends the running of the five-year period for purposes of meeting the two out of five year "use of house as principal residence" test used to qualify for the exclusion of the gain on sale of the residence for up to 10 years for members of the military on official extended duty. Effective for sales after May 6, 1997.

- Provides a deduction from federal adjusted gross income for unreimbursed travel, meal, and lodging expenses of members of the National Guard and reserves when they travel at least 100 miles and must stay overnight to attend a guard or reserve meeting. Prior law allowed most of these expenses as a miscellaneous itemized deduction. Effective beginning in tax year 2003.

- Exempts astronauts who lose their life on a space mission from income tax. Effective for deaths after December 31, 2002.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003

- Allows the deduction of contributions to a health savings account (HSA) for individuals with high-deductible medical health plan coverage. The maximum deduction is $2,250 for individuals with self-only coverage and $4,500 for individuals with family coverage. The maximum deduction is $500 higher for individuals age 55 or older, and is increased by an additional $100 per year until tax year 2009, when it will be $1,000 higher than the maximum deduction for individuals under age 55. "High-deductible" plan is defined as having an annual deductible of at least $1,000 for self-only coverage and $2,000 for family coverage, and having a maximum combined deductible and out-of-pocket expense requirement of at most $5,000 for self-only coverage and $10,000 for family coverage. Earnings on amounts contributed to HSAs are tax-exempt. Distributions from HSAs are tax-exempt if used for medical expenses. Effective beginning in tax year 2004.

- Exempts federal subsidies paid to employers who provide prescription drug coverage for their retirees. Provides for federal subsidies to be paid beginning in 2006.

Working Families Tax Relief Act of 2004

- Increase standard deduction for married taxpayers starting in 2005 and ending in 2011 to twice the standard deduction of an unmarried single taxpayer. Old law was 174% for 2005; 184% for 2006; 187% for 2007; 190% for 2008; 200% for 2009 and 2010. In 2011, the deduction reverts back to 170%.

- $250 deduction in the computation of federal adjusted gross income for teachers' unreimbursed expenses for material used in K-12 was extended to apply to 2004 and 2005.

- Fair market value deduction for corporations donating computer hardware and software to charities extended to 2004 and 2005.

- Deduction for purchase of a clean-fuel vehicle in 2004 or 2005 will not phase-out 25% and 50%

respectively. The 75% phase-out in 2006 and complete phase-out of deductions after 2006 will still occur.

- Limit on percentage depletion deduction for marginal production oil and gas wells was removed for 2004 and 2005.

American Jobs Creation Act of 2004

- Phase-out exclusion of net income generated by sales outside the United States (for Minnesota this directly affects some resident individuals and some corporations under Minn. Stat. § 290.01, subd. 19d(17)). The extraterritorial income exclusion phases out 20% in 2005; 40% in 2006; and 100% in 2007 and thereafter.

- Phase in deduction for percentage of net income from manufacturing activities in the United States. For 2005 and 2006, deduction is 3% of the lesser of the taxpayer's taxable income or qualified production activity income. The percentage increases to 6% for 2007, 2008, and 2009, and becomes 9% in 2010 and thereafter. The deduction cannot exceed 50% of the wages paid by the taxpayer.

- The current ability to expense rather than depreciate up to $100,000 of newly purchased business assets was extended to 2006 and 2007. The $400,000 investment limitation was also extended. Without the change, the $100,000 would have been capped at $25,000 and the $400,000 would have reverted to $200,000 starting with assets placed in service after December 31, 2005.

- The ability to expense the business purchase of SUV's over 6,000 lbs. in weight is limited to $25,000 for SUV's placed in service after October 22, 2004.

- Leasehold improvements to real property are allowed to be depreciated over 15 years on a straight line basis rather than over the longer 39 year life of the buildings. Effective for improvements placed in service after October 22, 2004 and before January 1, 2006.

- Improvements to restaurants receive the same treatment as the above leasehold improvements.

- First year 30% bonus depreciation for noncommercial aircraft used in a trade or business is extended for new aircraft first put in service in 2005 but purchased before 2005 (same treatment as passenger and cargo aircraft under the old law).

- Reforestation expenditures can be expensed in the year incurred or paid up to a $10,000 limit. As under the old law, the remaining expenditures are amortized over 84 months. Effective for expenses incurred after October 22, 2004.

- Mail carriers who use their own vehicle to deliver the mail are allowed to claim the excess of their actual vehicle expenses over their employer reimbursement as an itemized deduction of employee business expense starting in 2004.

- Attorneys fees and court costs in wrongful discrimination cases where the recovery of damages is taxable income is changed from an itemized deduction to a deduction allowed in the computation of federal adjusted gross income to the extent of the amount of taxable damages effective for costs paid after October 22, 2004.

- Starting in 2005 the charitable deduction for motor vehicles, boats, or planes donated to a charity is limited to the price the charity receives from selling the vehicle if the item donated is sold "as is" and is worth more than $500. The charity must notify the donor of the use of the item by the charity or the proceeds of the sale, if sold.

- Effective for contributions after June 3, 2004, the deduction for charitable contributions of patents or other intellectual property is limited to the donor's basis in the property or its fair market value. After the property is donated, the donor is allowed to deduct a percentage of the net income generated by the charity from the donated property. The percentage starts at 100% the first two years after donation and decreases 10% each year thereafter until no deduction is allowed in the 13th year.

- Livestock sold because of drought, flood, or weather related conditions are considered to be involuntarily converted for the purposes of deferring the gain on the sale. The period for replacing the sold livestock increased from two years to four years. (Old law only allowed this treatment if livestock was sold because of soil contamination.)

- In 2004 and 2005, individuals are allowed to deduct as an itemized deduction the greater of the state income taxes they pay or the state sales and use tax they pay on consumer purchases.

- Current law requires that a rural electric co-op is only a tax exempt entity if at least 85% of its income is derived from its members. The new law effective for tax years beginning after October 22, 2004, excludes from the income used in the 85% test, income derived from the sale of transmission service or ancillary service provided on a nondiscriminatory open market basis. Provision sunsets after December 31, 2006.

- In the case of the exclusion of gain on the sale of a personal residence if the residence was acquired in a like-kind exchange, the residence must have been owned by the taxpayer for at least five years to qualify for the exclusion. The old law only required at least two years of ownership to qualify. Effective for sales after October 22, 2004.

- For property leased to tax exempt entities under a lease entered into after March 10, 2004, the amount of deduction allowed to the lessor is limited to the amount of lease income for the tax year. Excess deductions are carried forward to succeeding tax years.

- A corporation is only allowed to deduct entertainment expenses for amounts incurred for a corporate officer, 10% or more shareholder, or director to the extent the expenses are included in the income of the officer, shareholder, or director. Effective for expenses incurred after October 22, 2004.

- For movies and television shows made in the United States (75% of compensation paid for work in the United States), the first $15 million of expense of production costs of taxpayers can be deducted in the year rather than deducted on an income forecast method as prescribed under the old law. The $15 million is increased to $20 million if production is made in a low income community. Effective for productions started after October 22, 2004 and sunsets after December 31, 2008.

- The income forecast method of depreciating the cost of a film or television show was changed to include the cost of projected future residuals and participations in the adjusted basis of the film or show. Effective for films or shows placed in service after October 22, 2004.

- Business start-up expenses of up to $5000 may be deducted in the year the business starts (taxpayer election). The remaining expense must be amortized over 180 months. The old law, which applies if the election is not made, provides for amortizing all the start-up expenses over 60 months. Effective for start-up costs paid after October 22, 2004.

- The price paid for sports franchises and player contracts is treated as any other intangible business asset, amortized over a fifteen year period. Old law allowed more rapid deduction of the purchase price. Effective for franchises and contracts acquired after October 22, 2004.

- Exclusion from income of a health care worker in certain areas for the amount of student loans paid by the National Health Service Corporation Loan Program. Effective for 2004 and thereafter.

- The ability of employees to defer the recognition of income from unqualified deferred compensation was limited by making the requirements to define both funded and unfunded unqualified deferral compensation plans harder to attain. Effective for income deferred after December 31, 2004.

- Where a corporation is transferring assets in a tax free transaction from an entity not subject to United States tax and the transferee's basis in the transferred assets is greater than the fair market value of the assets, the transferor's tax basis in the acquired assets is the fair market value of the assets rather than the transferee's tax basis as was the case under the old law. Effective for transactions after October 22, 2004.

- The definition of disqualified debt instrument (debt that will be repaid in stock of the issuer of debt or in stock owned by issuer) was expanded. Interest deduction by the debtor is not available for interest on disqualified debt instruments. Effective for debt issued after October 3, 2004.

- Currently deductible charitable contributions for tidal wave relief made in January of 2005, at the election of the taxpayer, can be deducted as a charitable contribution for the 2004 tax year. Effective for the calendar 2004 tax year.

Section 3. Additions to Federal Taxable Income for Individuals, Trusts, and Estates. Amends Minn. Stat. § 290.01, subd. 19a, to require individuals, trusts, and estates to add back to federal taxable income the new manufacturer's deductions; the difference between the standard deduction for married couples allowed under the 2003 Internal Revenue Code and the deduction allowed under the current Internal Revenue Code; 80% of the difference between the I.R.C. section 179 expenses allowed under the 2003 Internal Revenue Code; and the amount allowed under the current Code; and the amount of deduction a taxpayer claims for non-business state sales and use tax, but only to the extent the deduction generates a federal tax benefit using the 2003 Internal Revenue Code standard deductions. Generally effective for tax years beginning after December 31, 2004, except add-back of consumer sales taxes deducted is effective for tax years beginning after December 31, 2003.

Section 4. Subtractions from Federal Taxable Income for Individuals, Trusts, and Estates. Amends Minn. Stat. § 290.01, subd. 19b, to allow a subtraction for one fifth of the addition required for I.R.C. section 179 expenses in section 3 above which exceeds the taxpayer's net operating loss generated in the year of the addition, in each of the 5 years succeeding the year of the addition (similar to the subtraction for bonus depreciation). Also allows those taxpayers who do not itemize deductions on their federal returns to elect to use contributions made in January 2005 for tidal wave relief when computing their 2004 Minnesota charitable contributions. Finally, allows a subtraction for all federal active duty pay and state payments to National Guard members for state active duty within the state of Minnesota. Effective for tax years beginning after December 31, 2004, except that the charitable contribution change is effective for contributions made in January, 2005.

Section 5. Additions to Federal Taxable Income for Corporate Franchise Tax. Amends Minn. Stat. § 290.01, subd. 19c, to require "C" corporations to add to federal taxable income the new federal manufacturer's deduction and 80% of the difference between the I.R.C. § 179 expenses allowed under the code and the amount that would have been allowable under the 2003 Internal Revenue Code (similar to a modification made by individuals). Effective for tax years beginning after December 31, 2004.

Section 6. Subtraction from Federal Taxable Income for Corporate Franchise Tax. Amends Minn. Stat. § 290.01, subd. 19d, to allow a subtraction from federal taxable income for one fifth of the amount of add-back for I.R.C. § 179 expenses required in section 5 above, in each of the five years succeeding the year of add-back. Effective for tax years beginning after December 31, 2004.

Section 7. Update to Other References to the Internal Revenue Code in Chapter 270. Amends Minn. Stat. § 290.01, subd. 31, to adopt federal changes to federal adjusted gross income used for computing individual alternative minimum tax and household income which is used to compute the dependent care and education credit; changes to the definitions of "dependent" and "qualified child" used for the individual refundable credit; change to the federal earned income tax credit; and the changes to qualifications for electing "s" corporation status. The main changes to federal adjusted gross income are described in section 2.

The federal changes to "dependent child" and "qualified child" were designed to make the two terms synonymous. The main change in "dependent child" is that under the old dependency test the taxpayer must have provided more than half of the support of the child. Under the new test the child meets the test if the child does not provide more than half their own support (scholarships are disregarded). The three tie breakers where more than one taxpayer can claim a child are: 1) closeness of relationship, 2) if two parents can claim child, the tie breaker goes to the parent whom the child lived with longer, or 3) if the child lived with each parent the same amount of time during the year, the child is the qualifying child of the parent with the higher adjusted gross income

For the federal earned income credit that Minnesota uses as a basis for the Working Family Credit, the new federal law provides that combat pay which is excluded from federal adjusted income and earned income for employment tax purposes, if elected by the taxpayer, is nevertheless earned income for purposes of generating the federal earned income tax credit for tax years 2004 and 2005.

In the area of "S" corporations the main change was to increase the number of shareholders a corporation electing "S" status can have from 75 to 100 shareholders and to treat families (parents, children, grandchildren, aunts, uncles, nieces, nephews, as opposed to just husband and wife) owning stock in one corporation as one shareholder. Effective for 2005 and thereafter.

The proposed Minnesota changes would adopt the federal changes effective at the same time the federal changes were effective.

Sections 8 and 9. Technical Change to Additional Tax on Certain Lump Sum Pension Plan Distribution. Amends Minn. Stat. § 290.032, subds. 1 and 2, to correct an obsolete cite to a section of the Internal Revenue Code that has been removed from the Code and made an uncodified provision of federal law. Effective for tax years beginning after December 31, 1999.

Section 10. Change in Ratio Non-resident Individuals Use to Compute Minnesota Tax for Federal Changes Not Adopted. Amends Minn. Stat. § 290.06, subd. 2c to provide that the numerator of the ratio used by non-residents, which is Minnesota assignable federal adjusted gross income, is modified for the portion of the additions for the manufacturing and I.R.C. § 179 expensing additions and subtractions to the extent the modifications are assignable to Minnesota. The denominator is modified by the total amount of the modifications. Effective for tax years beginning after December 31, 2004.

Section 11. Household Income Change for Dependent Care Credit and Education Credit. Amends Minn. Stat. § 290.067, subd. 2a, to provide that the new manufacturer's deduction and deductions for contributions to health savings accounts are not allowed as deductions in computing household income which is used to phase out the dependent care and education credits. Effective for tax years beginning after December 31, 2003.

Section 12. Old Standard Deduction Used in the Computation of Marriage Penalty Credit. Amends Minn. Stat. § 290.0675, subd. 1, provides that in calculating the marriage penalty credit (additional amount a married couple pays in Minnesota tax over what they would have paid as two single taxpayers which is attributable to the tax brackets) the old federal standard deduction rather than the new standard deduction is used, since Minnesota is not adopting the new standard deduction. Effective for tax years beginning after December 31, 2004.

Section 13. Change to the Individual Alternative Minimum Tax. Amends Minn. Stat. § 290.091, subd. 2, to include the new additions for I.R.C. § 179 expenses and the manufacturer's deduction and the new subtraction for I.R.C. § 179 expenses in the computation of Minnesota alternative minimum taxable income. Effective for tax years beginning after December 31, 2004.

Section 14. Household Income for Property Tax Refund. Amends Minn. Stat. § 290A.03, subd. 3, to make parallel changes to the definition of household income for the property tax refund, as were noted in section 11. Effective for property tax refunds based on household income for 2004 and thereafter.

Section 15. Update of References to Internal Revenue Code in the Property Tax Refund Chapter. Amends Minn. Stat. § 290A.03, subd. 15, to adopt the federal changes that affect household income which uses the definition of federal adjusted gross income as a starting point and the definition of a dependent, as discussed in sections 2 and 7. It should be noted that the new federal exclusions and exemptions from federal adjusted income will still not be applicable to the computation of household income. Only new federal deductions from income that are not specifically mentioned in section 11 will lower household income from current law. Effective for property tax refunds based on property taxes payable on or after December 31, 2004 or rent paid after December 31, 2004.

ARTICLE 3: SALES, USE, AND SPECIAL TAXES

Section 1. State Contracts with Sales and Use Tax Permit Holders. Amends Minn. Stat. § 16C.03 to provide that the department of administration and the legislature must cancel a contract for goods or services with any vendor or bar a vendor from future contracts who has not registered to collect sales or use tax on its taxable sales in Minnesota. This section only applies to the executive and legislative branches of government and does not apply to the judicial branch contracts nor does it apply contracts with Minnesota state colleges and universities. The commissioner of revenue shall provide to the department of administration and the legislature a list of vendors who are subject to being debarred or having their contracts cancelled. The proposal provides that the cancellation and debarment provisions may be waived if the vendor is the sole source of goods or services, in the case of an emergency or when it is in the best interests of the state. Effective for contracts entered into after December 31, 2005.

Section 2. Tricare Program. Amends Minn. Stat. § 295.53, subd. 1, by adding an exemption from the MinnesotaCare tax for payments received under the federal Tricare program. Tricare is a medical program for active duty members, retirees and their dependents. The new provision clarifies that enrollee deductibles, coinsurance, and co-payments are subject to tax. Effective for gross revenues received under the federal Tricare program after December 31, 2004.

Section 3. Liquor Gross Receipts Tax. Amends Minn. Stat. ch. 295 by adding a new section 295.75. The additional 2.5 percent sales tax on alcoholic beverages is scheduled to end on December 31, 2005. This is a proposal to replace this revenue by enacting a 2.5 percent gross receipts tax on retail liquor sales.

Subd. 1. Definitions. For purposes of this tax, the following terms are defined: commissioner, gross receipts, liquor, liquor retailer, and retail sale.

Subd. 2. Gross receipts tax imposed. This subdivision provides for the imposition on each liquor retailer of a 2.5 percent tax on gross revenues from the sales in Minnesota of liquor.

Subd. 3. Use tax; credit for taxes paid. This subdivision provides for a use tax and a credit for taxes paid to another jurisdiction.

Subd. 4. Tax collection required. This subdivision requires certain liquor retailers with nexus in Minnesota to collect the use tax.

Subd. 5. Taxes paid to another jurisdiction; credit. This subdivision provides that a liquor retailer that has paid a similar tax to another jurisdiction is entitled to a credit for the tax paid to another jurisdiction.

Subd. 6. Exemptions. This subdivision provides that all the exemptions applicable to the sales and use taxes are applicable to the taxes imposed under this section.

Subd. 7. Sourcing of sales. This subdivision provides that all of the sourcing provisions related to the sales and use taxes apply to the taxes imposed by this section.

Subd. 8. Payment; reporting. This subdivision provides that the reporting must be made on a form prescribed by the commissioner and that the tax must be filed and paid using the filing cycle and due dates provides for the taxes imposed under chapter 297A.

Subd. 9. Administration. This subdivision provides that the audit, assessment, refund, penalty, interest, enforcement, collection remedies, appeal and administrative provisions of chapter 270 and 289A that are applicable to the sales and use taxes apply to the taxes imposed under this section.

Subd. 10. Interest on overpayments. This subdivision provides that interest must be paid on an overpayment or credited to the taxpayer from the date of payment of the tax until the refund is paid or credited; and the date of payment is the due date of the return or the date of actual payment of the tax, whichever is later.

Subd. 11. Deposit of revenues. This subdivision provides that the commissioner shall deposit all revenues, including penalties and interest, derived from the tax imposed by this section in the general fund.

This section is effective for sales and purchases occurring on or after January 1, 2006.

Section 4. Motor Vehicle Leases. Amends Minn. Stat. § 297A.61, subd. 4, to provide that a retail sale occurs for leases of most licensed motor vehicles when the lease is executed. For leases of vehicles with a gross weight rating greater than 10,000 pounds and leases of vehicles for not more than 28 days, a retail sale occurs each time period when an obligation to make a lease payment becomes due. Currently, all leases of motor vehicles are treated as a series of sales with multiple obligations and sales tax is due on each lease payment when it becomes due. Effective for leases entered into after June 30, 2005.

Section 5. Motor Vehicle Lease Sales Price. Amends Minn. Stat. § 297A.61, subd. 7, to provide that the sales price for a lease of a motor vehicle, subject to the acceleration of sales tax, is the total amount of consideration to be paid during the term of the lease. The section also provides how to calculate the sales price when charges are determinable at the time the lease is executed and when the lease is open-ended. Effective for leases entered into after June 30, 2005.

Section 6. Sales Tax on Cigarettes. This section provides a sales tax exemption, Minn. Stat. § 297A.67, subd. 32, for the sale of cigarettes that are subject to a new tax under Minn. Stat. § 297F.25 which is imposed upon the sale of cigarettes by distributors to retailers and cigarette subjobbers. Effective for sales and purchases made after July 31, 2005.

Section 7. Industrial Production. Amends Minn. Stat. § 297A.68, subd. 2, to provide that the transportation, transmission or distribution of petroleum, liquefied gas, natural gas, steam, or water through pipes, lines, tanks or mains would not qualify as industrial production. This provision does not apply to blending of petroleum or biodiesel fuel. Effective for sales and purchases made after June 30, 2005.

Section 8. Capital Equipment. Amends Minn. Stat. § 297A.68, subd. 5, to provide that equipment used primarily in the transportation, transmission or distribution of petroleum, liquefied gas, natural gas, steam, or water through pipes, lines, tanks or mains would not qualify as capital equipment. This provision does not apply to machinery or equipment used to blend petroleum or biodiesel fuel. Effective for sales and purchases made after June 30, 2005.

Section 9. Motor Vehicle Leases. Adds a new section to Minn. Stat. ch. 297A, that provides how to calculate the motor vehicle lease price when an accelerated sales tax is due on a motor vehicle lease. The section provides that sales tax may be refunded when a lease is terminated within 90 days or when the vehicle is returned to the manufacturer under Minnesota's "Lemon Laws." This section also provides how a lease is taxed in Minnesota when the lease originated in another state and provides a credit for taxes paid to another state if the other state had previously taxed the lease payments. Effective for leases entered into after June 30, 2005, and for vehicles registered in Minnesota after June 30, 2005, if the lease originated in another state.

Section 10. Bad Debt. Amends Minn. Stat. § 297F.14, subd. 4, that contains the cigarette tax bad debt provisions to clarify when the offset may be claimed and that any recovery of the debt must be reimbursed to the commissioner. Effective for claims filed on or after July 1, 2005.

Section 11. Cigarette Sales Tax. Adds a new section, Minn. Stat. § 297F.25. This section provides for a tax on the sale of cigarettes from distributors to retailers and cigarette subjobbers.

Subd. 1. Imposition. The tax is imposed at the rate of 6.5 percent of the weighted average retail price that must be determined annually by the commissioner of revenue by surveying cigarette retailers statewide.

Subd. 2. Payment. This subdivision provides that the tax payments must be made on the same dates prescribed for the cigarette excise taxes.

Subd. 3. Return. This subdivision provides that the tax return must be filed on the same dates prescribed for the cigarette excise tax returns.

Subd. 4. Form of Return. This subdivision provides that the tax return must contain the information and be in the form prescribed by the commissioner.

Subd. 5. Tax as Debt. This subdivision provides that the tax is required to be collected by the distributor and is a debt from the retailer or subjobber to the distributor recoverable at law in the same manner as other debts and that retailers and subjobbers must pay the tax to the distributor before the 12th day of the month following the month in which the cigarettes were purchased from the distributor.

Subd. 6. Sales Tax Stamp. This subdivision provides that payment of the cigarette tax and of the tax imposed by this section is evidenced by a dual purpose single stamp affixed to each package.

Subd. 7. Administration. This subdivision provides that the administrative provisions of Minn. Stat. Chapter 297F apply to this tax.

Subd. 8. Deposit of Revenues. This subdivision provides that the tax and penalties and interest are to be deposited in the general fund.

This section is effective for all sales made on or after August 1, 2005.

Section 12. Allocation of Revenues. Amends Minn. Stat. § 297H.13, subd. 2, that provides for the allocation of the revenues collected by the solid waste management tax to (1) appropriate annually to the department of revenue the amounts necessary to cover its costs in administering these taxes and (2) increases the revenues going to the environmental fund from $22 million or 50 percent of the amounts remitted, whichever is greater, to $33,760,000 or 70 percent of the amounts remitted, whichever is greater. This section is effective for amounts remitted on or after July 1, 2005.

Section 13. Direct Business. Amends Minn. Stat. § 297I.01, by adding a new subdivision to define direct business and include premiums related to stop loss coverage. This would overturn the Minnesota Supreme Court decision in *BCBSM, Inc. vs. Commissioner of Revenue,* 663 N.W.2d 531 (Minn. 2003) decided on June 12, 2003. Effective for insurance premiums received after December 31, 2005.

Section 14. Disposition of Proceeds. Amends Minn. Stat. § 473.843, subd. 2, that provides for the disposition of proceeds collected through the Metropolitan Solid Waste Landfill Fee to appropriate annually to the department of revenue the amounts necessary to cover its costs in administering this fee. Effective for amounts remitted on or after July 1, 2005.

Section 15. Rental Motor Vehicle Tax. 2001 Minn. Laws, 1st Spec. Sess., ch. 5, art. 12, sec. 95 is amended to reimpose the rental motor vehicle tax that was scheduled to be repealed effective for sales and purchases made after December 31, 2005. Effective the day following final enactment.

Section 16. Floor Stocks Tax. This section creates a floor stocks tax that is imposed on all persons engaged in the business in this state of selling cigarettes as distributors, retailers, subjobbers, vendors, manufacturers, or manufacturer's representatives who have stamped cigarettes and unaffixed stamps in their possession on August 1, 2005. Effective August 1, 2005.

ARTICLE 4: INTERNATIONAL ECONOMIC DEVELOPMENT ZONE

Section 1. Property Tax Exemption. Amends Minn. Stat. § 272.02 by adding a subdivision to provide for an exemption from property tax for improvements to real and personal property located in the International Economic Development Zone and used as a regional distribution center. Also provides an exemption for any other improvements to real and personal property located in the Zone that are occupied by July 1 of the assessment year by a qualified business conducting freight forwarding operations. Effective beginning for property taxes payable in 2008.

Section 2. Subtraction from Federal Taxable Income for Individuals, Estates and Trusts. Amends Minn. Stat. § 290.01, subd. 19b, to provide for a subtraction from income for tax-free International Economic Development Zone income (as discussed in Section 18). Effective for tax years beginning after December 31, 2006.

Section 3. Taxable Income of a Corporation. Amends Minn. Stat. § 290.01, subd. 29, to provide an exemption from corporate taxable income for International Economic Development Zone income (as discussed in Section 19). Effective for tax years beginning after December 31, 2006.

Section 4. Taxation of Nonresidents. Amends Minn. Stat. § 290.06, subd. 2c, to provide that tax-exempt International Economic Development Zone income is excluded from the numerator and denominator of the nonresident allocation fraction. Effective for tax years beginning after December 31, 2006.

Section 5. International Economic Development Zone Job Credit. Amends Minn. Stat. § 290.06 by adding a new subdivision allowing a refundable credit against tax for job creation in the International Economic Development Zone (as discussed in section 20). The provision is effective the day following final enactment, but no credits will be allowed until tax year 2007.

Section 6. Child and Dependent Care Credit. Amends Minn. Stat. § 290.067, subd. 1, to clarify that individuals with exempt International Economic Development Zone income must prorate their child and dependent care credit in the same manner as a nonresident. Effective for tax years beginning after December 31, 2006.

Section 7. Working Family Credit. Amends Minn. Stat. § 290.0671, subd. 1, to clarify that individuals with exempt International Economic Development Zone income must prorate their working family credit in the same manner as a nonresident. Effective for tax years beginning after December 31, 2006.

Section 8. Individual Alternative Minimum Taxable Income. Amends Minn. Stat. § 290.091, subd. 2, to allow a subtraction from individual alternative minimum taxable income for tax exempt International Economic Development Zone income. Effective for tax years beginning after December 31, 2006.

Section 9. Corporate Alternative Minimum Taxable Income. Amends Minn. Stat. § 290.0921, subd. 3, to allow a subtraction from corporate alternative minimum taxable income for tax-exempt International Economic Development Zone income. Effective for tax years beginning after December 31, 2006.

Section 10. Minimum Fee Exemption. Amends Minn. Stat. § 290.0922, subd. 2, to exempt from the minimum fee any qualified business with all of its Minnesota payroll and property in the International Economic Development Zone. Effective for tax years beginning after December 31, 2006.

Section 11. Minimum Fee Modification. Amends Minn. Stat. § 290.0922, subd. 3, to exclude zone payroll and zone property of a qualified business from the calculation of the minimum fee. Effective for tax years beginning after December 31, 2006.

Section 12. Sales Tax Exemptions. Amends Minn. Stat. § 297A.68 by adding a new subdivision allowing an exemption from state and local sales and use tax for purchases of tangible personal property or taxable services purchased for use in the International Economic Development Zone by a qualified business that has signed a business subsidy agreement. Effective the day following final enactment but applies only to purchases made by a qualified business after December 31, 2006.

Provides an exemption from state and local sales and use tax for building materials, supplies and installed equipment used to improve real property for use by a qualified business in the furtherance of its freight forwarding operations. Also provides an exemption from state and local sales and use tax for building materials, supplies and installed equipment used to construct a regional distribution center. The building exemptions apply to purchases made by the qualified business or by a contractor. The construction exemptions are available for sales made after June 30, 2006.

Section 13. Definitions. Amends Minn. Stat. ch. 469 by adding a new section 469.321. The new section contains definitions for the substantive provisions of the International Economic

Development Zone program.

Subdivision 1 limits the scope of the section to the provisions of the International Economic Development Zone laws.

Subd. 2. "Foreign trade zone" means the same as the phrase is used in the United States Code.

Subd. 3. "Foreign trade zone authority" means the Greater Metropolitan Foreign Trade Zone Commission number 119; a joint powers authority created by the county of Hennepin; the cities of Minneapolis and Bloomington; and the Metropolitan Airports Commission, and any other political subdivisions that enter into the authority after its creation.

Subd. 4 defines "International Economic Development Zone" or "Zone," as that geographic area designated by the foreign trade zone authority that is entitled to the tax benefits of this article.

Subd. 5 defines "person" to include an individual, corporation, partnership, limited liability company, association or any other entity.

Subd. 6 defines "qualified business" as the owner or operator of the regional distribution center who has signed a business subsidy agreement, or a freight forwarder who has signed a business subsidy agreement and is carrying on a trade or business at a place of business located in the International Economic Development Zone and who is certified by the foreign trade zone authority as a trade or business that furthers the purpose of developing international distribution capacity and capability.

Also requires qualified businesses to pay each employee total compensation, including benefits not mandated by law, of at least 110 percent of the federal poverty guidelines for a family of four.

Subd. 7 defines "regional distribution center" as a distribution center developed within a foreign trade zone. It must have as its primary purpose the facilitation of the gathering of freight for the purpose of centralizing the functions necessary for the shipment of freight in international commerce, including, but not limited to, security and customs functions.

Subd. 8 defines "International Economic Development Zone percentage" or "zone percentage." This percentage is used to determine the amount of exempt income of a business that operates partly within and partly without the International Economic Development Zone. It is calculated as a fraction. The numerator is the sum of the ratio of the taxpayer's property factor under section 290.191 located in the International Economic Development Zone and used as a regional distribution center or in freight forwarding operations over the total Minnesota property factor calculated under section 290.191 plus the ratio of the taxpayer's International Economic Development Zone payroll over the total Minnesota payroll determined under section 290.191. The denominator is two. If the business is part of a unitary business, the denominator of the payroll and property factors is the entire Minnesota payroll and property of the unitary business.

Subd. 9 defines "International Economic Development Zone payroll factor" as that portion of payroll as defined in section 290.191 that represents wages paid for operating or maintaining the regional distribution center, or for freight forwarding related services, performed in the International Economic Development Zone and wages paid for those services performed by persons with offices in the International Economic Development Zone if the employment requires the person to work outside the International Economic Development Zone and such work is incidental to the work performed by the individual within the Zone. However, wages paid for services performed outside the Zone are not International Economic Development Zone payroll if more than 10% of the services performed by the employee are performed outside the Zone.

Subd. 10 defines "freight forwarder" as a business that, for compensation, ensures that goods produced or sold by another business move from point of origin to point of destination.

The entire section is effective the day following final enactment.

Section 14. Application for Designation. Amends Minn. Stat. ch. 469 by adding section 469.3215. The section describes the process by which local government units make application to the Foreign Trade Zone Authority for International Economic Development Zone status. An application can be submitted by a local government unit or units, or by a joint powers board. A local government unit, however, cannot submit more than one application.

The application must include a resolution or ordinance from each city, town or county in which the Zone is located, agreeing to provide the property tax and local option sales tax benefits provided by the International Economic Development Zone law. It must also include an agreement to treat International Economic Development Zone tax benefits as business subsidies under the Minnesota business subsidy law, as well as supporting evidence necessary for the Foreign Trade Zone Authority to evaluate the application.

The applications must be submitted by December 31, 2005.

Effective the day following final enactment.

Section 15. Designation of International Economic Development Zone. Amends Minn. Stat. ch. 469 by adding a new section 469.322 which allows the Foreign Trade Zone Authority to designate one International Economic Development Zone. The Zone must include a regional distribution center. It must consist of between 500 and 1,000 contiguous acres. The Zone must be located within 60 miles, or 90 minutes drive time, from the Minneapolis-St. Paul International Airport. Designation must occur by June 30, 2006. The duration of the Zone is 12 years, starting January 1, 2007.

In making the zone designation, the Authority, in consultation with the Minnesota Departments of Employment and Economic Development, Revenue and Transportation, and the Metropolitan Council must consider:

1. access to major transportation routes,
2. consistency with current state transportation and air cargo planning,
3. adequacy of the size of the site,
4. access to airport facilities,
5. present and future capacity at the designated airport,
6. the capability to meet integrated present and future air cargo, security, and inspection services, and
7. access to other infrastructure and financial incentives

to maximize the security, efficiency and volume of Minnesota's export shipments.

Prior to designation, the Foreign Trade Zone Authority, in consultation with the applicant local government unit, must conduct a transportation impact study based on the regional model and utilizing traffic forecasting and assignments. The results must be used to evaluate the effects of the proposed use on the transportation system and identify any needed improvements. If the site is in the metropolitan area the study must also evaluate the effect of the transportation impacts on the Metropolitan Transportation System plan as well as the comprehensive plans of the municipalities that would be affected. The cost of the study must be paid by the applicant. Effective the day following final enactment.

Section 16. Foreign Trade Zone Authority Powers. Amends Minn. Stat. chapter 468 by adding section 469.323. Requires the Foreign Trade Zone Authority to create a development plan for the regional distribution center. In developing the plan, the Authority must consult with interested municipalities as well as interested businesses, potential financiers, and appropriate state and federal agencies.

Also requires the Authority to prepare a business plan for the International Economic Development Zone. The plan must establish, at a minimum, the amount of investment, the number of jobs, and the amount of freight handled at the end of three, five, and 10 year periods by the Zone. It must also include an analysis of the economic feasibility of the regional distribution center once it becomes operational and of the operations of freight forwarders and other businesses that choose to locate within the boundaries of the Zone. If the Authority determines that the analysis does not establish the economic feasibility of the regional distribution center, a Zone cannot be designated.

Also authorizes the Authority to establish a port authority.

Finally, provides that International Economic Development Zone tax benefits are paid by the local government for purposes of the Minnesota prevailing wage and business subsidy laws. Effective the day following final enactment.

Section 17. Tax Incentives. Amends Minn. Stat. ch. 469 by adding section 469.324 that provides a general list of the tax benefits available to International Economic Development Zone businesses and their property. As discussed more fully in other sections, exemptions are available for sales and use tax, corporate franchise tax (including the alternative minimum tax and the minimum fee), individual income tax (including the alternative minimum tax), and property tax. In addition, qualified businesses may be eligible for a refundable jobs credit.

Section 18. Income Tax Exemption. Amends Minn. Stat. ch. 469 by adding section 469.325, that describes income tax exemptions available to individuals, estates and trusts for International Economic Development Zone activities. They are:

1. Exemption from tax for net rents derived from the rent of real or tangible personal property located and used in the Zone by a qualified business. If the tangible property was used both within and without the Zone, the subtraction is prorated based on the number of days that the property was used in the Zone.

2. Exemption from tax on net income from operation of a qualified business. The exemption is calculated by multiplying the net income of the business by its zone percentage. The maximum exemption is 20% of the sum of the business's International Economic Development Zone payroll plus the adjusted basis of property at the time the property is first used in the Zone.

3. Exemption from taxation on capital gains.

    1. Gains from the sale or exchange of real property located in the Zone. If the property was held prior to Zone designation, the exemption must be prorated based on the number of days the asset was held during the period of Zone designation.

    2. Gains from the sale or exchange of tangible personal property used by a qualified business in the Zone. If the tangible property was used both within and without the Zone, or owned prior to Zone designation, the subtraction is prorated based on the number of days that the property was used in the Zone.

    3. Gains from the sale of a qualified business. The exemption is calculated by multiplying the gain by the business's Zone percentage in the year prior to the sale. (For this calculation the denominator of the Zone percentage is the total payroll and property factors of the business, not simply its total Minnesota payroll and property. This exemption applies to the sale of a corporation, s-corporation or partnership interest, provided the Zone percentage exceeds 25%. At the request of the individual, the qualified business must certify to the individual in writing the applicable Zone percentage.

The entire section is effective for tax years beginning after December 31, 2006.

Section 19. Corporate Tax Exemption. Amends Minn. Stat. ch. 469 by adding section 469.326 which provides an exemption from the corporate franchise tax, the corporate alternative minimum tax and the minimum fee for Zone activities of a qualified business. The exemption from franchise tax and alternative minimum tax is calculated by multiplying the corporation's net taxable income, or alternative taxable income, by its Zone percentage. The exemption from the minimum fee is calculated by excluding Zone property and payroll from the computations. The maximum exemption is 20% of the sum of the corporation's International Economic Development Zone payroll plus the adjusted basis of property at the time the property is first used by the corporation in the Zone. Effective for tax years beginning after December 31, 2006.

Section 20. Jobs Credit. Amends Minn. Stat. ch. 469 by adding section 469.327 which provides a refundable jobs credit to any qualified business operating in the International Economic Development Zone. The credit is calculated as follows:

1. The taxpayer determines the lesser of the following two differences:
    a. The increase in the business's payroll within the Zone since the year that the Zone was designated by the Foreign Trade Zone Authority, or
    b. The increase in the business's total Minnesota payroll since the year of designation.

2. From the difference is then subtracted the product of $30,000 times the number of full time equivalent employees employed by the business in the Zone.

3. The result is multiplied by 7% to determine the credit.

The $30,000 amount is adjusted annually for inflation beginning in 2005. The amount necessary to pay any refunds is appropriated to the commissioner of revenue from the general fund.

Effective for tax years beginning after December 31, 2006.

Section 21. Repayment of Tax Benefits. Amends Minn. Stat. ch. 469 by adding section 469.328 which requires the repayment of two years of tax benefits if a business breaches the terms of its business subsidy agreement. The business is required to make any repayment of state taxes or local sales taxes to the commissioner of revenue within 30 days after ceasing to do business in the Zone as a qualified business. If the taxpayer fails to make the repayment, the commissioner can issue an order assessing the tax within two years of the date that the business ceased operating in the Zone as a qualified business, or within any other applicable period of limitation under chapter 289A. The assessment is made, and unpaid amounts collected, using procedures established in chapter 270 and 289A for the collection of tax. Penalties and interest imposed under chapter 289A are applicable.

For the repayment of a property tax, the tax is due 30 days after the county auditor sends a tax statement to the business. It the business fails to pay, the repayment shall be added to the property tax for payment in the year following the year that the treasurer discovers that the business is no longer operating in the Zone as a qualified business.

The repayment provision can be waived by the commissioner of revenue if he determines, in consultation with the Foreign Trade Zone Authority and other state and local government officials including the commissioner of employment and economic development, that repayment would not be in the best interest of the state or the Zone, or that the cessation of business was the result of circumstances beyond its control, such as loss of major supplies or customers, natural disaster or unforeseen industry trends. The entire section is effective the day following final enactment.

Section 22. Zone Performance Reporting. The successful International Economic Development Zone applicant must annually report to the commissioner of employment and economic development on its progress in meeting the zone performance goals under, and the applicant's compliance with, the business subsidy law under Minn. Stat. §§ 116J.993 to 116J.995. Effective the day following final enactment.

ARTICLE 5: MISCELLANEOUS

Section 1. Designation for Political Checkoff. Amends Minn. Stat. § 10A.31, subd. 1 to change the state elections campaign fund checkoff. Under the change, the amount designated to the state elections campaign fund will no longer be paid from the general fund, but instead will be added to the tax or subtracted from the refund otherwise payable by or to the taxpayer. The taxpayer may contribute \$1 to \$25 (\$50 for a joint return) on their original individual income tax return and on their original property tax refund return. Effective for designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005.

Section 2. Political Checkoff Instructions. Amends Minn. Stat. § 10A.31, subd. 3 so that the income tax and property tax refund instructions published by the commissioner of revenue are consistent with the changes made to Minn. Stat. § 10A.31, subd. 1 above. Effective for designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005.

Section 3. Appropriation. Amends Minn. Stat. § 10A.31, subd. 4 to remove the appropriation from the general fund for the taxpayer designations to the state elections campaign fund. Requires the amounts designated and paid by taxpayers to be transferred and credited to the state elections campaign fund. Also repeals the $1.5 million biennial appropriation from the general fund to the state elections fund. Effective for designations made on income tax returns filed for tax years beginning after December 31, 2004, and property tax refund returns based on property taxes payable in 2006 or rent constituting property taxes paid in 2005. The repeal of the $1.5 million appropriation is effective for elections occurring after December 31, 2004.

Section 4, 6, 7, and 11. Repeal of the Political Contribution Refund. Section 11 repeals the political contribution refund found in Minn. Stat. § 290.06, subd. 23 and the political contribution receipt in Minn. Stat. § 10A.322, subd. 4. Sections 4, 6, and 7 remove references to the political contribution refund in Minn. Stat. §§ 270A.03, subd. 7 (Revenue Recapture Act), 289A.01, subd. 6 (definition of person eligible to receive a refund), and 289A.50, subd. 1 (definition of overpayment). Effective for political contributions based on contributions made on or after July 1, 2005.

Section 5. Homestead Market Value Credits. Amends Minn. Stat. § 273.1384, subd. 1, to change the computation of homestead market value credits for residences that are part homestead and part nonhomestead. This happens when one or more of the owners, or a spouse of the owner, does not use the property as their homestead. Under current law, the credit is computed using the value of the homestead portion. This can result in a larger credit (and lower taxes) for a part-owner residing in a home, than if a full-owner resided in that same home; depending on the value of the home. The proposed language will prevent that from occurring by prorating the credit in those situations based on the occupant's percentage of ownership or to 50% in the case of an absent spouse. Effective for taxes payable in 2006 and thereafter.

Section 8. Rent Constituting Property Taxes. Amends Minn. Stat. § 290A.03, subd. 11 to reduce rent constituting property tax from 19% of gross rent paid to 16% of gross rent paid in 2005, and 15% of gross rent paid in 2006 and thereafter. Effective for rent constituting property taxes payable based on rent paid after December 31, 2004.

Section 9. Biotechnology and Health Sciences Funding. Amends Minn. Stat. § 469.335 to allow the commissioner of employment and economic development to issue $1,000,000 in tax benefit certificates in fiscal year 2006 to qualified businesses in the Biotechnology and Health Sciences Zone. Certificates not issued in 2006 can be awarded in fiscal year 2007.

Section 10. 2005 and 2006 City Aid Payments. An uncodified section extends the market value credit reimbursement reductions for cities for 2005 and 2006. Each city's reduction amount for 2005 and 2006 will be the lesser of its 2003 reduction or the amount of its current year reimbursement. Effective the day following final enactment.

Section 12. Repealer. Repeals Minn. Stat. §§ 10A.322, subd. 4 and 290.06, subd. 23, relating to the political contribution refund. Also repeals Minn. Stat. § 16A.522, subd. 4, to eliminate transfer of unrestricted general fund balances to the tax relief account. Effective the day following final enactment.

Senator ..... moves to amend S.F. No. 753 as follows:

Page 35, line 35, delete "branch" and insert "and judicial branches" and after "government" insert ", and all municipalities, counties, school districts, special taxing districts, state colleges and universities,"

Page 36, line 6, delete "This subdivision"

Page 36, delete lines 7 and 8 and insert "For"

Page 36, line 20, delete "the commissioner and the legislative branch" and insert "all governmental entities subject to this subdivision"

Page 36, line 24, delete "by the"

Page 36, line 25, delete "commissioner or the legislative branch"

Page 36, line 28, delete "commissioner" and insert "purchaser of the goods or services"

Pages 85 to 88, delete sections 1 to 4

Pages 88 to 90, delete sections 6 and 7

Page 92, delete section 11

Renumber the sections in sequence and correct the internal references

Amend the title accordingly

Agenda #2

Senator ..... moves to amend S.F. No. 1209 as follows:

Delete everything after the enacting clause and insert:

"ARTICLE 1

INCOME AND CORPORATE FRANCHISE TAXES

Section 1. Minnesota Statutes 2004, section 289A.20, subdivision 2, is amended to read:

Subd. 2. [WITHHOLDING FROM WAGES, ENTERTAINER WITHHOLDING, WITHHOLDING FROM PAYMENTS TO OUT-OF-STATE CONTRACTORS, AND WITHHOLDING BY PARTNERSHIPS AND SMALL BUSINESS CORPORATIONS.] (a) A tax required to be deducted and withheld during the quarterly period must be paid on or before the last day of the month following the close of the quarterly period, unless an earlier time for payment is provided. A tax required to be deducted and withheld from compensation of an entertainer and from a payment to an out-of-state contractor must be paid on or before the date the return for such tax must be filed under section 289A.18, subdivision 2. Taxes required to be deducted and withheld by partnerships ~~and~~, S corporations, and trusts must be paid on ~~or before the date the return must be filed under section 289A.18, subdivision 2~~ a quarterly basis as estimated taxes under section 289A.25 for partnerships and trusts and under section 289A.26 for S corporations.

(b) An employer who, during the previous quarter, withheld more than $1,500 of tax under section 290.92, subdivision 2a or 3, or 290.923, subdivision 2, must deposit tax withheld under those sections with the commissioner within the time allowed to deposit the employer's federal withheld employment taxes under Code of Federal Regulations, title 26, section 31.6302-1, as amended through December 31, 2001, without regard to the safe harbor or de minimis rules in subparagraph (f) or the one-day rule in subsection (c), clause (3). Taxpayers must submit a copy of their federal notice of deposit status to the commissioner upon request by the commissioner.

(c) The commissioner may prescribe by rule other return periods or deposit requirements. In prescribing the reporting period, the commissioner may classify payors according to the amount of their tax liability and may adopt an appropriate reporting period for the class that the commissioner judges to be consistent with efficient tax collection. In no event will the duration of the reporting period be more than one year.

(d) If less than the correct amount of tax is paid to the commissioner, proper adjustments with respect to both the tax and the amount to be deducted must be made, without interest, in the manner and at the times the commissioner prescribes. If the underpayment cannot be adjusted, the amount of the underpayment will be assessed and collected in the manner and at the times the commissioner prescribes.

(e) If the aggregate amount of the tax withheld during a fiscal year ending June 30 under section 290.92, subdivision 2a or 3, is equal to or exceeds the amounts established for remitting federal withheld taxes pursuant to the regulations promulgated under section 6302(h) of the Internal Revenue Code, the employer must remit each required deposit for wages paid in the subsequent calendar year by electronic means.

(f) A third-party bulk filer as defined in section 290.92, subdivision 30, paragraph (a), clause (2), who remits withholding deposits must remit all deposits by electronic means as provided in paragraph (e), regardless of the aggregate amount of tax withheld during a fiscal year for all of the employers.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2005.

Sec. 2. Minnesota Statutes 2004, section 290.01, subdivision 6b, is amended to read:

Subd. 6b. [FOREIGN OPERATING CORPORATION.] The term "foreign operating corporation," when applied to a corporation, means a domestic corporation with the following characteristics:

(1) it is part of a unitary business at least one member of which is taxable in this state;

(2) it is not a foreign sales corporation under section 922 of the Internal Revenue Code, as amended through December 31, 1999, for the taxable year; ~~and~~

(3) ~~either~~ (i) the average of the percentages of its

property and payrolls, including the pro rata share of its unitary partnerships' property and payrolls, assigned to locations ~~inside~~ outside the United States ~~and-the-District-of Columbia,-excluding-the-commonwealth-of-Puerto-Rico-and possessions-of-the-United-States~~, where the United States includes the District of Columbia and excludes the commonwealth of Puerto Rico and possessions of the United States, as determined under section 290.191 or 290.20, is ~~20~~ 80 percent or ~~less~~ more; or (ii) it has in effect a valid election under section 936 of the Internal Revenue Code; and

(4) it has at least $1,000,000 of payroll and at least $2,000,000 of property, as determined under section 290.191 or 290.20, that are located outside the United States. If the domestic corporation does not have payroll as determined under section 290.191 or 290.20, but it or its partnerships have paid at least $1,000,000 for work, performed directly for the domestic corporation or the partnerships, outside the United States, then paragraph (3)(i) shall not require payrolls to be included in the average calculation.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 3. Minnesota Statutes 2004, section 290.92, is amended by adding a subdivision to read:

Subd. 31. [PAYMENTS TO PERSONS WHO ARE NOT EMPLOYEES; WITHHOLDING.] Any person engaged in a trade or business who in the course of such trade or business makes payments to an individual, who is not an employee of the person, for work described in industry code numbers 23 through 238990 of the North American Industry Classification System, shall deduct from the payment and withhold two percent of the amount as Minnesota withholding tax when the amount paid to that individual by the same person during the calendar year exceeds $600. For purposes of this section, a payment to any person that is subject to withholding under this subdivision must be treated as if the payment was a wage paid by an employer to an employee. Every individual who is to receive a payment that is subject to

<u>withholding under this subdivision shall furnish the contracting person with a statement, containing the name, address, and Social Security account number of the person receiving the payment.</u>

[EFFECTIVE DATE.] <u>This section is effective for payments made after July 31, 2005.</u>

ARTICLE 2

FEDERAL UPDATE

Section 1. Minnesota Statutes 2004, section 290.01, subdivision 19, is amended to read:

Subd. 19. [NET INCOME.] The term "net income" means the federal taxable income, as defined in section 63 of the Internal Revenue Code of 1986, as amended through the date named in this subdivision, incorporating any elections made by the taxpayer in accordance with the Internal Revenue Code in determining federal taxable income for federal income tax purposes, and with the modifications provided in subdivisions 19a to 19f.

In the case of a regulated investment company or a fund thereof, as defined in section 851(a) or 851(g) of the Internal Revenue Code, federal taxable income means investment company taxable income as defined in section 852(b)(2) of the Internal Revenue Code, except that:

(1) the exclusion of net capital gain provided in section 852(b)(2)(A) of the Internal Revenue Code does not apply;

(2) the deduction for dividends paid under section 852(b)(2)(D) of the Internal Revenue Code must be applied by allowing a deduction for capital gain dividends and exempt-interest dividends as defined in sections 852(b)(3)(C) and 852(b)(5) of the Internal Revenue Code; and

(3) the deduction for dividends paid must also be applied in the amount of any undistributed capital gains which the regulated investment company elects to have treated as provided in section 852(b)(3)(D) of the Internal Revenue Code.

The net income of a real estate investment trust as defined and limited by section 856(a), (b), and (c) of the Internal Revenue Code means the real estate investment trust taxable income as defined in section 857(b)(2) of the Internal Revenue Code.

The net income of a designated settlement fund as defined in section 468B(d) of the Internal Revenue Code means the gross income as defined in section 468B(b) of the Internal Revenue Code.

The provisions of sections 1113(a), 1117, 1206(a), 1313(a), 1402(a), 1403(a), 1443, 1450, 1501(a), 1605, 1611(a), 1612, 1616, 1617, 1704(l), and 1704(m) of the Small Business Job Protection Act, Public Law 104-188, the provisions of Public Law 104-117, the provisions of sections 313(a) and (b)(1), 602(a), 913(b), 941, 961, 971, 1001(a) and (b), 1002, 1003, 1012, 1013, 1014, 1061, 1062, 1081, 1084(b), 1086, 1087, 1111(a), 1131(b) and (c), 1211(b), 1213, 1530(c)(2), 1601(f)(5) and (h), and 1604(d)(1) of the Taxpayer Relief Act of 1997, Public Law 105-34, the provisions of section 6010 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206, the provisions of section 4003 of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, Public Law 105-277, and the provisions of section 318 of the Consolidated Appropriation Act of 2001, Public Law 106-554, shall become effective at the time they become effective for federal purposes.

The Internal Revenue Code of 1986, as amended through December 31, 1996, shall be in effect for taxable years beginning after December 31, 1996.

The provisions of sections 202(a) and (b), 221(a), 225, 312, 313, 913(a), 934, 962, 1004, 1005, 1052, 1063, 1084(a) and (c), 1089, 1112, 1171, 1204, 1271(a) and (b), 1305(a), 1306, 1307, 1308, 1309, 1501(b), 1502(b), 1504(a), 1505, 1527, 1528, 1530, 1601(d), (e), (f), and (i) and 1602(a), (b), (c), and (e) of the Taxpayer Relief Act of 1997, Public Law 105-34, the provisions of sections 6004, 6005, 6012, 6013, 6015, 6016, 7002, and 7003 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206, the provisions of section 3001 of the Omnibus Consolidated and Emergency

Supplemental Appropriations Act, 1999, Public Law 105-277, the provisions of section 3001 of the Miscellaneous Trade and Technical Corrections Act of 1999, Public Law 106-36, and the provisions of section 316 of the Consolidated Appropriation Act of 2001, Public Law 106-554, shall become effective at the time they become effective for federal purposes.

The Internal Revenue Code of 1986, as amended through December 31, 1997, shall be in effect for taxable years beginning after December 31, 1997.

The provisions of sections 5002, 6009, 6011, and 7001 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206, the provisions of section 9010 of the Transportation Equity Act for the 21st Century, Public Law 105-178, the provisions of sections 1004, 4002, and 5301 of the Omnibus Consolidation and Emergency Supplemental Appropriations Act, 1999, Public Law 105-277, the provision of section 303 of the Ricky Ray Hemophilia Relief Fund Act of 1998, Public Law 105-369, the provisions of sections 532, 534, 536, 537, and 538 of the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law 106-170, the provisions of the Installment Tax Correction Act of 2000, Public Law 106-573, and the provisions of section 309 of the Consolidated Appropriation Act of 2001, Public Law 106-554, shall become effective at the time they become effective for federal purposes.

The Internal Revenue Code of 1986, as amended through December 31, 1998, shall be in effect for taxable years beginning after December 31, 1998.

The provisions of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, Public Law 106-519, and the provision of section 412 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147, shall become effective at the time it became effective for federal purposes.

The Internal Revenue Code of 1986, as amended through December 31, 1999, shall be in effect for taxable years beginning after December 31, 1999. The provisions of sections 306 and 401 of the Consolidated Appropriation Act of 2001, Public Law 106-554, and the provision of section 632(b)(2)(A) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, and provisions of sections 101 and 402 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147, shall become effective at the same time it became effective for federal purposes.

The Internal Revenue Code of 1986, as amended through December 31, 2000, shall be in effect for taxable years beginning after December 31, 2000. The provisions of sections 659a and 671 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, the provisions of sections 104, 105, and 111 of the Victims of Terrorism Tax Relief Act of 2001, Public Law 107-134, and the provisions of sections 201, 403, 413, and 606 of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147, shall become effective at the same time it became effective for federal purposes.

The Internal Revenue Code of 1986, as amended through March 15, 2002, shall be in effect for taxable years beginning after December 31, 2001.

The provisions of sections 101 and 102 of the Victims of Terrorism Tax Relief Act of 2001, Public Law 107-134, shall become effective at the same time it becomes effective for federal purposes.

The Internal Revenue Code of 1986, as amended through June 15, 2003, shall be in effect for taxable years beginning after December 31, 2002<u>, provided that the provisions of the American Jobs Creation Act of 2004, Public Law 108-435, are effective at the same time they became effective for federal income tax purposes</u>. The provisions of section 201 of the Jobs and Growth Tax Relief and Reconciliation Act of 2003, H.R. 2, if it is enacted into law, are effective at the same time it became effective for federal purposes.

Except as otherwise provided, references to the Internal Revenue Code in subdivisions 19a to 19g mean the code in effect for purposes of determining net income for the applicable year.

Sec. 2. Minnesota Statutes 2004, section 290.01, subdivision 19a, is amended to read:

Subd. 19a. [ADDITIONS TO FEDERAL TAXABLE INCOME.] For individuals, estates, and trusts, there shall be added to federal taxable income:

(1)(i) interest income on obligations of any state other than Minnesota or a political or governmental subdivision, municipality, or governmental agency or instrumentality of any state other than Minnesota exempt from federal income taxes under the Internal Revenue Code or any other federal statute; and

(ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code, except the portion of the exempt-interest dividends derived from interest income on obligations of the state of Minnesota or its political or governmental subdivisions, municipalities, governmental agencies or instrumentalities, but only if the portion of the exempt-interest dividends from such Minnesota sources paid to all shareholders represents 95 percent or more of the exempt-interest dividends that are paid by the regulated investment company as defined in section 851(a) of the Internal Revenue Code, or the fund of the regulated investment company as defined in section 851(g) of the Internal Revenue Code, making the payment; and

(iii) for the purposes of items (i) and (ii), interest on obligations of an Indian tribal government described in section 7871(c) of the Internal Revenue Code shall be treated as interest income on obligations of the state in which the tribe is located;

(2) the amount of income or sales and use taxes paid or accrued within the taxable year under this chapter and income or sales and use taxes paid to any other state or to any province or territory of Canada, to the extent allowed as a deduction under section 63(d) of the Internal Revenue Code of 1986, as amended through June 15, 2003, but the addition may not be more than the amount by which the itemized deductions as allowed

under section 63(d) of the Internal Revenue Code exceeds the amount of the standard deduction as defined in section 63(c) of the Internal Revenue Code. For the purpose of this paragraph, the disallowance of itemized deductions under section 68 of the Internal Revenue Code of 1986, income <u>or sales and use</u> tax is the last itemized deduction disallowed;

(3) the capital gain amount of a lump sum distribution to which the special tax under section 1122(h)(3)(B)(ii) of the Tax Reform Act of 1986, Public Law 99-514, applies;

(4) the amount of income taxes paid or accrued within the taxable year under this chapter and income taxes paid to any other state or any province or territory of Canada, to the extent allowed as a deduction in determining federal adjusted gross income. For the purpose of this paragraph, income taxes do not include the taxes imposed by sections 290.0922, subdivision 1, paragraph (b), 290.9727, 290.9728, and 290.9729;

(5) the amount of expense, interest, or taxes disallowed pursuant to section 290.10;

(6) the amount of a partner's pro rata share of net income which does not flow through to the partner because the partnership elected to pay the tax on the income under section 6242(a)(2) of the Internal Revenue Code; ~~and~~

(7) 80 percent of the depreciation deduction allowed under section 168(k) of the Internal Revenue Code. For purposes of this clause, if the taxpayer has an activity that in the taxable year generates a deduction for depreciation under section 168(k) and the activity generates a loss for the taxable year that the taxpayer is not allowed to claim for the taxable year, "the depreciation allowed under section 168(k)" for the taxable year is limited to excess of the depreciation claimed by the activity under section 168(k) over the amount of the loss from the activity that is not allowed in the taxable year. In succeeding taxable years when the losses not allowed in the taxable year are allowed, the depreciation under section 168(k) is allowed<u>;</u>

<u>(8) 80 percent of the amount by which the deduction allowed by section 179 of the Internal Revenue Code exceeds the</u>

deduction allowable by section 179 of the Internal Revenue Code of 1986, as amended through December 31, 2003; and

(9) to the extent deducted in computing federal taxable income, the amount of the deduction allowable under section 199 of the Internal Revenue Code.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004, except the changes in clause (2) are effective for tax years beginning after December 31, 2003.

Sec. 3. Minnesota Statutes 2004, section 290.01, subdivision 19b, is amended to read:

Subd. 19b. [SUBTRACTIONS FROM FEDERAL TAXABLE INCOME.] For individuals, estates, and trusts, there shall be subtracted from federal taxable income:

(1) interest income on obligations of any authority, commission, or instrumentality of the United States to the extent includable in taxable income for federal income tax purposes but exempt from state income tax under the laws of the United States;

(2) if included in federal taxable income, the amount of any overpayment of income tax to Minnesota or to any other state, for any previous taxable year, whether the amount is received as a refund or as a credit to another taxable year's income tax liability;

(3) the amount paid to others, less the amount used to claim the credit allowed under section 290.0674, not to exceed $1,625 for each qualifying child in grades kindergarten to 6 and $2,500 for each qualifying child in grades 7 to 12, for tuition, textbooks, and transportation of each qualifying child in attending an elementary or secondary school situated in Minnesota, North Dakota, South Dakota, Iowa, or Wisconsin, wherein a resident of this state may legally fulfill the state's compulsory attendance laws, which is not operated for profit, and which adheres to the provisions of the Civil Rights Act of 1964 and chapter 363A. For the purposes of this clause, "tuition" includes fees or tuition as defined in section

290.0674, subdivision 1, clause (1). As used in this clause, "textbooks" includes books and other instructional materials and equipment purchased or leased for use in elementary and secondary schools in teaching only those subjects legally and commonly taught in public elementary and secondary schools in this state. Equipment expenses qualifying for deduction includes expenses as defined and limited in section 290.0674, subdivision 1, clause (3). "Textbooks" does not include instructional books and materials used in the teaching of religious tenets, doctrines, or worship, the purpose of which is to instill such tenets, doctrines, or worship, nor does it include books or materials for, or transportation to, extracurricular activities including sporting events, musical or dramatic events, speech activities, driver's education, or similar programs. For purposes of the subtraction provided by this clause, "qualifying child" has the meaning given in section 32(c)(3) of the Internal Revenue Code;

(4) income as provided under section 290.0802;

(5) to the extent included in federal adjusted gross income, income realized on disposition of property exempt from tax under section 290.491;

(6) to the extent included in federal taxable income, postservice benefits for youth community service under section 124D.42 for volunteer service under United States Code, title 42, sections 12601 to 12604;

(7) to the extent not deducted in determining federal taxable income by an individual who does not itemize deductions for federal income tax purposes for the taxable year, an amount equal to 50 percent of the excess of charitable contributions allowable as a deduction for the taxable year under section 170(a) of the Internal Revenue Code over $500;

(8) for taxable years beginning before January 1, 2008, the amount of the federal small ethanol producer credit allowed under section 40(a)(3) of the Internal Revenue Code which is included in gross income under section 87 of the Internal Revenue Code;

(9) for individuals who are allowed a federal foreign tax credit for taxes that do not qualify for a credit under section 290.06, subdivision 22, an amount equal to the carryover of subnational foreign taxes for the taxable year, but not to exceed the total subnational foreign taxes reported in claiming the foreign tax credit. For purposes of this clause, "federal foreign tax credit" means the credit allowed under section 27 of the Internal Revenue Code, and "carryover of subnational foreign taxes" equals the carryover allowed under section 904(c) of the Internal Revenue Code minus national level foreign taxes to the extent they exceed the federal foreign tax credit;

(10) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (7), an amount equal to one-fifth of the delayed depreciation. For purposes of this clause, "delayed depreciation" means the amount of the addition made by the taxpayer under subdivision 19a, clause (7), minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. The resulting delayed depreciation cannot be less than zero; ~~and~~

(11) job opportunity building zone income as provided under section 469.316; and

(12) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (8), or 19c, clause (17), in the case of a shareholder of a corporation that is an S corporation, an amount equal to one-fifth of the addition made by the taxpayer under subdivision 19a, clause (8), or 19c, clause (17), in the case of a shareholder of a corporation that is an S corporation, minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. If the net operating loss exceeds the addition for the tax year, a subtraction is not allowed under this clause.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 4. Minnesota Statutes 2004, section 290.01, subdivision 19c, is amended to read:

Subd. 19c. [CORPORATIONS; ADDITIONS TO FEDERAL TAXABLE INCOME.] For corporations, there shall be added to federal taxable income:

(1) the amount of any deduction taken for federal income tax purposes for income, excise, or franchise taxes based on net income or related minimum taxes, including but not limited to the tax imposed under section 290.0922, paid by the corporation to Minnesota, another state, a political subdivision of another state, the District of Columbia, or any foreign country or possession of the United States;

(2) interest not subject to federal tax upon obligations of: the United States, its possessions, its agencies, or its instrumentalities; the state of Minnesota or any other state, any of its political or governmental subdivisions, any of its municipalities, or any of its governmental agencies or instrumentalities; the District of Columbia; or Indian tribal governments;

(3) exempt-interest dividends received as defined in section 852(b)(5) of the Internal Revenue Code;

(4) the amount of any net operating loss deduction taken for federal income tax purposes under section 172 or 832(c)(10) of the Internal Revenue Code or operations loss deduction under section 810 of the Internal Revenue Code;

(5) the amount of any special deductions taken for federal income tax purposes under sections 241 to 247 of the Internal Revenue Code;

(6) losses from the business of mining, as defined in section 290.05, subdivision 1, clause (a), that are not subject to Minnesota income tax;

(7) the amount of any capital losses deducted for federal income tax purposes under sections 1211 and 1212 of the Internal Revenue Code;

(8) the exempt foreign trade income of a foreign sales corporation under sections 921(a) and 291 of the Internal

Revenue Code;

(9) the amount of percentage depletion deducted under sections 611 through 614 and 291 of the Internal Revenue Code;

(10) for certified pollution control facilities placed in service in a taxable year beginning before December 31, 1986, and for which amortization deductions were elected under section 169 of the Internal Revenue Code of 1954, as amended through December 31, 1985, the amount of the amortization deduction allowed in computing federal taxable income for those facilities;

(11) the amount of any deemed dividend from a foreign operating corporation determined pursuant to section 290.17, subdivision 4, paragraph (g);

(12) the amount of any environmental tax paid under section 59(a) of the Internal Revenue Code;

(13) the amount of a partner's pro rata share of net income which does not flow through to the partner because the partnership elected to pay the tax on the income under section 6242(a)(2) of the Internal Revenue Code;

(14) the amount of net income excluded under section 114 of the Internal Revenue Code;

(15) any increase in subpart F income, as defined in section 952(a) of the Internal Revenue Code, for the taxable year when subpart F income is calculated without regard to the provisions of section 614 of Public Law 107-147; ~~and~~

(16) 80 percent of the depreciation deduction allowed under section 168(k) of the Internal Revenue Code. For purposes of this clause, if the taxpayer has an activity that in the taxable year generates a deduction for depreciation under section 168(k) and the activity generates a loss for the taxable year that the taxpayer is not allowed to claim for the taxable year, "the depreciation allowed under section 168(k)" for the taxable year is limited to excess of the depreciation claimed by the activity under section 168(k) over the amount of the loss from the activity that is not allowed in the taxable year. In succeeding taxable years when the losses not allowed in the taxable year

are allowed, the depreciation under section 168(k) is allowed;

(17) 80 percent of the amount by which the deduction allowed by section 179 of the Internal Revenue Code exceeds the deduction allowable by section 179 of the Internal Revenue Code of 1986, as amended through December 31, 2003; and

(18) to the extent deducted in computing federal taxable income, the amount of the deduction allowable under section 199 of the Internal Revenue Code.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 5. Minnesota Statutes 2004, section 290.01, subdivision 19d, is amended to read:

Subd. 19d. [CORPORATIONS; MODIFICATIONS DECREASING FEDERAL TAXABLE INCOME.] For corporations, there shall be subtracted from federal taxable income after the increases provided in subdivision 19c:

(1) the amount of foreign dividend gross-up added to gross income for federal income tax purposes under section 78 of the Internal Revenue Code;

(2) the amount of salary expense not allowed for federal income tax purposes due to claiming the federal jobs credit under section 51 of the Internal Revenue Code;

(3) any dividend (not including any distribution in liquidation) paid within the taxable year by a national or state bank to the United States, or to any instrumentality of the United States exempt from federal income taxes, on the preferred stock of the bank owned by the United States or the instrumentality;

(4) amounts disallowed for intangible drilling costs due to differences between this chapter and the Internal Revenue Code in taxable years beginning before January 1, 1987, as follows:

(i) to the extent the disallowed costs are represented by physical property, an amount equal to the allowance for depreciation under Minnesota Statutes 1986, section 290.09, subdivision 7, subject to the modifications contained in subdivision 19e; and

(ii) to the extent the disallowed costs are not represented by physical property, an amount equal to the allowance for cost depletion under Minnesota Statutes 1986, section 290.09, subdivision 8;

(5) the deduction for capital losses pursuant to sections 1211 and 1212 of the Internal Revenue Code, except that:

(i) for capital losses incurred in taxable years beginning after December 31, 1986, capital loss carrybacks shall not be allowed;

(ii) for capital losses incurred in taxable years beginning after December 31, 1986, a capital loss carryover to each of the 15 taxable years succeeding the loss year shall be allowed;

(iii) for capital losses incurred in taxable years beginning before January 1, 1987, a capital loss carryback to each of the three taxable years preceding the loss year, subject to the provisions of Minnesota Statutes 1986, section 290.16, shall be allowed; and

(iv) for capital losses incurred in taxable years beginning before January 1, 1987, a capital loss carryover to each of the five taxable years succeeding the loss year to the extent such loss was not used in a prior taxable year and subject to the provisions of Minnesota Statutes 1986, section 290.16, shall be allowed;

(6) an amount for interest and expenses relating to income not taxable for federal income tax purposes, if (i) the income is taxable under this chapter and (ii) the interest and expenses were disallowed as deductions under the provisions of section 171(a)(2), 265 or 291 of the Internal Revenue Code in computing federal taxable income;

(7) in the case of mines, oil and gas wells, other natural deposits, and timber for which percentage depletion was disallowed pursuant to subdivision 19c, clause (11), a reasonable allowance for depletion based on actual cost. In the case of leases the deduction must be apportioned between the lessor and lessee in accordance with rules prescribed by the commissioner. In the case of property held in trust, the

allowable deduction must be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the trust, or if there is no provision in the instrument, on the basis of the trust's income allocable to each;

(8) for certified pollution control facilities placed in service in a taxable year beginning before December 31, 1986, and for which amortization deductions were elected under section 169 of the Internal Revenue Code of 1954, as amended through December 31, 1985, an amount equal to the allowance for depreciation under Minnesota Statutes 1986, section 290.09, subdivision 7;

(9) amounts included in federal taxable income that are due to refunds of income, excise, or franchise taxes based on net income or related minimum taxes paid by the corporation to Minnesota, another state, a political subdivision of another state, the District of Columbia, or a foreign country or possession of the United States to the extent that the taxes were added to federal taxable income under section 290.01, subdivision 19c, clause (1), in a prior taxable year;

(10) 80 percent of royalties, fees, or other like income accrued or received from a foreign operating corporation or a foreign corporation which is part of the same unitary business as the receiving corporation;

(11) income or gains from the business of mining as defined in section 290.05, subdivision 1, clause (a), that are not subject to Minnesota franchise tax;

(12) the amount of handicap access expenditures in the taxable year which are not allowed to be deducted or capitalized under section 44(d)(7) of the Internal Revenue Code;

(13) the amount of qualified research expenses not allowed for federal income tax purposes under section 280C(c) of the Internal Revenue Code, but only to the extent that the amount exceeds the amount of the credit allowed under section 290.068;

(14) the amount of salary expenses not allowed for federal income tax purposes due to claiming the Indian employment credit

under section 45A(a) of the Internal Revenue Code;

(15) the amount of any refund of environmental taxes paid under section 59A of the Internal Revenue Code;

(16) for taxable years beginning before January 1, 2008, the amount of the federal small ethanol producer credit allowed under section 40(a)(3) of the Internal Revenue Code which is included in gross income under section 87 of the Internal Revenue Code;

(17) for a corporation whose foreign sales corporation, as defined in section 922 of the Internal Revenue Code, constituted a foreign operating corporation during any taxable year ending before January 1, 1995, and a return was filed by August 15, 1996, claiming the deduction under section 290.21, subdivision 4, for income received from the foreign operating corporation, an amount equal to 1.23 multiplied by the amount of income excluded under section 114 of the Internal Revenue Code, provided the income is not income of a foreign operating company;

(18) any decrease in subpart F income, as defined in section 952(a) of the Internal Revenue Code, for the taxable year when subpart F income is calculated without regard to the provisions of section 614 of Public Law 107-147; ~~and~~

(19) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19c, clause (16), an amount equal to one-fifth of the delayed depreciation. For purposes of this clause, "delayed depreciation" means the amount of the addition made by the taxpayer under subdivision 19c, clause (16). The resulting delayed depreciation cannot be less than zero; and

(20) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19c, clause (17), an amount equal to one-fifth of the amount of the addition.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 6. Minnesota Statutes 2004, section 290.01,

subdivision 31, is amended to read:

Subd. 31. [INTERNAL REVENUE CODE.] Unless specifically defined otherwise, "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through June 15, 2003, and as further amended by the American Jobs Creation Act of 2004, Public Law 108-435.

[EFFECTIVE DATE.] This section is effective the day following final enactment except the changes incorporated by federal changes are effective at the same times as the changes were effective for federal purposes.

Sec. 7. Minnesota Statutes 2004, section 290.06, subdivision 2c, is amended to read:

Subd. 2c. [SCHEDULES OF RATES FOR INDIVIDUALS, ESTATES, AND TRUSTS.] (a) The income taxes imposed by this chapter upon married individuals filing joint returns and surviving spouses as defined in section 2(a) of the Internal Revenue Code must be computed by applying to their taxable net income the following schedule of rates:

(1) On the first $25,680, 5.35 percent;

(2) On all over $25,680, but not over $102,030, 7.05 percent;

(3) On all over $102,030, 7.85 percent.

Married individuals filing separate returns, estates, and trusts must compute their income tax by applying the above rates to their taxable income, except that the income brackets will be one-half of the above amounts.

(b) The income taxes imposed by this chapter upon unmarried individuals must be computed by applying to taxable net income the following schedule of rates:

(1) On the first $17,570, 5.35 percent;

(2) On all over $17,570, but not over $57,710, 7.05 percent;

(3) On all over $57,710, 7.85 percent.

(c) The income taxes imposed by this chapter upon unmarried individuals qualifying as a head of household as defined in section 2(b) of the Internal Revenue Code must be computed by applying to taxable net income the following schedule of rates:

(1) On the first $21,630, 5.35 percent;

(2) On all over $21,630, but not over $86,910, 7.05 percent;

(3) On all over $86,910, 7.85 percent.

(d) In lieu of a tax computed according to the rates set forth in this subdivision, the tax of any individual taxpayer whose taxable net income for the taxable year is less than an amount determined by the commissioner must be computed in accordance with tables prepared and issued by the commissioner of revenue based on income brackets of not more than $100. The amount of tax for each bracket shall be computed at the rates set forth in this subdivision, provided that the commissioner may disregard a fractional part of a dollar unless it amounts to 50 cents or more, in which case it may be increased to $1.

(e) An individual who is not a Minnesota resident for the entire year must compute the individual's Minnesota income tax as provided in this subdivision. After the application of the nonrefundable credits provided in this chapter, the tax liability must then be multiplied by a fraction in which:

(1) the numerator is the individual's Minnesota source federal adjusted gross income as defined in section 62 of the Internal Revenue Code and increased by the additions required under section 290.01, subdivision 19a, clauses (1), (5), ~~and~~ (6), (7), (8), and (9), and reduced by the subtraction under section 290.01, subdivision 19b, clause (11), and the Minnesota assignable portion of the subtraction for United States government interest under section 290.01, subdivision 19b, clause (1), and the subtractions under clauses (10), (11), and (12), after applying the allocation and assignability provisions of section 290.081, clause (a), or 290.17; and

(2) the denominator is the individual's federal adjusted gross income as defined in section 62 of the Internal Revenue Code of 1986, increased by the amounts specified in section 290.01, subdivision 19a, clauses (1), (5), ~~and~~ (6), (7), (8), and (9), and reduced by the amounts specified in section 290.01,

subdivision 19b, clauses (1) ~~and~~, (10), (11), and (12).

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 8. Minnesota Statutes 2004, section 290.067, subdivision 2a, is amended to read:

Subd. 2a. [INCOME.] (a) For purposes of this section, "income" means the sum of the following:

(1) federal adjusted gross income as defined in section 62 of the Internal Revenue Code; and

(2) the sum of the following amounts to the extent not included in clause (1):

(i) all nontaxable income;

(ii) the amount of a passive activity loss that is not disallowed as a result of section 469, paragraph (i) or (m) of the Internal Revenue Code and the amount of passive activity loss carryover allowed under section 469(b) of the Internal Revenue Code;

(iii) an amount equal to the total of any discharge of qualified farm indebtedness of a solvent individual excluded from gross income under section 108(g) of the Internal Revenue Code;

(iv) cash public assistance and relief;

(v) any pension or annuity (including railroad retirement benefits, all payments received under the federal Social Security Act, supplemental security income, and veterans benefits), which was not exclusively funded by the claimant or spouse, or which was funded exclusively by the claimant or spouse and which funding payments were excluded from federal adjusted gross income in the years when the payments were made;

(vi) interest received from the federal or a state government or any instrumentality or political subdivision thereof;

(vii) workers' compensation;

(viii) nontaxable strike benefits;

(ix) the gross amounts of payments received in the nature of disability income or sick pay as a result of accident, sickness, or other disability, whether funded through insurance or otherwise;

(x) a lump sum distribution under section 402(e)(3) of the Internal Revenue Code of 1986, as amended through December 31, 1995;

(xi) contributions made by the claimant to an individual retirement account, including a qualified voluntary employee contribution; simplified employee pension plan; self-employed retirement plan; cash or deferred arrangement plan under section 401(k) of the Internal Revenue Code; or deferred compensation plan under section 457 of the Internal Revenue Code; ~~and~~

(xii) nontaxable scholarship or fellowship grants; and

(xiii) the amount of deduction allowed under section 199 of the Internal Revenue Code.

In the case of an individual who files an income tax return on a fiscal year basis, the term "federal adjusted gross income" means federal adjusted gross income reflected in the fiscal year ending in the next calendar year. Federal adjusted gross income may not be reduced by the amount of a net operating loss carryback or carryforward or a capital loss carryback or carryforward allowed for the year.

(b) "Income" does not include:

(1) amounts excluded pursuant to the Internal Revenue Code, sections 101(a) and 102;

(2) amounts of any pension or annuity that were exclusively funded by the claimant or spouse if the funding payments were not excluded from federal adjusted gross income in the years when the payments were made;

(3) surplus food or other relief in kind supplied by a governmental agency;

(4) relief granted under chapter 290A;

(5) child support payments received under a temporary or final decree of dissolution or legal separation; and

(6) restitution payments received by eligible individuals and excludable interest as defined in section 803 of the Economic Growth and Tax Relief Reconciliation Act of 2001,

Public Law 107-16.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2003.

Sec. 9. Minnesota Statutes 2004, section 290.091, subdivision 2, is amended to read:

Subd. 2. [DEFINITIONS.] For purposes of the tax imposed by this section, the following terms have the meanings given:

(a) "Alternative minimum taxable income" means the sum of the following for the taxable year:

(1) the taxpayer's federal alternative minimum taxable income as defined in section 55(b)(2) of the Internal Revenue Code;

(2) the taxpayer's itemized deductions allowed in computing federal alternative minimum taxable income, but excluding:

(i) the charitable contribution deduction under section 170 of the Internal Revenue Code to the extent that the deduction exceeds 1.0 percent of adjusted gross income, as defined in section 62 of the Internal Revenue Code;

(ii) the medical expense deduction;

(iii) the casualty, theft, and disaster loss deduction; and

(iv) the impairment-related work expenses of a disabled person;

(3) for depletion allowances computed under section 613A(c) of the Internal Revenue Code, with respect to each property (as defined in section 614 of the Internal Revenue Code), to the extent not included in federal alternative minimum taxable income, the excess of the deduction for depletion allowable under section 611 of the Internal Revenue Code for the taxable year over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year);

(4) to the extent not included in federal alternative minimum taxable income, the amount of the tax preference for intangible drilling cost under section 57(a)(2) of the Internal Revenue Code determined without regard to subparagraph (E);

(5) to the extent not included in federal alternative

minimum taxable income, the amount of interest income as provided by section 290.01, subdivision 19a, clause (1); and

(6) the amount of addition required by section 290.01, subdivision 19a, ~~clause~~ clauses (7), (8), and (9);

less the sum of the amounts determined under the following:

(1) interest income as defined in section 290.01, subdivision 19b, clause (1);

(2) an overpayment of state income tax as provided by section 290.01, subdivision 19b, clause (2), to the extent included in federal alternative minimum taxable income;

(3) the amount of investment interest paid or accrued within the taxable year on indebtedness to the extent that the amount does not exceed net investment income, as defined in section 163(d)(4) of the Internal Revenue Code. Interest does not include amounts deducted in computing federal adjusted gross income; and

(4) amounts subtracted from federal taxable income as provided by section 290.01, subdivision 19b, clauses (10) ~~and~~, (11), and (12).

In the case of an estate or trust, alternative minimum taxable income must be computed as provided in section 59(c) of the Internal Revenue Code.

(b) "Investment interest" means investment interest as defined in section 163(d)(3) of the Internal Revenue Code.

(c) "Tentative minimum tax" equals 6.4 percent of alternative minimum taxable income after subtracting the exemption amount determined under subdivision 3.

(d) "Regular tax" means the tax that would be imposed under this chapter (without regard to this section and section 290.032), reduced by the sum of the nonrefundable credits allowed under this chapter.

(e) "Net minimum tax" means the minimum tax imposed by this section.

[EFFECTIVE DATE.] This section is effective for tax years beginning after December 31, 2004.

Sec. 10. Minnesota Statutes 2004, section 290A.03,

subdivision 3, is amended to read:

Subd. 3. [INCOME.] (1) "Income" means the sum of the following:

(a) federal adjusted gross income as defined in the Internal Revenue Code; and

(b) the sum of the following amounts to the extent not included in clause (a):

(i) all nontaxable income;

(ii) the amount of a passive activity loss that is not disallowed as a result of section 469, paragraph (i) or (m) of the Internal Revenue Code and the amount of passive activity loss carryover allowed under section 469(b) of the Internal Revenue Code;

(iii) an amount equal to the total of any discharge of qualified farm indebtedness of a solvent individual excluded from gross income under section 108(g) of the Internal Revenue Code;

(iv) cash public assistance and relief;

(v) any pension or annuity (including railroad retirement benefits, all payments received under the federal Social Security Act, supplemental security income, and veterans benefits), which was not exclusively funded by the claimant or spouse, or which was funded exclusively by the claimant or spouse and which funding payments were excluded from federal adjusted gross income in the years when the payments were made;

(vi) interest received from the federal or a state government or any instrumentality or political subdivision thereof;

(vii) workers' compensation;

(viii) nontaxable strike benefits;

(ix) the gross amounts of payments received in the nature of disability income or sick pay as a result of accident, sickness, or other disability, whether funded through insurance or otherwise;

(x) a lump sum distribution under section 402(e)(3) of the Internal Revenue Code <u>of 1986, as amended through December 31,</u>

1995;

(xi) contributions made by the claimant to an individual retirement account, including a qualified voluntary employee contribution; simplified employee pension plan; self-employed retirement plan; cash or deferred arrangement plan under section 401(k) of the Internal Revenue Code; or deferred compensation plan under section 457 of the Internal Revenue Code; ~~and~~

(xii) nontaxable scholarship or fellowship grants; and

(xiii) the amount of deduction allowed under section 199 of the Internal Revenue Code.

In the case of an individual who files an income tax return on a fiscal year basis, the term "federal adjusted gross income" shall mean federal adjusted gross income reflected in the fiscal year ending in the calendar year. Federal adjusted gross income shall not be reduced by the amount of a net operating loss carryback or carryforward or a capital loss carryback or carryforward allowed for the year.

(2) "Income" does not include:

(a) amounts excluded pursuant to the Internal Revenue Code, sections 101(a) and 102;

(b) amounts of any pension or annuity which was exclusively funded by the claimant or spouse and which funding payments were not excluded from federal adjusted gross income in the years when the payments were made;

(c) surplus food or other relief in kind supplied by a governmental agency;

(d) relief granted under this chapter;

(e) child support payments received under a temporary or final decree of dissolution or legal separation; or

(f) restitution payments received by eligible individuals and excludable interest as defined in section 803 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16.

(3) The sum of the following amounts may be subtracted from income:

(a) for the claimant's first dependent, the exemption amount multiplied by 1.4;

(b) for the claimant's second dependent, the exemption amount multiplied by 1.3;

(c) for the claimant's third dependent, the exemption amount multiplied by 1.2;

(d) for the claimant's fourth dependent, the exemption amount multiplied by 1.1;

(e) for the claimant's fifth dependent, the exemption amount; and

(f) if the claimant or claimant's spouse was disabled or attained the age of 65 on or before December 31 of the year for which the taxes were levied or rent paid, the exemption amount.

For purposes of this subdivision, the "exemption amount" means the exemption amount under section 151(d) of the Internal Revenue Code for the taxable year for which the income is reported.

[EFFECTIVE DATE.] This section is effective for property tax refunds based on household income for 2004 and thereafter.

Sec. 11. Minnesota Statutes 2004, section 290A.03, subdivision 15, is amended to read:

Subd. 15. [INTERNAL REVENUE CODE.] "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through June 15, 2003, and as further amended by the American Jobs Creation Act of 2004, Public Law 108-435.

[EFFECTIVE DATE.] This section is effective for property tax refunds based on property taxes payable on or after December 31, 2004, and rent paid on or after December 31, 2003.

ARTICLE 3

SALES, USE, AND SPECIAL TAXES

Section 1. Minnesota Statutes 2004, section 16C.03, is amended by adding a subdivision to read:

Subd. 18. [CONTRACTS WITH FOREIGN VENDORS.] (a) The commissioner and other agencies to which this section applies and the legislative branch of government shall, subject to paragraph (d), cancel a contract for goods or services from a vendor or an affiliate of a vendor or suspend or debar a vendor or an affiliate of a vendor from future contracts upon notification from the commissioner of revenue that the vendor or an affiliate of the vendor has not registered to collect the sales and use tax imposed under chapter 297A on its sales in Minnesota or to a destination in Minnesota. This subdivision shall not apply to state colleges and universities, the courts, and any agency in the judicial branch of government. For purposes of this subdivision, the term "affiliate" means any person or entity that is controlled by, or is under common control of, a vendor through stock ownership or other affiliation.

(b) Beginning January 1, 2006, each vendor or affiliate of a vendor selling goods or services, subject to tax under chapter 297A, to an agency or the legislature must provide its Minnesota sales and use tax business identification number, upon request, to show that the vendor is registered to collect Minnesota sales or use tax.

(c) The commissioner of revenue shall periodically provide to the commissioner and the legislative branch a list of vendors who have not registered to collect Minnesota sales and use tax and who are subject to being suspended or debarred as vendors or having their contracts canceled.

(d) The provisions of this subdivision may be waived by the commissioner or the legislative branch when the vendor is the single source of such goods or services, in the event of an emergency, or when it is in the best interests of the state as determined by the commissioner in consultation with the commissioner of revenue. Such consultation is not a disclosure violation under chapter 270B.

[EFFECTIVE DATE.] This section is effective for all contracts entered into after December 31, 2005.

Sec. 2. [295.75] [LIQUOR GROSS RECEIPTS TAX.]

Subdivision 1. [DEFINITIONS.] (a) For purposes of this section, the following terms have the meanings given.

(b) "Commissioner" means the commissioner of revenue.

(c) "Gross receipts" means the total amount received, in money or by barter or exchange, for all liquor sales at retail as measured by the sales price, but does not include any taxes imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the purchaser.

(d) "Liquor" means:

(1) intoxicating liquor, as defined in section 340A.101, subdivision 14;

(2) beverage containing intoxicating liquor; and

(3) 3.2 percent malt liquor, as defined in section 340A.101, subdivision 19, when sold at an on-sale or off-sale municipal liquor store or other establishment licensed to sell any type of intoxicating liquor.

(e) "Liquor retailer" means a retailer that sells liquor.

(f) "Retail sale" has the meaning given in section 297A.61, subdivision 4.

Subd. 2. [GROSS RECEIPTS TAX IMPOSED.] A tax is imposed on each liquor retailer equal to 2.5 percent of gross receipts from retail sales in Minnesota of liquor.

Subd. 3. [USE TAX IMPOSED; CREDIT FOR TAXES PAID.] (a) A person that receives liquor for use or storage in Minnesota, other than from a liquor retailer that paid the tax under subdivision 2, is subject to tax at the rate imposed under subdivision 2. Liability for the tax is incurred when the person has possession of the liquor in Minnesota. The tax must be remitted to the commissioner in the same manner prescribed for the taxes imposed under chapter 297A.

(b) A person that has paid taxes to another jurisdiction on the same transaction and is subject to tax under this section is entitled to a credit for the tax legally due and paid to another jurisdiction to the extent of the lesser of (1) the tax actually paid to the other jurisdiction, or (2) the amount of tax imposed by Minnesota on the transaction subject to tax in the other jurisdiction.

Subd. 4. [TAX COLLECTION REQUIRED.] A liquor retailer with nexus in Minnesota, who is not subject to tax under subdivision

2, is required to collect the tax imposed under subdivision 3 from the purchaser of the liquor and give the purchaser a receipt for the tax paid. The tax collected must be remitted to the commissioner in the same manner prescribed for the taxes imposed under chapter 297A.

Subd. 5. [TAXES PAID TO ANOTHER JURISDICTION; CREDIT.] A liquor retailer that has paid taxes to another jurisdiction measured by gross receipts and is subject to tax under this section on the same gross receipts is entitled to a credit for the tax legally due and paid to another jurisdiction to the extent of the lesser of (1) the tax actually paid to the other jurisdiction, or (2) the amount of tax imposed by Minnesota on the gross receipts subject to tax in the other taxing jurisdictions.

Subd. 6. [EXEMPTIONS.] All of the exemptions applicable to the taxes imposed under chapter 297A are applicable to the taxes imposed under this section.

Subd. 7. [SOURCING OF SALES.] All of the provisions of section 297A.668 apply to the taxes imposed by this section.

Subd. 8. [PAYMENT; REPORTING.] A liquor retailer shall report the tax on a return prescribed by the commissioner of revenue, and shall remit the tax with the return. The return and the tax must be filed and paid using the filing cycle and due dates provided for taxes imposed under chapter 297A.

Subd. 9. [ADMINISTRATION.] Unless specifically provided otherwise by this section, the audit, assessment, refund, penalty, interest, enforcement, collection remedies, appeal, and administrative provisions of chapters 270 and 289A that are applicable to taxes imposed under chapter 297A apply to taxes imposed under this section.

Subd. 10. [INTEREST ON OVERPAYMENTS.] Interest must be paid on an overpayment refunded or credited to the taxpayer from the date of payment of the tax until the date the refund is paid or credited. For purposes of this subdivision, the date of payment is the due date of the return or the date of actual payment of the tax, whichever is later.

<u>Subd. 11.</u> [DEPOSIT OF REVENUES.] <u>The commissioner shall deposit all revenues, including penalties and interest, derived from the tax imposed by this section in the general fund.</u>

[EFFECTIVE DATE.] <u>This section is effective for sales and purchases occurring on or after January 1, 2006.</u>

Sec. 3. Minnesota Statutes 2004, section 297A.68, subdivision 2, is amended to read:

Subd. 2. [MATERIALS CONSUMED IN INDUSTRIAL PRODUCTION.] (a) Materials stored, used, or consumed in industrial production of personal property intended to be sold ultimately at retail are exempt, whether or not the item so used becomes an ingredient or constituent part of the property produced. Materials that qualify for this exemption include, but are not limited to, the following:

(1) chemicals, including chemicals used for cleaning food processing machinery and equipment;

(2) materials, including chemicals, fuels, and electricity purchased by persons engaged in industrial production to treat waste generated as a result of the production process;

(3) fuels, electricity, gas, and steam used or consumed in the production process, except that electricity, gas, or steam used for space heating, cooling, or lighting is exempt if (i) it is in excess of the average climate control or lighting for the production area, and (ii) it is necessary to produce that particular product;

(4) petroleum products and lubricants;

(5) packaging materials, including returnable containers used in packaging food and beverage products;

(6) accessory tools, equipment, and other items that are separate detachable units with an ordinary useful life of less than 12 months used in producing a direct effect upon the product; and

(7) the following materials, tools, and equipment used in metalcasting: crucibles, thermocouple protection sheaths and tubes, stalk tubes, refractory materials, molten metal filters and filter boxes, degassing lances, and base blocks.

(b) This exemption does not include:

(1) machinery, equipment, implements, tools, accessories, appliances, contrivances and furniture and fixtures, except those listed in paragraph (a), clause (6); and

(2) petroleum and special fuels used in producing or generating power for propelling ready-mixed concrete trucks on the public highways of this state.

(c) Industrial production includes, but is not limited to, research, development, design or production of any tangible personal property, manufacturing, processing (other than by restaurants and consumers) of agricultural products (whether vegetable or animal), commercial fishing, refining, smelting, reducing, brewing, distilling, printing, mining, quarrying, lumbering, generating electricity, the production of road building materials, and the research, development, design, or production of computer software. Industrial production does not include painting, cleaning, repairing or similar processing of property except as part of the original manufacturing process. Industrial production does not include the transportation, transmission, or distribution of petroleum, liquefied gas, natural gas, water, or steam, in, by, or through pipes, lines, tanks, mains, or other means of transporting those products. For purposes of this paragraph, "transportation, transmission, or distribution" does not include blending of petroleum or biodiesel fuel as defined in section 239.77.

[EFFECTIVE DATE.] This section is effective for sales and purchases made after June 30, 2005.

Sec. 4. Minnesota Statutes 2004, section 297A.68, subdivision 5, is amended to read:

Subd. 5. [CAPITAL EQUIPMENT.] (a) Capital equipment is exempt. The tax must be imposed and collected as if the rate under section 297A.62, subdivision 1, applied, and then refunded in the manner provided in section 297A.75.

"Capital equipment" means machinery and equipment purchased or leased, and used in this state by the purchaser or lessee primarily for manufacturing, fabricating, mining, or refining tangible personal property to be sold ultimately at retail if the machinery and equipment are essential to the integrated production process of manufacturing, fabricating, mining, or refining. Capital equipment also includes machinery and equipment used to electronically transmit results retrieved by a customer of an on-line computerized data retrieval system.

(b) Capital equipment includes, but is not limited to:

(1) machinery and equipment used to operate, control, or regulate the production equipment;

(2) machinery and equipment used for research and development, design, quality control, and testing activities;

(3) environmental control devices that are used to maintain conditions such as temperature, humidity, light, or air pressure when those conditions are essential to and are part of the production process;

(4) materials and supplies used to construct and install machinery or equipment;

(5) repair and replacement parts, including accessories, whether purchased as spare parts, repair parts, or as upgrades or modifications to machinery or equipment;

(6) materials used for foundations that support machinery or equipment;

(7) materials used to construct and install special purpose buildings used in the production process;

(8) ready-mixed concrete equipment in which the ready-mixed concrete is mixed as part of the delivery process regardless if mounted on a chassis and leases of ready-mixed concrete trucks; and

(9) machinery or equipment used for research, development, design, or production of computer software.

(c) Capital equipment does not include the following:

(1) motor vehicles taxed under chapter 297B;

(2) machinery or equipment used to receive or store raw materials;

(3) building materials, except for materials included in paragraph (b), clauses (6) and (7);

(4) machinery or equipment used for nonproduction purposes, including, but not limited to, the following: plant security, fire prevention, first aid, and hospital stations; support operations or administration; pollution control; and plant cleaning, disposal of scrap and waste, plant communications, space heating, cooling, lighting, or safety;

(5) farm machinery and aquaculture production equipment as defined by section 297A.61, subdivisions 12 and 13;

(6) machinery or equipment purchased and installed by a contractor as part of an improvement to real property; ~~or~~

(7) machinery or equipment used in the transportation, transmission, or distribution of petroleum, liquefied gas, natural gas, water, or steam, in, by, or through pipes, lines, tanks, mains, or other means of transporting those products. This clause does not apply to machinery or equipment used to blend petroleum or biodiesel fuel as defined in section 239.77; or

(8) any other item that is not essential to the integrated process of manufacturing, fabricating, mining, or refining.

(d) For purposes of this subdivision:

(1) "Equipment" means independent devices or tools separate from machinery but essential to an integrated production process, including computers and computer software, used in operating, controlling, or regulating machinery and equipment; and any subunit or assembly comprising a component of any machinery or accessory or attachment parts of machinery, such as tools, dies, jigs, patterns, and molds.

(2) "Fabricating" means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(3) "Integrated production process" means a process or series of operations through which tangible personal property is manufactured, fabricated, mined, or refined. For purposes of this clause, (i) manufacturing begins with the removal of raw materials from inventory and ends when the last process prior to loading for shipment has been completed; (ii) fabricating begins

with the removal from storage or inventory of the property to be assembled, processed, altered, or modified and ends with the creation or production of the new or changed product; (iii) mining begins with the removal of overburden from the site of the ores, minerals, stone, peat deposit, or surface materials and ends when the last process before stockpiling is completed; and (iv) refining begins with the removal from inventory or storage of a natural resource and ends with the conversion of the item to its completed form.

(4) "Machinery" means mechanical, electronic, or electrical devices, including computers and computer software, that are purchased or constructed to be used for the activities set forth in paragraph (a), beginning with the removal of raw materials from inventory through completion of the product, including packaging of the product.

(5) "Machinery and equipment used for pollution control" means machinery and equipment used solely to eliminate, prevent, or reduce pollution resulting from an activity described in paragraph (a).

(6) "Manufacturing" means an operation or series of operations where raw materials are changed in form, composition, or condition by machinery and equipment and which results in the production of a new article of tangible personal property. For purposes of this subdivision, "manufacturing" includes the generation of electricity or steam to be sold at retail.

(7) "Mining" means the extraction of minerals, ores, stone, or peat.

(8) "On-line data retrieval system" means a system whose cumulation of information is equally available and accessible to all its customers.

(9) "Primarily" means machinery and equipment used 50 percent or more of the time in an activity described in paragraph (a).

(10) "Refining" means the process of converting a natural resource to an intermediate or finished product, including the treatment of water to be sold at retail.

[EFFECTIVE DATE.] This section is effective for sales and purchases made after June 30, 2005.

Sec. 5. Minnesota Statutes 2004, section 297I.01, is amended by adding a subdivision to read:

Subd. 6a. [DIRECT BUSINESS.] (a) "Direct business" means all insurance provided by an insurance company or its agents, and specifically includes stop-loss insurance purchased in connection with a self-insurance plan for employee health benefits or for other purposes, but excludes:

(1) reinsurance in which an insurance company assumes the liability of another insurance company; and

(2) self-insurance.

(b) For purposes of this subdivision, an insurance company includes a nonprofit health service corporation, health maintenance organization, and community integrated service network.

[EFFECTIVE DATE.] This section is effective for insurance premiums received after December 31, 2005.

Sec. 6. Laws 2001, First Special Session chapter 5, article 12, section 95, is amended to read:

Sec. 95. [REPEALER.]

(a) Minnesota Statutes 2000, sections 297A.61, subdivision 16; 297A.68, subdivision 21; and 297A.71, subdivisions 2 and 16, are repealed effective for sales and purchases occurring after June 30, 2001, except that the repeal of section 297A.61, subdivision 16, paragraph (d), is effective for sales and purchases occurring after July 31, 2001.

(b) Minnesota Statutes 2000, ~~sections~~ section 297A.62, subdivision 2, ~~and 297A.64, subdivision 1, are~~ is repealed effective for sales and purchases made after December 31, 2005.

(c) Minnesota Statutes 2000, section 297A.71, subdivision 15, is repealed effective for sales and purchases made after June 30, 2002.

(d) Minnesota Statutes 2000, section 289A.60, subdivision 15, is repealed effective for liabilities after January 1, 2003.

[EFFECTIVE DATE.] This section is effective the day following final enactment.

ARTICLE 4

MISCELLANEOUS

Section 1. Minnesota Statutes 2004, section 273.1384, subdivision 1, is amended to read:

Subdivision 1. [RESIDENTIAL HOMESTEAD MARKET VALUE CREDIT.] Each county auditor shall determine a homestead credit for each class 1a, 1b, 1c, and 2a homestead property within the county equal to 0.4 percent of the first $76,000 of market value of the property~~.--The-amount-of-homestead-credit-for-a-homestead may-not-exceed-$304-and-is-reduced-by~~ minus .09 percent of the market value in excess of $76,000. The credit amount may not be less than zero. In the case of an agricultural or resort homestead, only the market value of the house, garage, and immediately surrounding one acre of land is eligible in determining the property's homestead credit. In the case of a property which is classified as part homestead and part nonhomestead, (i) the credit shall apply only to the homestead portion of the property~~.~~, but (ii) if a portion of a property is classified as nonhomestead solely because not all the owners occupy the property, or solely because both spouses do not occupy the property, the credit amount shall be initially computed as if that nonhomestead portion were also in the homestead class and then prorated to the owner-occupant's percentage of ownership or prorated to one-half if both spouses do not occupy the property.

[EFFECTIVE DATE.] This section is effective for taxes payable in 2006 and thereafter.

Sec. 2. [APPROPRIATION TO DEPARTMENT OF REVENUE FOR COMPLIANCE ACTIVITIES.]

(a) $5,786,000 is appropriated from the general fund to the commissioner of revenue for fiscal year 2006 and $7,510,000 is appropriated from the general fund to the commissioner of revenue for fiscal year 2007.

(b) $5,096,000 the first year and $6,190,000 the second year are for additional activities to identify and collect tax liabilities from individuals and businesses that currently do not pay all taxes owed. This initiative is expected to result in new general fund revenues of $42,800,000 for the biennium ending June 30, 2007.

(c) The department must report to the chairs of the house Ways and Means and senate Finance Committees by March 1, 2006, and January 15, 2007, on the following performance indicators:

(1) the number of corporations noncompliant with the corporate tax system each year and the percentage and dollar amounts of valid tax liabilities collected;

(2) the number of businesses noncomplant with the sales and use tax system and the percentage and dollar amount of the valid tax liabilities collected; and

(3) the number of individual noncompliant cases resolved and the percentage and dollar amounts of valid tax liabilities collected.

The report must also identify base level expenditures and staff positions related to compliance and audit activities, including baseline information as of January 1, 2004. The information must be provided at the budget activity level.

(d) Of the amounts appropriated under paragraph (a), $690,000 the first year and $1,320,000 the second year are for additional activities to identify and collect tax liabilities from individuals and businesses that currently do not pay all taxes owed. This initiative is expected to result in new general revenues of $25,200,000 for the biennium ending June 30, 2007.

Sec. 3. [CITY AID PAYMENTS.]

In 2005 and subsequent years, market value credit reimbursements for each city payable under Minnesota Statutes, section 273.1384, are reduced by the dollar amount of the 2003 reduction in market value credit reimbursements for that city due to Laws 2003, First Special Session chapter 21, article 5, section 12. No city's market value credit reimbursements are reduced to less than zero under this section. To the extent sufficient information is available on each payment date, the commissioner shall pay the annual 2005 and subsequent year market value credit reimbursement amounts, after reduction under this section, to cities in equal installments on the dates specified in Minnesota Statutes, section 273.1384.

[EFFECTIVE DATE.] This section is effective the day following final enactment."

Delete the title and insert:

"A bill for an act relating to taxation; requiring withholding; ~~changing the definition of foreign operating corporations;~~ conforming with certain federal income tax changes; prohibiting state contracts be with certain vendors; providing for taxation of liquor and rented vehicles; modifying certain sales tax exemptions; defining "direct business" for purposes of insurance taxes; modifying the homestead market value credit; appropriating money; amending Minnesota Statutes 2004, sections 16C.03, by adding a subdivision; 273.1384, subdivision 1; 289A.20, subdivision 2; 290.01, subdivisions 6b, 19, 19a, 19b, 19c, 19d, 31; 290.06, subdivision 2c; 290.067, subdivision 2a; 290.091, subdivision 2; 290.92, by adding a subdivision; 290A.03, subdivisions 3, 15; 297A.68, subdivisions 2, 5; 297I.01, by adding a subdivision; Laws 2001, First Special Session chapter 5, article 12, section 95; proposing coding for new law in Minnesota Statutes, chapter 295."

Senate Counsel, Research, and Fiscal Analysis
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Jo Anne Zoff Sellner
Director

Senate
State of Minnesota

TO: Members of the Senate Tax Committee

FROM: Jo Anne Zoff Sellner, Senate Counsel (651/296-3803)

DATE: March 3, 2005

RE: Tax Proposal

The delete-everything amendment to S. F. No. 1209 contains the following provisions:

Article 1
Income and Corporate Franchise Taxes

Section 1 requires partnerships, S corporations, and trusts to pay Minnesota withholding tax on Minnesota source income on a quarterly basis. Current law allows these to be paid annually.

Section 2 defines a foreign operating corporation to require that it has 80 percent or more of its average of payroll and property outside of the United States. It requires that a minimum of $1,000,000 of payroll and $2,000,000 of property must be located outside of the United States.

Section 3 requires businesses that hire individual independent contractors to perform construction work in Minnesota to withhold and remit to Minnesota two percent of the amount they paid the independent contractors if the amount of the payment exceeds $600.00.

Article 2
Federal Update

This article selectively updates income tax law to incorporate changes enacted by Congress in the American Jobs Creation Act of 2004. This federal act contained numerous business provisions that limited business deductions, created new deductions, and was intended to close certain loopholes. See Pages 4 through 6 of the summary of the Governor's Tax Bill provided by the Department of Revenue for detail on the provisions that are incorporated by reference in this article.

Article 3
Sales, Use, and Special Taxes

Section 1 requires the Department of Administration and the legislature to cancel contracts for goods or services with any vendors who have not registered to collect sales or use tax on their taxable sites in Minnesota. It also bars future contracts with such vendors by state agencies or the legislature. The prohibition does not apply to the judicial branch or higher education system, and it may be waived if the vendor is the exclusive provider of the goods or services being purchased, or in an emergency, or when it is in the best interests of the state to do so.

Section 2 imposes a gross receipts tax at a rate of 2.5 percent on the gross receipts from retail liquor sales. This tax is intended to replace the additional 2.5 percent sales tax on alcoholic beverages that will terminate on December 31, 2005.

Section 3 provides that for purposes of the sales tax exemption for materials consumed in industrial production, industrial production will not include the transportation, transmission, or distribution of petroleum, liquified gas, natural gas, water or steam through pipes, or other means of transporting those products.

Section 4 provides that the sales tax exemption for purchases of capital equipment is also not available to machinery or equipment used in the transportation, transmission, or distribution of petroleum, liquified gas, natural gas, water or steam in or through pipes, or similar means of transporting those products.

Section 5 defines "direct business" for purposes of the insurance tax law to include, among other things, stop-loss insurance coverage.

Section 6 eliminates the 2001 repealer of the car rental tax that had been scheduled to go in effect after 2005.

Article 4
Miscellaneous

Section 1 changes the computation of homestead market credits for residences that are part homestead and part nonhomestead, for example, when one of the owners or spouse of an owner does not occupy the property as a homestead. This provision will prorate the credit for partial occupancies by owners.

Section 2 appropriates money to the Department of Revenue for compliance activities. $5,786,000 is appropriated for fiscal year 2006, and $7,510,000 is appropriated for fiscal year 2007. The two compliance initiatives that are funded out of this appropriation are expected to result in new general fund revenues of $48,800,000 and $25,200,000 for the biennium ending June 30, 2007. The department is required to report to the legislature regarding the number of corporation, business, and individual noncompliant cases that have been resolved, and the percentage and dollar amounts of the valid tax liabilities that have been collected under this initiative.

Section 3 extends the marked value credit reimbursement reductions that had occurred in 2003 for payments in 2005 and subsequent years.

JZS:dv

FORM 6A

COMMITTEE REPORT - *WITH* AMENDMENTS

Committee on Taxes

S.F. No. 1209

☐ Resolution

☐ Re-referred (from another committee)

Amendments: A-1 Delete All Amendment

Delete Section 2, Article 1 of amendment

Title change, page 39 of amendment

Committee recommendation:

☒ And when so amended the bill do pass. OR

☐ And when so amended the bill do pass and be placed on the Consent Calendar. OR

☐ And when so amended the bill do pass and be re-referred to the Committee on

____________ .

No recommendation: And when so amended the bill be
☐ (re-referred to the Committee on . OR

☐ (reported to the Senate).

March 3, 2005 (date of committee recommendation)

Senator Pogemiller from the Committee on Taxes, to which was referred

S.F. No. 1209: A bill for an act relating to taxes; regulating tax preparers; amending Minnesota Statutes 2004, sections 270.30, subdivisions 1, 5, 6, 8, by adding subdivisions; 289A.08, subdivision 16; 289A.60, subdivision 13; proposing coding for new law in Minnesota Statutes 2004, chapter 270.

Reports the same back with the recommendation that the bill be amended as follows:

Delete everything after the enacting clause and insert:

"ARTICLE 1

INCOME AND CORPORATE FRANCHISE TAXES

Section 1. Minnesota Statutes 2004, section 289A.20, subdivision 2, is amended to read:

Subd. 2. [WITHHOLDING FROM WAGES, ENTERTAINER WITHHOLDING, WITHHOLDING FROM PAYMENTS TO OUT-OF-STATE CONTRACTORS, AND WITHHOLDING BY PARTNERSHIPS AND SMALL BUSINESS CORPORATIONS.] (a) A tax required to be deducted and withheld during the quarterly period must be paid on or before the last day of the month following the close of the quarterly period, unless an earlier time for payment is provided. A tax required to be deducted and withheld from compensation of an entertainer and from a payment to an out-of-state contractor must be paid on or before the date the return for such tax must be filed under section 289A.18, subdivision 2. Taxes required to be deducted and withheld by partnerships ~~and~~, S corporations, and trusts must be paid on ~~or before the date the return must be filed under section 289A.18, subdivision 2~~ a quarterly basis as estimated taxes under section 289A.25 for partnerships and trusts and under section 289A.26 for S corporations.

(b) An employer who, during the previous quarter, withheld more than $1,500 of tax under section 290.92, subdivision 2a or 3, or 290.923, subdivision 2, must deposit tax withheld under those sections with the commissioner within the time allowed to deposit the employer's federal withheld employment taxes under Code of Federal Regulations, title 26, section 31.6302-1, as amended through December 31, 2001, without regard to the safe harbor or de minimis rules in subparagraph (f) or the one-day

2007.

Sec. 3. [CITY AID PAYMENTS.]

In 2005 and subsequent years, market value credit reimbursements for each city payable under Minnesota Statutes, section 273.1384, are reduced by the dollar amount of the 2003 reduction in market value credit reimbursements for that city due to Laws 2003, First Special Session chapter 21, article 5, section 12. No city's market value credit reimbursements are reduced to less than zero under this section. To the extent sufficient information is available on each payment date, the commissioner shall pay the annual 2005 and subsequent year market value credit reimbursement amounts, after reduction under this section, to cities in equal installments on the dates specified in Minnesota Statutes, section 273.1384.

[EFFECTIVE DATE.] This section is effective the day following final enactment."

Delete the title and insert:

"A bill for an act relating to taxation; requiring withholding; conforming with certain federal income tax changes; prohibiting state contracts be with certain vendors; providing for taxation of liquor and rented vehicles; modifying certain sales tax exemptions; defining "direct business" for purposes of insurance taxes; modifying the homestead market value credit; appropriating money; amending Minnesota Statutes 2004, sections 16C.03, by adding a subdivision; 273.1384, subdivision 1; 289A.20, subdivision 2; 290.01, subdivisions 6b, 19, 19a, 19b, 19c, 19d, 31; 290.06, subdivision 2c; 290.067, subdivision 2a; 290.091, subdivision 2; 290.92, by adding a subdivision; 290A.03, subdivisions 3, 15; 297A.68, subdivisions 2, 5; 297I.01, by adding a subdivision; Laws 2001, First Special Session chapter 5, article 12, section 95; proposing coding for new law in Minnesota Statutes, chapter 295."

And when so amended the bill do pass. Amendments adopted. Report adopted.

....
(Committee Chair)

March 3, 2005....................
(Date of Committee recommendation)

HANDOUT #1

Name	Market Value Credit Reduction
AFTON	47,917
ALBERTVILLE CITY OF	85,071
ANDOVER	470,108
APPLE VALLEY CITY OF	1,112,293
ARDEN HILLS	100,979
BAXTER CITY OF	112,083
BECKER CITY OF	59,143
BIRCHWOOD	15,042
BLAINE (JT)	78,528
BLOOMINGTON	1,696,959
BREEZY POINT CITY OF	62,107
BURNSVILLE CITY OF	1,305,009
CENTERVILLE	84,431
CHAMPLIN	76,097
CHANHASSEN (JT) CITY OF	298,734
CHICKAMAW BEACH CITY OF	1,100
COATES CITY OF	1,473
COHASSET CITY OF	51,748
CORCORAN	73,628
CROSSLAKE CITY OF	65,119
DAYTON (JT)	109,875
DEEPHAVEN	28,154
DELLWOOD	3,160
DENHAM CITY OF	278
EAGAN CITY OF	1,223,402
EAST BETHEL	90,096
EAST GULL LAKE CITY OF	9,299
EDEN PRAIRIE	843,982
EDINA	528,756
ELKO	6,761
EMILY CITY OF	16,504
FIFTY LAKES CITY OF	10,150
FORADA CITY OF	2,453
FOREST LAKE	56,264
FORT RIPLEY CITY OF	287
GARRISON CITY OF	2,125
GEM LAKE	5,459
GENOLA CITY OF	649
GOLDEN VALLEY	509,969
GRANT	29,456

Name	Market Value Credit Reduction
GREENFIELD	39,488
GREENWOOD	3,772
HAM LAKE	63,443
HANOVER (JT)	15,010
HUGO	146,765
INDEPENDENCE	61,468
INVER GROVE HEIGHTS CITY	364,334
LAKE ELMO	72,054
LAKE SHORE CITY OF	21,273
LAKELAND SHORES	4,017
LAKEVILLE CITY OF	656,230
LILYDALE CITY OF	12,020
LINO LAKES	389,081
LITTLE CANADA	102,019
LONG BEACH CITY OF	2,639
LONGVILLE CITY OF	4,986
MAHTOMEDI	53,858
MANHATTAN BEACH CITY OF	1,059
MAPLE GROVE	988,270
MAPLEWOOD	268,296
MARINE ON SAINT CROIX	15,475
MEDICINE LAKE	3,374
MEDINA	31,080
MENDOTA HEIGHTS CITY OF	201,359
MIESVILLE CITY OF	2,857
MINNETONKA BEACH CITY	3,135
MINNETONKA CITY OF	787,036
MINNETRISTA	54,913
MONTICELLO CITY OF	276,882
NEW MARKET	17,999
NISSWA CITY OF	52,041
NORTH OAKS	7,281
OAK PARK HEIGHTS	88,487
OAKDALE	91,256
ORONO	54,409
OTTERTAIL CITY OF	5,542
PINE SPRINGS	1,578
PLYMOUTH	737,392
PRIOR LAKE	365,406
RAMSEY	173,930

Name	Market Value Credit Reduction
RED WING CITY OF	393,196
REGAL CITY OF	47
ROGERS	113,075
ROSEMOUNT CITY OF	350,338
ROSEVILLE	576,589
RUTLEDGE CITY OF	461
SAVAGE	519,544
SHAKOPEE	560,263
SHOREVIEW	480,123
SHOREWOOD	85,166
SPRING LAKE PARK (JT)	7,819
ST ANTHONY (JT)	68,785
ST MARY'S POINT	4,290
ST MICHAEL CITY OF	138,087
SUNFISH LAKE CITY OF	1,191
TONKA BAY	11,877
TURTLE RIVER CITY OF	343
VADNAIS HEIGHTS	189,238
VICTORIA CITY OF	73,390
WAYZATA	39,250
WILTON CITY OF	56
WOODBURY	902,448
WOODLAND	1,177
TOTAL	20,032,915

S.F. XXXX 3-3-05 | 2005 Session | $'s in 000's

Revenue Portion
Structural Balance Bill
$'s relative to General Fund
+ numbers = revenue gain/savings
- numbers = revenue loss/expenditure

ITEM	FY 2006	FY 2007	FY 06-07	FY 2008	FY 2009	FY 08-09
Income Tax						
Federal Conformity--Partial	8,580.0	12,185.0	**20,765.0**	19,620.0	17,465.0	**37,085.0**
Withholding Tax/Contractors	2,000.0	2,000.0	**4,000.0**	2,000.0	2,000.0	**4,000.0**
Quarterly Withholding NR Part.and C's	14,200.0	900.0	**15,100.0**	950.0	1,000.0	**1,950.0**
~~FOCs~~	~~1,300.0~~	~~980.0~~	~~**2,280.0**~~	~~650.0~~	~~500.0~~	~~**1,150.0**~~
Sales Tax						
Alcoholic Beverage Tax	24,830.0	60,040.0	**84,870.0**	61,870.0	63,150.0	**125,020.0**
Gas Pipelines/Industrial Production	1,600.0	3,200.0	**4,800.0**	3,200.0	3,200.0	**6,400.0**
Rental Vehicles Surtax	4,740.0	14,580.0	**19,320.0**	15,300.0	16,090.0	**31,390.0**
Out of State Vendors	680.0	2,730.0	**3,410.0**	4,300.0	4,410.0	**8,710.0**
Property Tax						
Fractional Homesteads/MVHC	0.0	500.0	**500.0**	500.0	500.0	**1,000.0**
Make Permanent City MVC Reduction	19,300.0	19,000.0	**38,300.0**	18,700.0	18,400.0	**37,100.0**
Miscellaneous						
Recognize Tax Compliance Revenues	26,200.0	41,800.0	**68,000.0**	41,800.0	41,800.0	**83,600.0**
Compliance Appropriation	(5,786.0)	(7,510.0)	**(13,296.0)**	(7,510.0)	(7,510.0)	**(15,020.0)**
Insurance Gross Earnings						
Impose Premiums Tax on Stop Loss	1,400.0	3,700.0	**5,100.0**	4,500.0	5,400.0	**9,900.0**
Total General Fund Changes	**99,044.0**	**154,105.0**	**253,149.0**	**165,880.0**	**166,405.0**	**332,285.0**
G.F. Total as Percent of $466M Deficit Solution			**54.3%**	***of $466m***		
Other Funds:						
HCAF						
Premiums Tax on Insurance Stop Loss	800.0	2,300.0	**3,100.0**	2,700.0	3,300.0	**6,000.0**

ALN
Senate Counsel, Research and Fiscal Analysis

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LONGVILLE CITY OF	4,986
MAHTOMEDI	53,858
MANHATTAN BEACH CITY OF	1,059
MAPLE GROVE	988,270
MAPLEWOOD	268,296
MARINE ON SAINT CROIX	15,475
MEDICINE LAKE	3,374
MEDINA	31,080
MENDOTA HEIGHTS CITY OF	201,359
MIESVILLE CITY OF	2,857
MINNETONKA BEACH CITY	3,135
MINNETONKA CITY OF	787,036
MINNETRISTA	54,913
MONTICELLO CITY OF	276,882
NEW MARKET	17,999
NISSWA CITY OF	52,041
NORTH OAKS	7,281
OAK PARK HEIGHTS	88,487
OAKDALE	91,256
ORONO	54,409
OTTERTAIL CITY OF	5,542
PINE SPRINGS	1,578
PLYMOUTH	737,392
PRIOR LAKE	365,406
RAMSEY	173,930

Name	Market Value Credit Reduction
RED WING CITY OF	393,196
REGAL CITY OF	47
ROGERS	113,075
ROSEMOUNT CITY OF	350,338
ROSEVILLE	576,589
RUTLEDGE CITY OF	461
SAVAGE	519,544
SHAKOPEE	560,263
SHOREVIEW	480,123
SHOREWOOD	85,166
SPRING LAKE PARK (JT)	7,819
ST ANTHONY (JT)	68,785
ST MARY'S POINT	4,290
ST MICHAEL CITY OF	138,087
SUNFISH LAKE CITY OF	1,191
TONKA BAY	11,877
TURTLE RIVER CITY OF	343
VADNAIS HEIGHTS	189,238
VICTORIA CITY OF	73,390
WAYZATA	39,250
WILTON CITY OF	56
WOODBURY	902,448
WOODLAND	1,177
TOTAL	20,032,915