

#1

Local Government Aid and HACA 1998 through 2006

Aid Payable Year	<u>LGA</u>	<u>HACA</u>	<u>Total</u>	2002 Law Inflation <u>Total</u>
1998	365.7	195.8	561.5	561.5
1999	380.5	195.8	576.3	576.3
2000	391.4	200.0	591.4	591.4
2001	411.5	201.1	612.6	612.6
2002	565.0	0.0	565.0	565.0
2003	464.9	0.0	464.9	586.8
2004	437.3	0.0	437.3	607.9
2005	436.7	0.0	436.7	623.1
2006	436.6	0.0	436.6	654.2

DRAFT

Percent Change in Government Revenues in Real (i.e., inflation adjusted) Dollars Per Capita / Per Pupil based on data from February 2005 Price of Government Report

Inflation adjustment based on implicit price deflator for state & local government purchases (Feb. 2005 JPGSL)

Time Frame	Total State Personal Income Per Capita	Total State Revenue Per Capita*	Total State Revenue minus Transfers Per Capita*	Total School Revenue Per Pupil	Total City Revenue Per Capita	Total County Revenue Per Capita*
CY 1990 / FY 1991 to CY 2005 / FY 2006	23.8%	32.9%	38.9%	23.6%	4.2%	9.9%
CY 1991 / FY 1992 to CY 2005 / FY 2006	24.8%	27.7%	30.9%	21.8%	5.7%	3.8%
CY 1992 / FY 1993 to CY 2005 / FY 2006	20.4%	21.5%	20.7%	20.8%	2.5%	5.3%
CY 1993 / FY 1994 to CY 2005 / FY 2006	21.8%	16.6%	14.2%	17.8%	1.5%	2.8%
CY 1994 / FY 1995 to CY 2005 / FY 2006	17.7%	15.1%	13.7%	13.2%	2.9%	3.2%
CY 1995 / FY 1996 to CY 2005 / FY 2006	15.6%	12.7%	9.8%	12.9%	0.0%	8.3%
CY 1996 / FY 1997 to CY 2005 / FY 2006	10.7%	7.8%	2.3%	13.4%	-0.8%	5.8%
CY 1997 / FY 1998 to CY 2005 / FY 2006	7.7%	5.0%	0.0%	9.2%	-3.9%	3.8%
CY 1998 / FY 1999 to CY 2005 / FY 2006	1.7%	9.7%	11.3%	7.5%	-7.1%	4.5%
CY 1999 / FY 2000 to CY 2005 / FY 2006	0.7%	4.0%	5.1%	5.6%	-5.3%	4.7%
CY 2000 / FY 2001 to CY 2005 / FY 2006	-0.6%	3.6%	6.2%	3.0%	-5.9%	1.4%
CY 2001 / FY 2002 to CY 2005 / FY 2006	0.5%	3.4%	5.6%	1.4%	-4.3%	-1.5%
CY 2002 / FY 2003 to CY 2005 / FY 2006	1.5%	0.6%	11.9%	-2.1%	-2.5%	-2.5%
CY 2003 / FY 2004 to CY 2005 / FY 2006	2.3%	-0.7%	3.9%	-3.0%	-1.2%	2.1%
CY 2004 / FY 2005 to CY 2005 / FY 2006	0.9%	-2.2%	-2.2%	-0.9%	-0.5%	2.0%

*County and state revenues adjusted for state takeover of income maintenance, public defender, and court administration costs. The adjustment was made by subtracting an estimate of the takeover costs from county revenues and adding them to state revenues for the years prior to the takeovers.

Figure 18
Local Government Aids
General Fund Revenue and Expenditure Changes
(dollars in thousands)

Provision	FY 2002	FY 2003	FY 2004	FY 2005
Eliminate School HACA	0	9,319	5,973	3,944
90/10 metering adjustment	0	(1,347)		
Net cost for school HACA elimination	0	7,972	5,973	3,944
Eliminate City HACA	0	200,371	200,371	202,035
Eliminate Town HACA	0	29,290	29,270	29,343
Eliminate Special District HACA	0	28,713	28,713	28,713
Eliminate non-County mobile home HACA	0	5,177	5,172	5,177
90/10 metering adjustment	0	(392)	0	0
Net cost of mobile home HACA elim.	0	4,785	5,172	5,177
Eliminate Town LGA	0	3,869	3,966	4,065
Increase City LGA	0	(140,000)	(143,500)	(147,088)
LGA reform reserve account	0	(14,000)	(14,350)	(14,709)
Subtotal: Local Government Aids*	0	121,000	115,615	109,763

* Does not include school operating referendum and rental housing replacement aids (described above) to be paid to local governments as part of tax base reforms.

Payments to Cities

Overall, aid payments to cities statewide will decline by about \$60 million, or about 10 percent beginning in 2002 (FY 2003). The changes include the elimination of \$200 million in city-HACA payments and a \$140 million increase in LGA payments to cities, from about \$420 million under prior law to about \$560 million under new law. However, individual cities may experience aid changes of more or less than 10 percent due to both differences in the statewide distribution of the eliminated HACA payments relative to the distribution of LGA payments and due to changes made in the distribution formula for city LGA payments. See the House Research website for a city-by-city run of aid changes.¹¹

Changes to the LGA formula for cities include:

- the grand-fathered aid base of non-metropolitan cities with a population of more than 10,000 was increased by the lesser of \$60 per capita for population in excess of 5,000 or \$2.5 million—this increase is in addition to the maximum increase under the following two bullets;
- for 2002 only, to allow distribution of the increased LGA appropriation, the maximum increase allowed for cities other than cities of the first class is increased to 40 percent of the sum of their 2001 levy plus HACA; and
- for 2002 only, the maximum increase allowed to the first class cities of Minneapolis, St. Paul, and Duluth is equal to 102.5 percent of the sum of their 2001 LGA and HACA.

In addition, LGA aid bases were increased for four cities to recognize unique circumstances, including: permanent increases of \$50,000 each for Hopkins and Chaska beginning in 2002 (FY 2003); an increase

¹¹www.house.leg.state.mn.us/hrd/jssinfo/lga02fin.pdf

Tax Committee Expenditure Changes

Omnibus tax provisions enacted by Chapter 21, 2003 First Special Session, along with a few provisions enacted as part of Chapter 127, 2003 Regular Session, will reduce general fund expenditures by an estimated \$541.5 million for the FY 2004-05 biennium. FY 2004-05 expenditures reflect aids paid in CY 2003 and CY 2004. As summarized in Table 1, FY 2004-05 expenditures will decline to \$2.737 billion from a February 2003 forecast base of \$3.279 billion, including reductions for:

- **Cities** totaling \$333.0 million, including \$292.6 million for local government aid (LGA) payments and \$40.4 million for lower market value credit reimbursement payments.
- **Counties** totaling \$189.5 million, including reductions of \$65.0 million in CY 2003 and \$124.6 million in CY 2004. In addition, market value credit reimbursement payments will be reduced by \$612,000 for two counties in CY 2005.
- **Towns** totaling \$7.5 million, including reductions to market value credit reimbursement payments of \$3.0 million in CY 2003 and \$4.5 million in CY 2004. The CY 2003 reductions are equal to 2 percent of a town's CY 2003 certified levy; the CY 2004 reductions are equal to 3 percent of a town's CY 2003 certified levy.
- **Special Taxing Districts** totaling \$6.6 million, including reductions to market value credit reimbursement payments of \$2.8 million in CY 2003 and \$3.8 million in CY 2004. The CY 2003 reductions are equal to 1.5 percent of a district's CY 2003 certified levy; the CY 2004 reductions are equal to 2 percent of a district's CY 2003 certified levy.

Further, a variety of smaller changes (described more fully below) include,

expenditure reductions of:

- \$5.2 million for lower taxpayer interest payments;
- \$1.6 million for the elimination of attached machinery aid;
- \$100,000 for the elimination of the oil filter refund program;
- \$627,000 in FY 2005 resulting from a correction to a court takeover provision enacted in 2001

and expenditure increases of:

- \$1.5 million for the border city disparity reduction credit program;
- \$200,000 for taxpayer assistance grants;
- \$412,000 for the department of revenue to administer the bill provisions; and
- \$30,000 to extend the Indian Casino Aid program to one more county.

Finally, homeowner property tax refunds are expected to increase somewhat relative to baseline as a result of selected property tax exemptions and increases in property taxes resulting from local governments levying back of a portion local aid reductions.

City Aid Reductions and New Distribution Formula

Chapter 21 requires permanent reductions in city local government aid (LGA) as well as temporary reductions in city market value credit reimbursement payments to cities that receive little or no LGA.

LGA payments are reduced by \$122.0 million in CY 2003 aids (20.8 percent) and by \$170.6 million in CY 2004 (28.1 percent) relative to the prior law baseline. The resulting LGA funding level of \$437.1 million for CY 2004, compared to \$607.6 million under prior law, will carry forward as the permanent funding level in CY 2005 and thereafter. In addition, market value credit reimbursement payments are reduced by \$20.2 million in both CY 2003 and CY 2004.

CY 2003 LGA and market value credit cuts are based on across-the-board reductions equal to a set percentage of a city's CY 2003 certified levy plus certified state aids subject to certain caps. Reductions for CY 2004 reflect the implementation of a new LGA distribution formula, subject to minimum and maximum cut criteria designed to phase-in the new distribution formula over time. Reductions in CY 2003 apply first to LGA and then to market value credit reimbursement payments; CY 2004 market value credit cuts are equal to the CY 2003 market value credit reduction, up to a city's total amount of market value credits.

Calendar 2003/ FY 2004

In CY 2003, every city is subject to an aid reduction equal to 9.3 percent of the city's "levy plus aid revenue base" for CY 2003. The levy plus aid revenue base for a city is equal to its CY 2003 certified levy plus the sum of the aid amounts the city is certified to receive in CY 2003 (before cuts) for LGA, existing or new construction low-income housing aid, and taconite aid. Cities may also receive revenue from other sources—such as local option sales taxes, fines and charges, or federal assistance—and CY 2003 aid reductions are limited to the lesser of:

- 9.3 percent of levy plus aid; or
- 5.25 percent of the city's total revenues for CY 2000, as reported by the Office of State Auditor, for cities over 1,000 in population, or 3.7 percent of total revenues for cities under 1,000 in population and for cities with a three-year average growth in levy plus aid of less than two percent.

The levy plus aid cut amount is subtracted first from a city's LGA payment and then from its market value credit reimbursements. The overall aid cut further limited to the sum of the payments a city would otherwise receive under these two programs. The reductions enacted for 2003 follow the same methodology as proposed by the Governor, although the percentage reductions differ slightly due to more current information becoming available during the legislative session.

Governor/House Proposal of May 20th Compared to Governor's Original Recommendation

The May 20th proposal includes new revenues to support an additional \$384 million more spending than in the Governor's budget. The key item is the Health Impact Fee that is expected to raise \$380 million in the 2006-07 biennium. In addition, the Governor offered compromise positions on the \$75 million federal contingency reserve and other revenue items proposed by the Senate and House. These new revenue sources more than offset the unrealized gaming revenues of \$200 million.

The proposal includes \$241 million in additional spending for K-12 Education, an amount necessary to support 4.5% formula increases in FY 2006 and FY 2007. In addition, \$100 million is added to the Governor's proposed spending level for Health & Human Services.

Additional Resources:

Health Impact Fee	\$380 million
No federal reserve	75 million
Loss of gaming revenues	-200 million
Other Revenues	<u>134 million</u>
Total	\$389 million

Additional Spending:

K-12 Education	\$241 million
Health & Human Services	100 million
Other	<u>43 million</u>
Total	\$384 million

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
Governor/House May 20 Proposal
(\$ in millions)

2006-07						
	<u>Gov</u>	<u>House</u>	<u>Senate</u>	<u>Gov/House Proposal</u>	<u>Change from Gov</u>	<u>Notes</u>
Education Net	12,405	12,423	12,809	12,646	241	4.5 & 4.5% increase on the formula, plus reforms
Higher Education Net	2,759	2,735	2,794	2,761	2	Bill passed
Taxes Spending	2,888	2,835	3,135	2,888	0	Adds misc. House/Sen items;
Taxes - Tax Revenues	159	123	1,569	248	89	Streamlined Sales passed 5/23
Taxes - Non-Tax Revenues	200	52	0	0	(200)	Removes gaming revenue
Taxes Net	2,529	2,660	1,566	2,641	112	
Health & Human Svcs Spending	7,889	7,887	8,645	7,989	100	Increase target by \$100 M
Health & Human Svcs Rev	(273)	(249)	(25)	(273)	0	
Health Impact Fee	0	0	0	380	380	Based on 75 cent/pack offer
Health & Human Svcs Net	8,162	8,136	8,670	8,262	(280)	
Env, Agric, Econ Dev Spending	662	652	727	679	17	Last House/Gov offer
Env, Agric, Econ Dev Rev	32	32	23	32	0	
Env, Agric, Econ Dev Tax Rev	(25)	(25)	0	(25)	0	
Env, Agric, Econ Dev Net	655	645	704	672	17	
Transportation Spending	159	162	159	159	0	Open issue
Transportation Rev	12	15	17	12	0	
Transportation Net	147	147	142	147	0	
Public Safety Spending	1,667	1,681	1,681	1,685	18	
Public Safety Rev	11	26	38	38	27	
Public Safety Net	1,656	1,655	1,643	1,647	(9)	Bill passed
State Govt Spending	563	565	573	559	(4)	
State Govt Rev	73	90	82	91	18	Bill passed - includes compliance changes
State Govt Net	490	475	491	468	(22)	
Debt Service	771	781	781	781	10	Recognizes cost of larger bonding bill
Other	51	54	54	51	0	
Misc Bills	0	0	3	0	0	
Spending Totals	29,814	29,775	31,361	30,198	384	
Total Change in Revenues	189	64	1,704	503	314	
Base Revenues	29,711	29,711	29,711	29,711	0	
Total Revenue	29,900	29,775	31,415	30,214	314	
Change in Reserves	75	0	0	0	(75)	Assumes no Federal Contingency Reserve
Ending /Structural Balance	11	0	54	16	5	Money on bottom line

MINNESOTA · REVENUE

Memorandum

To: Senator Larry Pogemiller
Representative Phil Krinkie
Senator William Belanger
Senator Don Betzold
Senator Mee Moua
Senator Rod Skoe
Representative Ron Abrams
Representative Morrie Lanning
Representative Ann Lenczewski
Representative Dean Simpson

From: Jack Mansur  Assistant Commissioner of Tax Policy & External Relations

Date: May 20, 2005

We have identified a number of administrative, interpretive, and drafting issues with provisions in the House and Senate Tax bills. We have set them forth below, indicated Revenue's preferences, and suggested changes where applicable.

A) Special Taxes

Cigarette Sales Tax: The cigarette sales tax and floor stocks tax are in both the House and the Senate's tax bills. (House file 785, article 8, sections 20 and 30. Senate file 1683, article 8, sections 21 and 29). The House version sets the initial tax rate at 20 cents per pack of 20 cigarettes. The Senate bill provides for a tax of 21 cents per pack. The floor stocks tax would follow the same tax rates. In the House bill subsequent tax changes are effective on August 1st while under the House bill they are effective July 1. The House position represents a compromise reached between the industry and the department on the average price per pack.

Insurance Premiums Tax Compacts: Senate file 1683, article 8, §28 contains authority for the Commissioner of Revenue to enter insurance premiums tax compacts (reciprocal agreements to exempt each other's locally domiciled insurers from retaliatory taxation) and requires a report to be made to the House and Senate tax chairs before February 1, 2006. It is likely that states with higher overall burdens would be interested in entering compacts and that others would not. It is questionable how helpful this legislation would be and Revenue prefers the House version which contains no such provisions.

B) MNCare Tax

Blood Components Definition: SF 1683, article 12, §2, 3 contain the definition and exemption language. The House bill has no comparable provision. Without the proposed language, it is not clear whether wholesale drug distributors are subject to the tax on the sale of blood components and whether hospitals and other providers can take a deduction for the cost of these components. Revenue prefers the Senate version.

Tricare Program Exemption: The House bill contains this provision in article 8, §4. There is no comparable Senate provision. Revenue prefers the House version since this change is needed to be consistent with the FEHBA exemption.

MnCare Tax Pass-through Provisions: The House bill, article 8, § 5 deals with the pass-through of the tax. There is no comparable Senate provision. Revenue has no position on these provisions, but would like to point out the following items:

- While this provision is not enforced by DOR, it further complicates the question as to who the tax is imposed upon.
- It states that providers may itemize the tax on patient billings. This provision is already included (or implied) in §295.53, subd. 3 and is addressed in case law.
- The proposed language deals only with providers and not with hospitals or surgical centers. This provision further complicates the pass-through provision by including requirements that are already in the law (requiring third party purchasers to reimburse providers for the tax portion on co-payments and deductibles, and stating that nothing in the law prohibits pharmacies from passing on additional charges). The provision also requires third party purchasers to provide documentation about their means for compliance with the new requirements. This requirement may be hard to enforce.
- Pharmacy benefits managers are not defined anywhere in chapter 295 and the definition in the bill language, saying that a pharmacy benefits manager performs pharmacy benefits management should be further defined.
- Subdivision 2 introduces a new undefined entity (health plan company) and subd. 2(1) repeats what was said in subdivision 1. We could work with staff on language if this goes forward.

C) Sales Tax

Capital Equipment: The House (art. 7, §19) and Senate versions (SF1209, art. 3, §4; SF 1683, art. 3, §7) are the same except for the effective dates, the small business provision, and the exclusion for telecom equipment and wire, cable, fiber, poles for telecom services.

The House version contains the upfront capital equipment exemption for small businesses. Revenue is opposed to the exemption certificate requirement. This would be an administrative burden. We would recommend that the department add a provision to the existing sales tax exemption certificate providing for an upfront exemption for qualifying businesses that they could use at time of purchase. Any compliance concerns could be addressed on audit. There is a provision in the bill that the business must be located in the state to qualify but the law already requires that the equipment must be used in MN so they must have a business location within the state. Is this unnecessary language or is there some new requirement that the business headquarters has to be in the state? This needs to be clarified.

The effective date for the telecommunications exclusion in SF 1683, article 3, §7 is for a window of time and it is unclear why. During the window, this equipment is not capital equipment, but it is unclear what happens after the sunset - is it capital equipment then? This needs to be clarified.

The effective date for adding back the primary test for on-line data retrieval is day following final enactment. Revenue recommends this change be retroactive for sales made after June 30, 2001, since it was inadvertently omitted during the sales tax recodification process in 2000.

If the exemption certificate requirement for small businesses is eliminated in the House version - we could work with all provisions in both the House and Senate - with a fix to the telecommunications issue previously noted.

Baby Products: Found in the House bill in article 7, §15, this section deletes certain items from baby products that are excluded from the over-the-counter drug definition. There aren't any provisions in the Senate Bills. Revenue needs the House language in order to remain in compliance with the standard product definitions for purposes of the streamlined sales tax agreement.

Personal Rapid Transit System (construction exemption): Found in the House bill in article 7, §27, and SF1683, article 3, §15. SF 1683, Art. 3, Sec. 15 makes DOR responsible for cutting off the exemption when the cost reaches \$200,000. There is no language to direct the Department on how to administer the cap. Should it be prorated? First come, first served? This needs clarification. Revenue prefers the Senate Language (except for the cap language - which Revenue opposes) with the House effective date.

Seller's Permit or Alternate Statement: The House version in article 7, §§31, 32 has a limit of \$500 per event. SF 1683, article 3, §24 limit is \$500 in a calendar year. It is likely the end result is the same for both versions. Revenue prefers the Senate version because the language is clearer.

Local Taxes; Certain Cities of the First Class: Found in the House bill, article 7, §33, the tax is imposed at least 30 days after local approval. To be in compliance with the streamlined sales tax agreement, the Department needs at least 60 days to notify sellers, and then it is only to be effective on the first day of a calendar quarter.

Amendment to House Bill (local tax authority for cities with a population of 2,500 or more):

No comparable Senate provision. Any city with a population of 2,500 or more can impose a local tax without specific legislative authorization. Revenue has concerns about the administrative areas of this proposal. If a large number of cities were to come forward all at once, setting up the individual programs may be an issue for us. This bill requires the Commissioner to approve the cities local sales tax projects to ensure that certain requirements are met. Since the certification process would take place before the tax begins, we would not be compensated for the certification process unless given an appropriation or authority to recoup our costs through administration of the future sales tax collections.

Use Tax Returns for Individuals: Found in SF 1683, article 3, §3. No comparable House provision. Revenue opposes using the Individual Income Tax system to report use tax. The Income Tax system is designed to collect and process one tax type and adding a state and local use tax would come with considerable administrative costs. We believe the best solution to this

problem is complying with the Streamline Sales tax agreement and ultimately requiring remote sellers to collect the state and local sales tax. We prefer the House position.

Regionwide Public Safety Radio Communication System: Found in SF 1683, article 3, §11. No comparable House provision. Revenue opposes the cap language - see reasons under Personal Rapid Transit system, above. This language makes the Department responsible for cutting off the exemption when the cost reaches \$4,800,000. This would be an administrative burden for both the Department and the taxpayer. The Department is neutral on the rest of the provision.

Donated meals: Found in SF 1683, article 3, § 12, it is not clear what the exemption would encompass. The current statutes tax "prepared food, candy, and soft drinks" - not "meals." The term "prepared food, candy, and soft drinks" would be the appropriate terms to use. In addition, paper products sold along with prepared food are normally purchased exempt for resale. Is the intent that these products would not be subject to use tax, as well? Revenue's position is that this language is not really necessary because most of the items used to prepare the meals are exempt groceries. However, if this is accepted, we would need clarifying language.

Commuter Rail Material, Supplies and Equipment: Found in SF1683, article 3, §13. Revenue does not want the cap language - see reasons noted in Personal Rapid Transit system, above. This provision makes DOR responsible for cutting off the exemption when the cost reaches \$8,600,000. The Department is neutral on the rest of the provision.

DOR administration of Duluth Tax: Found in SF 1683, article 3, §34. This would require that the state first petition for membership as a party of the streamlined sales tax agreement and then be found to be out of compliance with SSTP solely because of the delayed effective date for administering Duluth's local option sales tax. Using the word "until" is ambiguous as it could be read that the 2001 Session Law amendment which gives administration of Duluth's tax to the state would only be effective "until" Minnesota is found to be out of compliance--when the opposite is intended.

The requirement imposes a time consuming and unnecessary process, since Minnesota is already aware that if the health care provisions (currently included in both the House and Senate bills) pass, it would be found to be in compliance except for the local administration of the Duluth tax. If the member states find that Minnesota is out of compliance on two issues, one of them being local administration of Duluth's tax, this proposal would necessitate that only one issue be solved at a time, and then wait to be found out of compliance on the administration of Duluth's tax. We oppose this provision especially given the rest of the streamline language in the House and Senate bills.

Exemptions (advertising/out-of-state delivery): Found in SF 1683, article 11, §17. No comparable House provision. Revenue originally proposed this language but it has since come to our attention that it conflicts with the streamlined sales tax agreement. We learned of this after the Senate had already passed its tax bill.

Event Souvenir Clothing Taxation: Found in SF 2206, article 3, §1. No comparable House provision. Revenue opposes this provision as it would put Minnesota out of compliance with the streamlined sales tax agreement.

Other Exempt Meals (for certain meals to be served to children): Found in SF 2206, article 3, §2. No comparable House provision. This will be difficult to administer - how will the nonprofit group and the Department know if the meals are being served to families with an income of 250 percent or less of federal poverty guidelines? Revenue opposes this provision due to administrative complexities.

Energy Efficient Product Exemption: Found in SF 2206, article 3, §10. This makes permanent the exemption for energy efficient products; however, this exemption was replaced with "Solar Energy Products" exemption in the House bill, article 7, §16, and in SF 2206, article 3, §5. Is this provision redundant? Clarification of the intent is needed.

D) Property Tax:

Tax Forfeited Land: Senate bill has been amended to commissioner of "natural resources" rather than commissioner of "finance" (SF 1683 art 10 § 39). The House bill art 4 § 34 does not contain this change. Revenue would like this change.

Utility/Railroad Value Appeals: SF 1683 art 7 § 26 amends the utility value appeals statute. The House bill has an improved version (art 4 § 24.) In the House bill, language is added in a new paragraph (b) stating that the commissioner shall also offer informal appeals. This is not necessary as Revenue already has that ability. Because the language is mandatory we would be obligated to also offer informal appeals. Revenue prefers the House version minus the mandatory appeal language.

Wind Energy Tax: SF 1683, art 4 § 27 Amends wind energy tax distributions (based on prior year's tax rates). Conflicts with SF 1683 art 10 § 17 (based on set percentages beginning in 2006). Revenue prefers the article 10 version (which is consistent with the House bill at article 4 § 16).

Property Tax Exemption: SF 1683 art 7 § 1 amends and expands property tax exemptions for "net proceeds tax" properties. Conflicts with SF 1683 art 10 § 8 (recites current law and is identical to the House bill art 4 § 7.) Revenue prefers the art 10/House bill version.

Certification of Low Income Rental Property: The House bill, article 2, §18 looks like a straight classification issue and allows assessors to value the property as they normally would. The main difference between the House and Senate is that in the Senate version, the property would be valued differently from other properties using a capitalized rents formula. The bill requires the commissioner of revenue to work with the housing finance agency to develop some joint criteria and the valuations would be certified by the HFA. Revenue prefers the House language because it imposes no additional duties on the counties or the department and keeps valuation decisions consistent among various types of property.

Utility Valuation Rules: In SF 1683, Article 4, §45, there is language prohibiting utility valuation rules from taking effect before the end of the regular legislative session of the calendar year following adoption. There was similar language in last year's bill. Revenue opposes this provision.

E) Individual Income Tax

New Income Tax Check-offs: In the House bill, article 5, §§ 1, 33-37 seven new check-offs are added on individual income tax returns only. This legislation requires all of the check-offs to be on a separate schedule for the M-1. This will add complexity to the income tax returns and property tax refunds and administrative costs to implementing these provisions.

Local Use Tax Information in the Income Tax Instructions: In the House bill, article 5, §5 mandates this information be placed in the income tax instructions. Currently, these instructions have a section on filing the Minnesota use tax return. The use tax return and instructions has the information on local use taxes. Revenue believes it is not necessary to require the expansion of the income tax instructions to include the local use tax information a second time, and opposes this change.

Composite Returns: The language in the House bill, article 5, §8 would require modifications on the composite return. Although this is the Department's language, it should be noted that the computation of tax in paragraph (j) should be changed to incorporate the new additions and new subtractions in Article 6 for 179 expense, U.S. manufacturing deduction and Medicare employer subsidies. Further, the effective date for this section should be changed to "Effective for tax years ending after 12-31-04."

Restriction on Taxpayers Fraudulently Claiming Refundable Credit: The House provision in article 5, §13 is the original Department proposal which barred a taxpayer from claiming in the future a refundable credit which the taxpayer either fraudulently claimed or claimed with reckless disregard. The taxpayer was barred for ten years for fraud or two years for reckless disregard. The bar applied to PTR, WFC, Dependent Care Credit, and Ed credit. The Senate provision in SF1683, article 9, §7 is a 50 percent monetary penalty on the amount of refund claimed fraudulently. The penalty applies to every refund claimed for most tax types and no matter what credit generates the refund. The Senate provision is limited to fraud. Revenue prefers the Senate version, because of the broader application, and believes the civil monetary penalty is a better match of the violation and the punishment than the future barring of credits the taxpayer would otherwise be entitled to claim. The Senate position is a compromise worked out between the department and the Legal Services Advocacy Group.

Individual Resident Definition: The House provision in article 5, §14 makes military personnel domiciled in Minnesota residents again which Revenue supports for administrative simplification purposes caused by activated Guard and Reservists being treated as a part-year resident under current law. This section also limits the factors the Department and courts can consider in determining where an individual intends to make his or her home for a permanent or indefinite period of time. It is Revenue's position that anything which indicates the intent or truthfulness of the taxpayer, should be taken into account in determining the domicile of the taxpayer. While no one factor is controlling in all residency investigations, any factor can be

crucial to a particular situation. Limiting the scope of the residency investigation will make it more difficult to ascertain the true intent of the taxpayer, leading to circumstances where the residency determination is contrary to the clear intent of the taxpayer if all evidence were available. Furthermore, besides their relevancy in making tax assessments, several of these factors have been successfully used in a number of criminal tax prosecutions. Revenue opposes the factor limitation.

Subtraction for Individuals: Revenue generally supports the new subtractions for the military in the House bill, article 1, §17 and can live with the new subtraction for organ donation expense. However, we believe the subtraction for the military in clause (12) should be limited to residents and the subtraction for the military in the House bill, article 6, § 4, clause (13) should be limited to nonresidents and should parallel the language in clause 12 other than the limit for services in Minnesota. Also, it would be helpful if both subtractions were in the same section.

The organ donation subtraction in section 13 should be changed by deleting the first clause of the language and the entire second sentence. This language makes the computation of the subtraction complicated and as written, will probably not limit the subtraction for anybody claiming the subtraction.

Dairy Investment Credit: With the addition of pasture expenses in the House bill, article 1, section 20, the pasture expense may conflict with the language confining qualified expenses to expenses that are capitalized for federal income tax purposes. Revenue opposes this provision unless it can be made clear what pasture-type expenses would be capitalized.

Dependent Care Credit and Working Family Credit: The House bill allows a reduction in the "income" used to phase-out these credits for the earned income of the lesser earning spouse. These changes will complicate the computation of these credits, especially in the case of the Working Family Credit which is currently only available to taxpayers who qualify for the federal earned income credit. Under this proposal, a number of taxpayers will qualify for the Minnesota credit and not for the federal credit. From a policy point of view, both of these credits are targeted to low-income families. It should not matter whether one or both of the spouses in the family earn the family's income when computing the credit. It should also be noted that the current Working Family Credit already confers an additional tax benefit to married couples claiming this credit. Finally, it should be noted that the change to household income in the dependent care credit has the unintended consequence of increasing the phase-out range of the education credit under section Minn. Stat. §290.0674, subd. 2(a). Revenue opposes this provision.

Education Credit Change to Household Based on Family Size: The House bill, article 1, §27 removes the per child cap on the education credit. Revenue supports this change. This section also changes the household income level where the credit starts phasing-out from the current \$33,500 to the greater of \$33,500 or 175% of the federal poverty level adjusted for "family size." Thus the phase-out level for taxpayers will vary and will complicate the computation of the credit. Further, the term "family" is not defined for either state or federal income tax purposes. For example, if a grandmother, father, mother and two children live together, does it matter if the

mother and father are not married, or if the grandmother is a dependent of either the mother or the father? Revenue opposes this change.

Estate Tax Changes: Revenue supports the provision in the House bill, article 1, §40 that does not allow a deduction for state estate tax since it simplifies the Minnesota estate tax computation. We are neutral about allowing a separate Minnesota marital deduction for a separate Minnesota qualified terminable interest election since although it complicates the Minnesota estate tax it does have a valid tax policy rationale.

Federal Update: This is in article 6 of the House bill and article 2 of SF 1683. Revenue prefers the House version because it picks up the *latest* federal changes.

F) JOBZ

The JOBZ provisions are found in the House bill, art. 9 and SF 2206, art. 6 §3, art. 5, §§22, 40. Revenue prefers the House provisions and the SF2206, art. 6 provision.

G) Miscellaneous:

Delegations: The Department's amendment to the Commissioner of Revenue's delegation of authority statute (§270.02, subd. 3) to allow the delegations of one commissioner to carry over to a successor commissioner is in the House bill (Art. 11, section 3) but not the Senate bill. The Senate bill has a general provision (Article 14, section 1) that accomplishes this result for all state agencies (15.06), but the specific amendment to the DOR statute is missing. Revenue prefers the House version because the Senate version appears to still require each new commissioner to file paperwork with the Secretary of State to merely reconfirm existing delegations. This is an administrative burden with no real value since the delegations are already on file.

Electronic Payments to the Department: SF 1683, article 13 contains the reduction in thresholds for mandated electronic payments to the department. The House bill has no comparable provisions. Revenue prefers the Senate language.

Statute of Limitations: This is an amendment to Minn. Stat. § 270.0603, subd. 3, that requires the Department of Revenue to distribute pamphlets explaining tax appeal and procedural rights to all taxpayers contacted regarding the assessment or collection of tax. Senate File 2206, Art, 6 §1 adds language stating that failure to receive the taxpayer rights pamphlet does not affect any time limits applicable to the assessment or collection action, including the time limit for filing a refund claim. This amendment is in response to the Minnesota Supreme Court case of MBNA America Bank vs. Commissioner of Revenue, decided April 7, 2005. In that case the court held that because the Department of Revenue failed to provide the taxpayer with an explanation of its claim for refund rights regarding a corporate tax assessment order, the one-year time limit in which the taxpayer could pay the order and file a refund claim never began to run. There is no similar provision in the House Bill. Revenue prefers the Senate version.

Property Tax Refund - rent refund percentage: This provision is in the House bill, article 2, §§29-32, 34. It changes the rent refund percentage calculation back to the way it was in the 1990's, using scheduled rents. The percentage would be calculated by dividing a hypothetical

rent ("scheduled rent") into the actual tax on the building. The "scheduled rent" is calculated by assuming that the entire building is rented for the entire year. Revenue opposes this method of computing refunds because it would make the program much more complicated for crp issuers, and more difficult for Revenue to administer.

Electronic CRP's: In SF1683, article 10, §42 the commissioner may require landlords to electronically submit their crp's. This only applies to crp issuers with more than 100 rental units. The Department proposal (HF657, article 2, section 43) phased in the requirement so as to ultimately apply to those owners issuing 10 crp's. The House has no similar position.



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May 20, 2005

TO: Senator Lawrence Pogemiller Representative Philip Krinkie
Senator William Belanger Representative Ron Abrams
Senator Don Betzold Representative Dean Simpson
Senator Mee Moua Representative Morrie Lanning
Senator Rod Skoe Representative Ann Lenczewski

FROM: Peggy Ingison *PSI*
Commissioner

RE: *Taconite Production Replacement Aid*

I understand that questions were raised during the Tax Conference Committee meeting last evening about the nature of the Taconite Production Replacement Aid shift that I included in the list of payment shifts made over the years. Let me explain the circumstances of the shift as you determine whether it is appropriately included on that list.

The Taconite Production Replacement Aid was created when the 2001 Tax Bill reduced the Taconite Production Tax and was intended to compensate for the loss of tax revenues experienced by Iron Range cities and counties. At the time, the aid was transferred to the IRRB once a year for distribution in the same manner as tax proceeds, also collected once a year, were distributed.

The 2003 Legislature modified MS 298.27 so that the Taconite Production Tax would be due in two equal payments (one in February and one in August). Because the aid distribution is tied to the collection and distribution of tax proceeds, the effect was to create two semi-annual aid payments to the IRRB. One half-year payment was made in FY 2004 with the other half of the FY 2004 payment shifted to August of FY 2005. The one-time shift between FY 2004 and FY 2005 totaled \$3.8 million.

Please feel free to call me if you have additional questions.

Letters from readers

Thank you for smoking

Changes we can expect if Gov. Tim Pawlenty's proposed school funding plan to increase the cigarette tax is passed:

➤ Schools post signs at their entrances proclaiming, "Tobacco use is sanctioned on these premises."

➤ Teachers who catch kids smoking in the bathrooms give them a thumbs up and thank them for reducing class sizes.

➤ Health curriculum is revised to reflect the new view that "Smoking is bad for your health but good for your education."

➤ Parent-teacher organizations replace book fairs and candy sales in favor of hawking cigarettes to fund new playground equipment.

➤ School boards vote to replace their current school mascots with Joe Camel.

Tracy Blodgett, Woodbury.

Truth in labeling?

Sen. Larry Pogemiller, DFL-Minneapolis, should drop his stubborn insistence on tax increases and call his revenue plan what it clearly is: a Republican Windfall User Fee.

Ben Weiss, St. Paul.

Try on one of these

I don't much approve of Gov. Tim Pawlenty, so I have mixed feelings about saving his bacon, but here goes.

To solve Minnesota's budget problems, restore the income tax as it was before then-Gov. Jesse Ventura and the Republicans cut it. Call the increased revenue a "civilization fee," or a "decency fee," or perhaps a "non-Mississippi fee."

Bryant Julstrom, St. Cloud.

Fringes everywhere

The Star Tribune "believes" "The U.S. Senate is preserved" (editorial, May 25), but it's evident the compromise deal didn't preserve the Constitution on the matter. What is clear is that before the deal, 40 members of the Senate were able to obstruct the president's judicial nominees. Now, with the much-lauded deal in place, just 14 senators can hold nominees hostage. Seems we're going in reverse.

The last time I checked Article II, Sec. 2 of the Constitution, the order is laid out: It's the president's job to nominate judges and then the Senate's job to vote them up or down — no prior consultation needed. And confirmation is accomplished with a majority vote, not the supermajority threshold we've seen imposed by Democratic filibusters.

Incidentally, it's not just us "fringe fundamentalists" who understand that. We're in good company with the seven freshmen Republican senators elected last November, the leadership of the House and Senate, and the president, also reelected last November.

Guess there's a lot of fringe types running around these days.

Sonja Swiatkiewicz, senior manager, media and constituent communications, Focus on the Family Action, Colorado Springs, Colo.

Funding stem cell research

Michael Kinsley gets it partly right and partly wrong in his May 25 commentary, "Bioethicists fiddle as patients keep dying."

He's right that Leon Kass is viewed by some as "the secretary of bioethics," but that's the problem. Prof. Kass has become more a mouthpiece for the Bush administration than a credible voice for thoughtful analysis of controversial ethical issues.

But Kinsley is wrong to blame all bioethicists for what he takes to be the wrongheaded views of a few. I'm guessing Kinsley would object if I wrote that it is the fault of all op-ed columnists that the current administration seems to be overly influenced by the views of a few conservative pundits.

There are many in bioethics who support far greater public investment in embryonic stem cell research with far fewer restrictions, and they have written and spoken out forcefully saying so. It's no surprise that these are not the voices represented on the current President's Council on Bioethics, which Kass chairs. Kinsley gets it right that it's his money and time that are on the line, but the blame lies with an administration that won't tolerate, let alone consider, dissenting views on stem cell research policy — a much bigger problem than the ethical noodling of Leon Kass and his cronies.

Jeffrey Kahn, Minneapolis; director, Center for Bioethics, University of Minnesota.

This debate should be understood the same way as abortion, i.e., a woman can have one, but I as a taxpayer do not have to pay for it.

Michael Kinsley's article sounds as if the feds are forbidding all stem cell research except for certain cell lines. The truth is that only federal tax money recipients are under these rules. Privately financed researchers are not. Shall I assume he is ignorant or is he assuming readers are?

Darlene Bahr, Eagan.

America's shame

I was filled with shame and anger upon reading your May 21 account of an Afghan detainee who was tortured and killed by U.S. interrogators.

It is now painfully evident that the U.S. government has condoned torture of prisoners in Guantánamo, Bagram and Abu Ghraib. Our military occupies the entirety of Afghanistan and Iraq, but would have us believe that it cannot control three prisons each roughly the size of the Metrodome.

These detainees are being beaten, tortured and killed in our name, by our government. Until we can extricate ourselves from this disaster, the Red Cross (with cameras) should be given complete access to the prisons.

John Deitering, Buffalo, Minn.

Back to school, Senator

I confess I don't lose any love on Sen. Norm Coleman, but watching the Senate subcommittee hearings last week I couldn't help but feel a bit sorry for him.

Let's face it: British Member of Parliament George Galloway has a black belt in down-in-the-trenches politics and is a master of the Queen's English — attributes that Coleman failed to exhibit during the hearings. And who invited whom into the ring?

What Coleman needs is a few sparring rounds with men of lesser talent before he tangles with Galloway again. Sticking to the same topic of profiteering on activities in Iraq, I suggest Dick Cheney and Halliburton.

Cliff Erickson, Minnetonka.

The coach's English

The Vikings' sale is completed and Mike Tice will remain their coach. I'd like the new owners to tell Tice to curb his vulgar language while on the sidelines during TV games.

If I, as a senior citizen, can read his lips I know younger sports fans can also. English contains a multitude of expressive words, in addition to the F word that is so dear to Tice and does not seem to help the Vikings win games:

Phyllis J. Gray, Bloomington.

Bring it to the floor

As important as any legislation under consideration in this special session is the amendment defining marriage as between a man and a woman. The moral fabric of our society is based upon this and the threats to this foundational institution are real. Minnesotans — by a margin of 63 percent — want to vote on this amendment, and it should be brought to the Senate floor for discussion and a decision to let the people vote.

Paul Kolars, St. Paul.

STARTRIB
5/27/05

	Agency/Program	Fund	Governor			House Rec			Senate Rec			Conference Committee			Conference Committee		
			FY06	FY07	FY06-07	FY06	FY07	FY06-07	FY06	FY07	FY06-07	FY06	FY07	FY06-07	FY08	FY09	FY08-09
239																	
240	Board of Veterinary Medicine																
241	Decision Items:																
242	Meth Manufacture From Animal Products Study								7		7		7		7		
243																	
244	Total Board of Veterinary Medicine								7		7		7				
257																	
258																	
259		TH	361	361	722	392	362	754	361	361	722	392	362	754	362	362	724
260		EN	49	49	98	49	49	98	49	49	98	49	49	98	194	194	388
261		SGSR	43,662	34,062	77,724	43,662	34,062	77,724	43,662	44,415	88,077	43,662	44,415	88,077	45,655	45,042	90,697
263		SR	5,423	5,422	10,845	5,634	5,530	11,164	6,823	6,822	13,645	5,634	5,493	11,127	5,326	5,326	10,652
264	TOTALS	GF	821,932	844,750	1,666,682	830,317	850,882	1,681,199	830,454	850,324	1,680,778	835,043	849,704	1,684,747	881,041	887,194	1,722,517
265			871,427	884,644	1,756,071	880,054	890,885	1,770,939	881,349	901,971	1,783,320	884,780	900,023	1,784,803	933,062	938,602	1,825,946
266	Revenue Adjustments - General Fund																
267	Increase in Crim Fine Surcharge by \$10 (Sen -\$12)	GF	4,900	6,500	11,400	4,900	6,500	11,400	5,880	7,800	13,680	5,880	7,800	13,680	7,800	7,800	15,600
268	Criminal Justice Special Project Account to GF	GF				1,500		1,500	1,500		1,500	1,500		1,500			
269	Real Estate Recording Fee Increase (H-\$4 S-\$6.50)	GF				5,877	5,923	11,800	9,550	9,630	19,180	9,550	9,630	19,180	9,408	9,349	18,757
270	Traffic Escorts - License Fee	GF				83	208	291							0		
271	Interfering with Ambulance - Fine/Surcharge Revenue	GF				78	104	182							0		
272	POST Bd Reduction in GF for their increase in SR	GF				(211)	(108)	(319)				(211)	(71)	(282)	(71)	(71)	(142)
273	Increase in Parking Surcharge (from \$3 to \$4)	GF				500	600	1,100	500	600	1,100	500	600	1,100	600	600	1,200
274	Civil Court Filing Fee Increase by \$5	GF							545	594	1,139	545	594	1,139	594	594	1,188
275	Liquor Wholesale/Manu License Fee Increases	GF							757	757	1,514	757	757	1,514	757	757	1,514
276	Total Revenue Adjustments	GF	4,900	6,500	11,400	12,727	13,227	25,954	18,732	19,381	38,113	18,521	19,310	37,831	19,088	19,029	38,117
277																	
278	Totals For General Fund after Adjustments	GF	817,032	838,250	1,655,282	817,590	837,655	1,655,245	811,722	830,943	1,642,865	816,522	830,394	1,646,916	861,953	868,165	1,684,400
279																	
280	Target							1,655,282			1,655,282			1,646,916			
281	Difference							(37)			(12,617)						
282																	
283	Revenue Adjustments - Other Funds																
284	Gas Theft-Suspend Drivers License	TH				24	24	48				24	24	48	24	24	48
285	Increase in 911 Fee	SGSR	17,050	6,832	23,882	17,050	6,832	23,882	17,050	17,080	34,130	17,050	17,080	34,130	16,873	16,631	33,504
286																	
287	Other Statutory Fee Increases																
288	Criminal Justice Data Network Fee Continuation	SR	75	75	150	75	75	150									
289	Fire Marshall - Inspection of Hotel/Motel/Resort Fee	SR	240	240	480												
291	Non DWI Reinstatement Fees (2) - POST	SR	763	832	1,595	763	832	1,595	763	832	1,595	763	832	1,595	832	832	1,664
292	Ramsey County \$1 Surcharge Increase	SR				92	110	202				92	110	202	92	110	202
293	Drivers' License Renewal Surcharge Increase by \$1	SR							1,400	1,400	2,800						
294																	
295	Total Statutory Fee Increases		1,078	1,147	2,225	930	1,017	1,947	2,163	2,232	4,395	855	942	1,797	924	942	1,866
296																	
297																	