ARTICLE ..

INTERNATIONAL ECONOMIC DEVELOPMENT ZONE

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

Subd. 69. [INTERNATIONAL ECONOMIC DEVELOPMENT ZONE PROPERTY.] (a) Improvements to real property, and personal property, classified under section 273.13, subdivision 24, and located within an 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 for property taxes assessed in 2007, payable in 2008, and thereafter.

Sec. 2. Minnesota Statutes 2004, section 290.06, is amended by adding a subdivision to read:

Subd. 33. [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 469.325 against the tax imposed by this chapter.

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

Sec. 3. 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 an 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 an 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) This subdivision applies to sales made during the period provided under section 469.324, subdivision 2, and, except as provided in paragraph (e), clause (2), after the business signs the business subsidy agreement required under chapter 469 and before the end of the duration of the zone.

(e) For purchases made:

(1) before July 1, 2007; or

(2) after June 30, 2007, for improvements to property to be occupied by a business that has not signed a business subsidy agreement at the time of the purchase, 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 in fiscal year 2008.

The taxpayer must attach to the claim for refund provided under clause (2) information sufficient for the commissioner to be able to determine that the improvements are being occupied by a business that has signed a business subsidy agreement.

[EFFECTIVE DATE.] This section is effective for sales after June 30, 2006.

Sec. 4. [469.321] [DEFINITIONS.]

Subdivision 1. [SCOPE.] For purposes of sections 469.321 to 469.327, 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 81b, 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, and includes any other political subdivisions that enter into the authority after its creation, as well as the county in which the zone is located. Notwithstanding Minnesota Statutes, section 471.59, the members of the authority are not required to have separate authority to establish or operate a foreign trade zone.

Subd. 4. [INTERNATIONAL ECONOMIC DEVELOPMENT 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.] "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.

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. [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.

Sec. 5. [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. 6. [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 a contiguous area of not less than 500 acres and not more than 1,000 acres in size. Unless the study required under section 13 concludes that the state would benefit from having more than one international economic development zone, only one zone may be designated.

(b) In making the designation, the foreign trade zone authority, in consultation with the Minnesota Department of Transportation 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. 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) Final zone designation must be made by June 30, 2006.

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

Sec. 7. [469.323] [FOREIGN TRADE ZONE AUTHORITY POWERS.]

Subdivision 1. [DEVELOPMENT OF REGIONAL DISTRIBUTION CENTER.] The foreign trade zone authority is responsible for creating and implementing 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 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 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 may exercise all powers granted to a city by sections 469.048 to 469.068 within the area of the international economic development zone, except it may not impose or request imposition of a property tax levy under section 469.053 by any city.

Subd. 4. [BUSINESS SUBSIDY LAW.] Tax exemptions, job credits, and tax increment financing provided under this section are business subsidies and the foreign trade zone authority is the local government agency 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. 8. [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 qualify for:

(1) exemption from the property tax as provided in section 272.02, subdivision 69;

(2) 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; and

(3) the jobs credit allowed under section 469.32~~7~~5.

Subd. 2. [DURATION.] (a) Except as provided in paragraph (b), the tax incentives described in subdivision 1, clauses (1) and (3), are available for no more than 12 consecutive taxable years for any taxpayer that claims them. The tax incentives described in subdivision 1, clause (2), are available for each taxpayer that claims them for taxes otherwise payable on transactions during a period of 12 years from the date when the first exemption is claimed by that taxpayer under each exemption. No exemptions described in subdivision 1, clauses (1) to (3), are available after December 31, 2020.

(b) For taxpayers that are freight forwarders, the durations provided under paragraph (a) are reduced to six years.

Sec. 9. [469.325] [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 prior to the calendar year in which the zone designation took effect.

(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 $70,000.

<u>(f) "Zone payroll factor" 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:</u>

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

<u>(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.</u>

<u>Subd. 3.</u> [INFLATION ADJUSTMENT.] <u>For taxable years beginning after December 31, 2006, the dollar amounts in subdivision 1, clause (2), and subdivision 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.</u>

<u>Subd. 4.</u> [REFUNDABLE.] <u>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.</u>

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

[EFFECTIVE DATE.] <u>This section is effective for taxable years beginning after December 31, 2005.</u>

Sec. 10. [469.326] [REPAYMENT OF TAX BENEFITS.]

<u>Subdivision 1.</u> [REPAYMENT OBLIGATION.] <u>A person must repay the amount of the tax reductions and refundable credits received under section 469.324, subdivision 1, clauses (1) to (3), during the two years immediately before it ceased to operate in the zone, if the person ceased to operate its facility located within the zone or otherwise ceases to be or is not a qualified business.</u>

Subd. 2. [DISPOSITION OF REPAYMENT.] The repayment must be paid to the state to the extent it represents a state 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.

Subd. 3. [REPAYMENT PROCEDURES.] (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 allowed under section 469.324.

(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.

(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 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 (c) 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.

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

Sec. 11. [469.327] [ADDITIONAL BENEFITS CONTINGENT ON JOBZ DETERMINATIONS.]

Notwithstanding section 469.312, subdivision 3, the governor may designate the international economic development zone as a job opportunity building zone if the governor reports to the tax committees of the senate and the house of representatives the following information:

(1) the estimated cost of providing the additional tax incentives provided under sections 469.310 to 469.320 to the international economic development zone; and

(2) the estimated cost of tax expenditures projected to have been obligated for all job opportunity building zone projects that have been approved before June 1, 2005.

If the zone is designated under this section, the additional tax incentives provided under sections 469.310 to 469.320 would be available only to qualified businesses.

Sec. 12. [GRANTS TO QUALIFYING BUSINESSES.]

$....... is appropriated from the general fund to the commissioner of employment and economic development to be distributed to the foreign trade zone authority to provide grants to qualified businesses as determined by the authority, subject to Minnesota Statutes, sections 116J.993 to 116J.995, to provide incentives for the businesses to locate their operations in an international economic development zone.

Sec. 13. [DEPARTMENT OF EMPLOYMENT AND ECONOMIC DEVELOPMENT STUDY; INTERNATIONAL AIR FREIGHT.]

The commissioner of employment and economic development must study and analyze the issue of whether the state would benefit from more than one international economic development zone as defined in Minnesota Statutes, section 469.321. The commissioner shall solicit input on the issue from businesses, communities, and economic development organizations. The commissioner must report the results of the study and analysis to the committees of the legislature having jurisdiction over economic development issues by December 1, 2005, along with any legislative recommendations.

#1

Major Differences between House and Senate on Tax Shelters:

Provision	House	Senate	Alternative/Option
Commissioner's authority to bring equitable actions	House allows commissioner to bring action to enjoin promotion of tax shelters (following similar federal provision)	No provision	
Look-back period	6 years	8½ years	Allow the greater of the House or the federal statute of limitations for tax shelters – i.e., for listed transactions, one year after the earlier of when (1) the IRS (DOR for state purposes) is given the required disclosure information or (2) a material advisor provides the list maintenance information to DOR. This would permanently toll the statute until the required disclosure is made, but would not open up closed tax years.
Definition of tax shelters	House is limited to I.R.S. defined shelters for purposes of federal tax	Senate allows DOR to designate Minnesota shelters	
Additional penalties	See separate chart on next page		
Authority to waive tax shelter penalties	Only commissioner may waive; no waiver for listed tax shelters	Senate follows current practice for other types of penalties.	Adopt language that parallels new federal rules, rather than California. See chart on next page for details.
Revenue differences			Ask DOF/DOR to resolve.
Treatment of participants in I.R.S. Son of Boss Settlement Initiative under VCI	Neither bill contains special provisions for this, but programs in other states (Illinois and California) excluded participants in the early IRS offshore shelter program. Son of Boss IRS program is now closed. Should these participants get full penalty waiver, even though they paid federal penalties?		Allow participation in the VCI under special terms comparable to the IRS settlement initiative – i.e., partial, not full, abatement of penalties.

Comparison of Penalty Provisions under House and Senate Tax Shelter Provisions					
Penalty type	**Federal**	**Minnesota**	**House**	**Senate**	**Options/Alternatives**
Substantial Understatement of Liability	I.R.C. § 6662 (accuracy related penalty): Special rule provides that the exception to the penalty for (1) "substantial authority" and (2) if the position is adequately disclosed and there is a reasonable basis for the tax treatment, do not apply to tax shelters.	Minn. Stat. § 289A.60, subd. 4, follows the special federal rule for tax shelters, but applies it to shelters the principal purpose of which is avoid state tax. If the update for chapter 289A is enacted, the changes in the American Jobs Creation Act for tax shelter rules will apply for Minnesota purposes. Federal law has lower thresholds for corporate understatements than Minnesota. Exceptions to the penalty are broader than under federal law. Federal law requires both disclosure and "reasonable cause," while Minnesota grants exception for disclosure alone.	House bill reduces the threshold for corporate understatements if the commissioner has contacted the taxpayer regarding a tax shelter (as defined under federal law) from 20% to the *lesser* of 10% or $5 million in tax. Federal law sets this threshold at $10 million. An exception (similar to the federal rule for individuals) is provided for all taxpayers who are contacted by the commissioner regarding a tax shelter, if the taxpayer had a reasonable belief that it was the proper treatment or the item was disclosed.	No provision	Modify the regular understatement penalty to parallel the federal rules – i.e., this would increase the $5 million threshold under the House bill to $10 million for corporations, eliminate the need for the commissioner to contact the taxpayer to trigger the lower threshold, and would require reasonable cause in addition to disclosure to satisfy the exception. It would also disqualify positions as not having "substantial authority" if the position is on a list published by the IRS.
Reportable transaction understatement	I.R.C. § 6662A imposes an understatement penalty for reportable transactions. This penalty is *in lieu* of the regular understatement penalty. The penalty is 20% of the understatement increasing to 30% if the position is not disclosed. No reasonable cause exception applies, unlike	No provision	Imposes 20 percent penalty on reportable transaction understatements that is somewhat similar to the federal penalty, but does not provide for increases in the rate to 30%. It is *in addition to* not in lieu of the basic understatement penalty. Thus, the two penalties in combination provide a 40% penalty	No provision	Adopt a reportable transaction understatement penalty that follows the federal rules.

Comparison of Penalty Provisions under House and Senate Tax Shelter Provisions					
Penalty type	**Federal**	**Minnesota**	**House**	**Senate**	**Options/Alternatives**
	the regular understatement penalty.		(compared with 20% or 30% under federal law).		
Penalty for filing frivolous return	I.R.C. § 6702 imposes a $500 penalty for filing a return that takes a frivolous position.	Minn. Stat. § 289A.60, subd. 7, imposes a penalty for filing a return that takes frivolous position equal to the greater of $1,000 or 25 percent of the tax.	The House bill increases the minimum penalty from $1,000 to $5,000 for filing a frivolous return, if the commissioner contacted the taxpayer regarding use of a tax shelter.	No provision	U.S. Senate passed provision similar to House bill. It did not survive the conference committee on the American Jobs Creation Act. If goal is to parallel federal law, the House provision could be dropped.
Penalty for promoting abusive shelters	I.R.C. § 6700 applies penalty to organizing or selling abusive tax shelters. Penalty is the *lesser* of $1,000 or 100% of the gross income from the activity. This penalty applies to *each* activity, so would likely apply to each investor a shelter is sold to. If the promoter has reason to know the deduction, credit, etc is false or fraudulent as to a material matter, the penalty increases to 50 percent of the gross income.	Minnesota follows the federal penalty, except the penalty is the *greater* of $1,000 or 20% of the gross income from the activity. Minnesota does not apply $1,000 amount to each activity, but overall. There is no provision to increase the rate to 50%.	The House bill raises the 20% penalty rate to 50% in all cases, not just those that meet the federal standard.	No provision	Provide for an increase in the penalty rate to 50% only in situations where the federal penalty rate would also be 50%.
Aiding and abetting understating of tax liability	I.R.C. § 6701 imposes a penalty on assisting in document preparation with knowledge or reason to know that it will result in understatement of tax liability. Penalty is $1,000 for individual	No provision	The House bill follows the federal penalty.	No provision	Adopt House provision to follow federal regime.

Comparison of Penalty Provisions under House and Senate Tax Shelter Provisions					
Penalty type	**Federal**	**Minnesota**	**House**	**Senate**	**Options/Alternatives**
	taxpayers and $10,000 for corporations.				
Failure to register tax shelters – promoters	I.R.C. § 6707(a) imposes a penalty equal to (1) $50,000 for failure to register a tax shelter or (2) for listed shelters, $200,000 or 50% of the gross income, if greater. This increases to 75% for intentional disregard.	No penalty – no registration requirement applies under Minnesota law.	The House bill imposes a $15,000 penalty. If the shelter is a listed shelter, this increases to the greater of (1) $100,000 or (2) 50% of the gross income of the shelter provider (75% for intentional failures).	The Senate bill is similar to House. A $10,000 penalty also applies for failure to report a Minnesota tax shelter.	Adopt penalty that follows federal law – i.e., increasing the minimums to $50,000 (from $15,000) and $200,000 (from $100,000 in both bills).
Failure to disclose reportable transactions by taxpayer	I.R.C. § 6707A imposes a penalty for failure to disclose reportable transactions of (1) $10,000 for natural person or (2) $50,000 in other cases. These amounts rise to $100,000 and $200,000 for listed transactions.	No penalty – no registration or disclosure requirement applies under Minnesota law.	House bill imposes a $100 penalty for each failure and $250 for each failure to provide number on tax return and a $15,000 penalty ($30,000 for listed shelters) for failure to report reportable transactions.	No provision	Adopt penalty that follows the federal penalty; drop $100 and $250 penalties in House bill.
Failure to provide investor lists	I.R.C. § 6708 imposes a penalty for failure to maintain and provide list of investors to IRS of $10,000 per day after the 20th day.	No penalty – no list maintenance requirement applies under Minnesota law.	House bill follows federal law, but also imposes a higher penalty on listed shelters equal to the greater of (1) $100,000 or (2) 50% of the gross income from the activity.	Senate bill similar to House bill. Senate also imposes penalties for failing to report and maintain and provide information. These penalties are the greater of $100,000 or 50% (75% for intentional failure) of gross income. A $15,000 penalty applies for failure to provide investor lists.	Adopt lesser penalty following federal law.
100% interest penalty	No provision	No provision	Imposes a penalty on taxpayer contacted by the commissioner regarding potentially abusive tax shelter equal to 100% of	No provision	Drop – this penalty is modeled on California and Illinois provisions, but has no parallel in federal law.

Comparison of Penalty Provisions under House and Senate Tax Shelter Provisions					
Penalty type	**Federal**	**Minnesota**	**House**	**Senate**	**Options/Alternatives**
			the interest payable on the unpaid tax.		
150% interest penalty	No provision	No provision	House bill applies 150% interest penalty to amended returns filed after 12/31/2005	No provision	Drop – this penalty is modeled on California and Illinois provisions, but has no parallel in federal law.
Limitation on abatement authority	I.R.C. § 6707A(d) prohibits rescission of certain tax shelter penalties related to listed shelter and requires a finding that rescission would promote tax compliance in other cases. These findings are not subject to judicial review. These limits apply to the penalties on promoters and taxpayers for failure to disclose reportable transactions.	No provision	Only commissioner (not subordinate) can decide to abate. Abatements not permitted for listed shelters. Abatements must satisfy four criteria: (1) violator has history of complying; (2) violation was unintentional; (3) imposing penalty would be inequitable; and (4) abating would promote compliance. Decision to abate is not subject to administrative or judicial review.	No provision	Adopt federal standards and limit to same two penalties that apply under federal law.
Failure to participate in VCI	No provision	No provision	No provision	200% of regular penalties apply to taxpayers with tax shelters who decline to participate in VCI.	

#2

Tax Shelter Penalties Comparison					
	Minnesota	**House**	**California**	**Illinois**	**New York**
	Current Law				
Taxpayer Penalties					
Substantial Understatment	Same penalty. 10% thresshold.	20% of unpaid tax. Reduces thresshold for understatement for corporations if commissioner has contacted t/p, from 10% to lesser of 10% or $5 million in tax. Exception for reasonable belief that treatement was more likely than not acceptable or if the item was disclosed.	If contacted by FTB: 20% if adequately disclosed 30% if not disclosed. 40% if transaction lacks economic substance.	30% if not disclosed, otherwise 20%.	10% if no substantial authority If disclosed, 20% of amount related to reportable transaction or listed transaction. 30% if not disclosed. Exception if item was disclosed or more likely than not belief.
Frivolous Return	Greater of $1000 or 25% of tax.	Greater of $5000 or 25% of tax if contacted by the commissioner. Otherwise greater of $1000 or 25% of tax.	$5000 - increased from $500	$500 - no changes for tax shelters	$500 - no changes for tax shelters
Failure to Provide Tax Shelter Registration Number on Return		$250	$250		

Failure to Report Reportable Transaction		$15,000 for reportable transaction. $30,000 for listed transaction. Applies only to hight net worth individuals and large entities.	$15,000 for reportable transaction. $30,000 for listed transaction.	See substantial underpayment penalty. Failure to disclose adds 10% to penalty.	Individuals: $10,000 for reportable transaction. $25,000 for listed transaction. Corporations: $20,000 for reportable, $50,000 for listed.
Interest Penalty		100% if contacted by the commissioner. 50% if not contacted.	100% if contacted by FTB. 50% if not contacted.	If contacted by IRS or Department, 100% interest penalty. 50% if not contacted.	
Material Advisor Penalties					
Promotion of Abusive Shelters		Greater of $1000 or 20% of gross income derived. (overall sales, not each activity)	50% of gross income derived.	Greater of $10,000 or 50% of gross income.	50% of gross income derived.
Aiding and Abetting Understating of Tax		$1000 for individual returns, $10,000 for corporate.	$1000 for taxpayers that have been contacted by the FTB. $5,000 if willful, reckless or intentional. Abatement requires reasonable basis for position.		Not to exceed $5000. No special language for shelters.

Failure to Register Tax Shelters or to Report Reportable Transactions.		$15,000 for reportable transaction. Greater of $100,000 or 50% of gross income (75% for intentional disregard) for listed transactions.	Reportable transactions - $15,000. Listed transactions - greater of $100,000 or 50% of gross income (75% for intentional disregard).	Reportable transactions - $15,000. Listed transactions - $100,000.	Individual Clients: $20,000 for reportable transaction. Greater of $50,000 or 50% of gross income for listed transaction. (75% if there in intentional failure.) Corporate client: Greater of 50% of gross income or $50,000, going to 75% if there is intentional failure.
Failure to Supply Tax Shelter Registration Number to Investors		$100 for each failure.	$100 for each failure.		
Failure to Provide Investor Lists		$10,000 per day after 20 days. For listed transactions, greater of $100,000 or 50% of gross income derived.	$10,000 per day after 20 days. If related to listed transaction, greater of $100,000 or 50% of gross income (75% for intentional disregard).	Reportable transactions - $15,000. Listed transactions - $100,000.	$10,000 per day after 20 days.
Miscellaneous Provisions					
State Tax Shelter Language?		No (Senate version - yes)	Yes	No	Yes
Statute of Limitations		6 years (8 1/2 in Senate version)	8 years	6 years	6 years
VCI Collections				$135 million	

Other		Civil action to enjoin promoter is available.	Civil action to enjoin promoter is available.	Other normal penalties are doubled. This means a 100% penalty for fraud and a 40% penalty for negligence.	

To: Sen. Pogemiller

#3

Dakota COUNTY

County Administration

Dakota County
Administration Center
1590 Highway 55
Hastings, MN 55033-2372

651.438.4418
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June 7, 2005

The Honorable Mike McGinn
Minnesota State Senate, District 38
G-19 State Office Building
100 Rev. Dr. Martin Luther King Jr. Blvd.
St. Paul, MN 55155

Dear Senator McGinn:

The construction of the Dakota County 800 MHz Radio Subsystem is in the final stages of design. The cost estimates for construction of the system are estimated at $9.7 - $11 million in equipment costs. The cost forecasts that have been shared with the Metro Radio Board and the Finance Committee of the State Radio Board all are exclusive of any sales tax, based on the fact that the construction costs for other portions of the metro system have been subject to the sales tax exemption. Most recently, this has benefited the subsystem construction in both Anoka and Ramsey Counties. Continuation of the exemption is under consideration in the Tax Working Group.

A repeal of the sales tax exemption for 800 MHz radio equipment would increase the cost of the Dakota County subsystem by approximately $650,000. Additionally, there would be a similar budget impact upon the local communities that need to buy subscriber radios. In Dakota County, the needs would be 1,900 radios at a cost of $2,800 per radio. This additional cost of $5.32 million for radios would add an additional $345,800 in subscriber radio sales tax.

We urge you and your colleagues in the Legislature to remove the August 1, 2005 sunset for the sales tax exemption for 800 MHz equipment purchased for the metropolitan area and to expand the coverage of this exemption statewide (or, at least to the geographic area covered by the third phase of the build-out of the 800 MHz system). **Please share our position with your colleagues on the Tax Working Group.** Anoka, Carver, and Hennepin Counties and cities have all enjoyed the financial benefits of the sales tax exemption. It is inequitable to deny this same benefit to those counties and cities that are now – or, soon will be – making similar investments.

Thank you for your attention to these concerns. Please contact us if we can provide further information or be of additional assistance.

Sincerely,

Nancy Schouweiler

Nancy Schouweiler, Chair
Dakota County Legislative Work Group

cc: Members, Dakota County Board of Commissioners
Brandt Richardson, County Administrator
Barry Tilley, Capitol Hill Associates
Keith Carlson, Metropolitan Inter-County Association

Senator ..... moves to amend S.F. No. .... as follows:

Page ..., after line ..., insert:

"Section 1. Minnesota Statutes 2004, section 289A.38, subdivision 6, is amended to read:

Subd. 6. [OMISSION IN EXCESS OF 25 PERCENT.] Additional taxes may be assessed within 6-1/2 years after the due date of the return or the date the return was filed, whichever is later, if:

(1) the taxpayer omits from ~~gross~~ taxable income an amount properly includable in it that is in excess of 25 percent of the amount of ~~gross~~ taxable income ~~stated-in-the-return~~ that would have been reported but for the omission;

(2) the taxpayer omits from a sales or withholding tax return an amount in excess of 25 percent of the taxes reported in the return; or

(3) the taxpayer omits from the gross estate assets in excess of 25 percent of the gross estate reported in the return.

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

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

the gross income from all sources of the corporation in the tax year is active foreign business income; and

(4) for purposes of this subdivision, active foreign business income means gross income that is (i) derived from sources without the United States, as defined in subtitle A, chapter 1, subchapter N, part 1 of the Internal Revenue Code; and (ii) attributable to the active conduct of a trade or business in a foreign county.

[EFFECTIVE DATE.] Section 2 does not change Minnesota law but clarifies the legislature's intention with respect to foreign operating corporations. It is the intent of the provisions related to foreign operating corporations that those be substantially foreign.

Sec. 3. 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). The deemed dividend shall be reduced by the amount of the addition to income required by clauses (17), (18), (19), and (20);

(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) an amount equal to the interest and intangible expenses, losses and costs paid, accrued, or incurred by any member of the taxpayer's unitary group to or for the benefit of a corporation that is a member of the taxpayer's unitary business group that qualifies as a foreign operating corporation. For purposes of this clause, intangible expenses and costs include:

(i) expenses, losses and costs for, or related to, the direct or indirect acquisition, use, maintenance or management, ownership, sale, exchange, or any other disposition of intangible property;

(ii) losses incurred, directly or indirectly, from factoring transactions or discounting transactions;

(iii) royalty, patent, technical, and copyright fees;

(iv) licensing fees; and

(v) other similar expenses and costs.

For purposes of this clause, "intangible property" includes stocks, bonds, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.

This clause shall not apply to any item of interest or intangible expenses or costs paid, accrued, or incurred, directly or indirectly, to a foreign operating corporation with respect to such item of income to the extent that the income to the foreign operation corporation is income from sources without the United States as defined in subtitle A, chapter 1, subchapter N, part 1 of the Internal Revenue Code;

(18) except as already included in the taxpayer's taxable income pursuant to clause (17), any interest income and income generated from intangible property received or accrued by a foreign operating corporation that is a member of the taxpayer's unitary group. For purposes of this clause, income generated from intangible property includes:

(i) income related to the direct or indirect acquisition, use maintenance or management, ownership, sale, exchange, or any other disposition of intangible property;

(ii) income from factoring transactions or discounting transactions;

(iii) royalty, patent, technical, and copyright fees;

(iv) licensing fees; and

(v) other similar income.

For purposes of this clause, "intangible property" includes stocks, bonds, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.

This clause shall not apply to any item of interest or intangible income received or accrued by a foreign operating corporation with respect to such item of income to the extent that the income is income from sources without the United States as defined in subtitle A, chapter 1, subchapter N, part 1 of the Internal Revenue Code;

(19) the dividends attributable to the income of a foreign operating corporation that is a member of the taxpayer's unitary group in an amount that is equal to the dividends paid deduction of a real estate investment trust under section 561(a) of the Internal Revenue Code for amounts paid or accrued by the real

estate investment trust to the foreign operating corporation; and

(20) the income of a foreign operating corporation that is a member of the taxpayer's unitary group in an amount that is equal to gains derived from the sale of real or personal property located in the United States.

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

Sec. 4. 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, unless the income resulting from such payments or accruals is income from sources within the United States as defined in subtitle A, chapter 1, subchapter N, part 1 of the Internal Revenue Code;

(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.

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

Sec. 5. Minnesota Statutes 2004, section 290.34, subdivision 1, is amended to read:

Subdivision 1. [BUSINESS CONDUCTED IN SUCH A WAY AS TO CREATE LOSSES OR IMPROPER TAXABLE NET INCOME.] <u>(a)</u> When any corporation liable to taxation under this chapter conducts its business in such a manner as, directly or indirectly, to benefit its members or stockholders or any person or corporation interested in such business or to reduce the income attributable to this state by selling the commodities or services in which it deals at less than the fair price which might be obtained therefor, or buying such commodities or services at more than the fair price for which they might have been obtained~~,~~.

(b) Or when any corporation, a substantial portion of whose shares is owned directly or indirectly by another corporation, deals in the commodities or services of the latter corporation in such a manner as to create a loss or improper net income or to reduce the taxable net income attributable to this state~~,~~.

(c) The commissioner of revenue may determine the amount of its income so as to reflect what would have been its reasonable taxable net income but for the arrangements causing the understatement of its taxable net income or the overstatement of its losses, having regard to the fair profits which, but for any agreement, arrangement, or understanding, might have been or could have been obtained from such business.

(d) When any corporation engages in a transaction or series of transactions whose primary business purpose is the avoidance of tax, or engages in a transaction or series of transactions without economic substance, that transaction or series of transactions shall be disregarded and the commissioner shall determine taxable net income without regard for any such transaction or series of transactions.

[EFFECTIVE DATE.] This section does not change Minnesota law but merely clarifies the legislature's intention with respect to transactions without economic substance or business purpose.

Sec. 6. [AGREEMENTS REGARDING LIABILITIES.]

Any taxpayer that does not meet the active foreign business income test in section ... may, by December 31, 2005, enter into an agreement regarding tax liability pursuant to section 270.67, subdivision 1, with the commissioner. The commissioner may, as a condition of any such agreement, waive the provisions of section 289A.38, subdivision 6. If upon audit, the commissioner assesses a liability based on this clarification, the commissioner may assess an additional 15 percent penalty in addition to any penalty that may be imposed pursuant to section 289A.60."