Senators Belanger and Limmer introduced–

S.F. No. 3326: Referred to the Committee on Taxes.

A bill for an act

relating to taxation; conforming certain provisions to changes in the Internal Revenue Code; providing an income and corporate franchise tax credit for investments in dairy operations; providing an income tax credit for qualified citizenship expenditures; accelerating the sales-only apportionment phase-in; conforming to federal income tax marriage penalty relief; providing a subtraction from federal taxable income for military pensions; providing a sales tax refund for certain resort expenditures; imposing levy limits for taxes payable in 2007; amending Minnesota Statutes 2004, sections 275.70, by adding a subdivision; 275.71, subdivisions 2, 4, 5; 275.74, subdivision 2; 290.06, by adding a subdivision; 297A.71, by adding a subdivision; Minnesota Statutes 2005 Supplement, sections 275.70, subdivision 5; 289A.02, subdivision 7; 290.01, subdivisions 19, 19a, 19b, 31; 290.06, subdivision 2c; 290.0675, subdivision 1; 290.091, subdivision 2; 290.191, subdivision 2; 290A.03, subdivision 15; 291.005, subdivision 1; 297A.75, subdivisions 1, 2, 3; proposing coding for new law in Minnesota Statutes, chapter 290.

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

Section 1. Minnesota Statutes 2004, section 275.70, is amended by adding a subdivision to read:

Subd. 2a. **Levy year.** The phrase "levy year" or "taxes levied in" refers to the year in which the taxes voted by the local governmental unit are to be certified to the county auditor under section 275.07, subdivision 1, paragraph (a).

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

Sec. 2. Minnesota Statutes 2005 Supplement, section 275.70, subdivision 5, is amended to read:

Subd. 5. **Special levies.** "Special levies" means those portions of ad valorem taxes levied by a local governmental unit for the following purposes or in the following manner:

(1) to pay the costs of the principal and interest on bonded indebtedness or to reimburse for the amount of liquor store revenues used to pay the principal and interest due on municipal liquor store bonds in the year preceding the year for which the levy limit is calculated;

(2) to pay the costs of principal and interest on certificates of indebtedness issued for any corporate purpose except for the following:

(i) tax anticipation or aid anticipation certificates of indebtedness;

(ii) certificates of indebtedness issued under sections 298.28 and 298.282;

(iii) certificates of indebtedness used to fund current expenses or to pay the costs of extraordinary expenditures that result from a public emergency; or

(iv) certificates of indebtedness used to fund an insufficiency in tax receipts or an insufficiency in other revenue sources;

(3) to provide for the bonded indebtedness portion of payments made to another political subdivision of the state of Minnesota;

(4) ~~to fund payments made to the Minnesota State Armory Building Commission under section 193.145, subdivision 2, to retire the principal and interest on armory construction bonds;~~

~~(5)~~ property taxes approved by voters which are levied against the referendum market value as provided under section 275.61;

~~(6) to fund matching requirements needed to qualify for federal or state grants or programs to the extent that either (i) the matching requirement exceeds the matching requirement in calendar year 2001, or (ii) it is a new matching requirement that did not exist prior to 2002;~~

~~(7)~~ (5) to pay the expenses reasonably and necessarily incurred in preparing for or repairing the effects of natural disaster including the occurrence or threat of widespread or severe damage, injury, or loss of life or property resulting from natural causes, in accordance with standards formulated by the Emergency Services Division of the state Department of Public Safety, as allowed by the commissioner of revenue under section 275.74, subdivision 2;

~~(8)~~ (6) pay amounts required to correct an error in the levy certified to the county auditor by a city or county in a levy year, but only to the extent that when added to the preceding year's levy it is not in excess of an applicable statutory, special law or charter limitation, or the limitation imposed on the governmental subdivision by sections 275.70 to 275.74 in the preceding levy year;

~~(9) to pay an abatement under section 469.1815;~~

~~(10) to pay any costs attributable to increases in the employer contribution rates under chapter 353 that are effective after June 30, 2001;~~

~~(11)~~ (7) to pay the operating or maintenance costs of a county jail as authorized in section 641.01 or 641.262, or of a correctional facility as defined in section 241.021, subdivision 1, paragraph (f), to the extent that the county can demonstrate to the commissioner of revenue that the amount has been included in the county budget as a direct result of a rule, minimum requirement, minimum standard, or directive of the Department of Corrections, or to pay the operating or maintenance costs of a regional jail as authorized in section 641.262. For purposes of this clause, a district court order is not a rule, minimum requirement, minimum standard, or directive of the Department of Corrections. If the county utilizes this special levy, except to pay operating or maintenance costs of a new regional jail facility under sections 641.262 to 641.264 which will not replace an existing jail facility, any amount levied by the county in the previous levy year for the purposes specified under this clause and included in the county's previous year's levy limitation computed under section 275.71, shall be deducted from the levy limit base under section 275.71, subdivision 2, when determining the county's current year levy limitation. The county shall provide the necessary information to the commissioner of revenue for making this determination~~;~~.

~~(12) to pay for operation of a lake improvement district, as authorized under section 103B.555. If the county utilizes this special levy, any amount levied by the county in the previous levy year for the purposes specified under this clause and included in the county's previous year's levy limitation computed under section 275.71 shall be deducted from the levy limit base under section 275.71, subdivision 2, when determining the county's current year levy limitation. The county shall provide the necessary information to the commissioner of revenue for making this determination;~~

~~(13) to repay a state or federal loan used to fund the direct or indirect required spending by the local government due to a state or federal transportation project or other state or federal capital project. This authority may only be used if the project is not a local government initiative;~~

~~(14) to pay for court administration costs as required under section 273.1398, subdivision 4b, less the (i) county's share of transferred fines and fees collected by the district courts in the county for calendar year 2001 and (ii) the aid amount certified to be paid to the county in 2004 under section 273.1398, subdivision 4c; however, for taxes levied to pay for these costs in the year in which the court financing is transferred to the state, the amount under this clause is limited to the amount of aid the county is certified to receive under section 273.1398, subdivision 4a;~~

~~(15) to fund a police or firefighters relief association as required under section 69.77 to the extent that the required amount exceeds the amount levied for this purpose in 2001;~~

~~(16) for purposes of a storm sewer improvement district under section 444.20; and~~

~~(17) to pay for the maintenance and support of a city or county society for the prevention of cruelty to animals under section 343.11. If the city or county uses this special levy, any amount levied by the city or county in the previous levy year for the purposes specified in this clause and included in the city's or county's previous year's levy limit computed under section 275.71, must be deducted from the levy limit base under section 275.71, subdivision 2, in determining the city's or county's current year levy limit.~~

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

Sec. 3. Minnesota Statutes 2004, section 275.71, subdivision 2, is amended to read:

Subd. 2. **Levy limit base.** The levy limit base for a local governmental unit for taxes ~~levied~~ payable in ~~2003~~ 2007 only is equal to ~~its adjusted levy limit base in the previous year, subject to~~: (1) the sum of its total property tax levy for taxes payable in 2006, including any levy of the local governmental unit required to be separately certified under section 275.07, subdivision 1, paragraph (b), or allowed to be separately certified under other law, and the total amount of aid it was certified to receive in 2006 under sections 298.28, 298.282, and 477A.011 to 477A.03; (2) less the sum of the amounts levied for taxes payable in 2006 that would have qualified as special levies under current law; and (3) including any adjustments under section 275.72~~, plus any aid amounts received in 2003 under section 273.138 or 273.166, minus the difference between its levy limit under subdivision 5 for taxes levied in 2002 and the amount it actually levied under that subdivision in that year, and certified property tax replacement aid payable in 2003 under section 174.242~~.

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

Sec. 4. Minnesota Statutes 2004, section 275.71, subdivision 4, is amended to read:

Subd. 4. **Adjusted levy limit base.** ~~(a)~~ For taxes ~~levied~~ payable in ~~2003~~ 2007 only, the adjusted levy limit base is equal to the levy limit base computed under ~~subdivisions~~ subdivision 2 ~~and 3~~ or section 275.72, ~~reduced by 40 percent of the difference between (1) the sum of 2003 certified aid payments, under sections 273.138, 273.1398 except for amounts certified under subdivision 4a, paragraph (b), 273.166, 477A.011 to 477A.03, 477A.06, and 477A.07, before any reduction under Laws 2003, First Special Session chapter 21, articles 5 and 6, and (2) the sum of the aids paid in 2004 under those same~~

~~sections, after any reductions in 2004 under Laws 2003, First Special Session chapter 21, articles 5 and 6.~~ for taxes payable in 2007 multiplied by:

(1) the sum of 100 plus a percentage equal to the percentage increase in the implicit price deflator divided by 100; and

(2) the sum of 100 plus a percentage equal to the positive percentage increase, if any, in the number of households in the local governmental unit for the most recent 12-month period for which data is available divided by 100.

~~(b) For taxes levied in 2003 only, the adjusted levy limit base is increased by 60 percent of the difference between a jurisdiction's market value credit in 2003 before any reductions under Laws 2003, First Special Session chapter 21, articles 5 and 6, and its market value credit in 2004 after reductions in Laws 2003, First Special Session chapter 21, articles 5 and 6.~~

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

Sec. 5. Minnesota Statutes 2004, section 275.71, subdivision 5, is amended to read:

Subd. 5. **Property tax levy limit.** For taxes ~~levied~~ payable in ~~2003~~ 2007 only, the property tax levy limit for a local governmental unit is equal to its adjusted levy limit base determined for taxes payable in 2007 under subdivision 4 plus any additional levy authorized for taxes payable in 2007 under section 275.73, which is levied against net tax capacity, reduced by the sum of (i) the total amount of aids and reimbursements that the local governmental unit is certified to receive in 2007 under sections 477A.011 to 477A.014, except for the increases in city aid bases ~~in calendar year 2002~~ first effective for aid payable in 2007 under section 477A.011, subdivision 36, ~~paragraphs (l), (n), and (o),~~ (ii) ~~homestead and agricultural aids it is certified to receive under section 273.1398, (iii)~~ taconite aids under sections 298.28 and 298.282 including any aid which was required to be placed in a special fund for expenditure in the next succeeding year, ~~(iv) temporary court aid under section 273.1398, subdivision 4a,~~ and ~~(v)~~ (iii) estimated payments to the local governmental unit in 2007 under section 272.029, adjusted for any error in estimation in the preceding year.

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

Sec. 6. Minnesota Statutes 2004, section 275.74, subdivision 2, is amended to read:

Subd. 2. **Authorization for special levies.** A local governmental unit may request authorization to levy for unreimbursed costs for natural disasters under section 275.70, subdivision 5, clause ~~(7)~~ (5). The local governmental unit shall submit a request to levy under section 275.70, subdivision 5, clause ~~(7)~~ (5), to the commissioner of revenue by September 30 of the levy year and the request must include information documenting the estimated unreimbursed costs. The commissioner of revenue may grant levy authority, up to the amount requested based on the documentation submitted. All decisions of the commissioner are final.

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

Sec. 7. Minnesota Statutes 2005 Supplement, section 289A.02, subdivision 7, is amended to read:

Subd. 7. **Internal Revenue Code.** Unless specifically defined otherwise, "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through ~~April 15~~ December 31, 2005.

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

Sec. 8. Minnesota Statutes 2005 Supplement, section 290.01, subdivision 19, is amended to read:

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

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

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

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

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

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

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

The Internal Revenue Code of 1986, as amended through ~~April 15~~ December 31, 2005, shall be in effect for taxable years beginning after December 31, 1996.

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

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

Sec. 9. Minnesota Statutes 2005 Supplement, section 290.01, subdivision 19a, is amended to read:

Subd. 19a. **Additions to federal taxable income.** For individuals, estates, and trusts, there shall be added to federal taxable income:

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

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

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

(2) the amount of income or sales and use taxes paid or accrued within the taxable year under this chapter and the amount of taxes based on net income paid or sales and use taxes paid to any other state or to any province or territory of Canada, to the extent

allowed as a deduction under section 63(d) of the Internal Revenue Code, but the addition may not be more than the amount by which the itemized deductions as allowed under section 63(d) of the Internal Revenue Code exceeds the amount of the standard deduction as defined in section 63(c) of the Internal Revenue Code ~~minus the addition which would have been required under clause (10) if the taxpayer had claimed the standard deduction~~. For the purpose of this paragraph, the disallowance of itemized deductions under section 68 of the Internal Revenue Code of 1986, income or sales and use tax is the last itemized deduction disallowed;

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

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

(5) the amount of expense, interest, or taxes disallowed pursuant to section 290.10 other than expenses or interest used in computing net interest income for the subtraction allowed under subdivision 19b, clause (1);

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

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

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

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

~~(10) for tax years beginning after December 31, 2004, to the extent deducted in computing federal taxable income, the amount by which the standard deduction allowed under section 63(c) of the Internal Revenue Code exceeds the standard deduction allowable under section 63(c) of the Internal Revenue Code of 1986, as amended through December 31, 2003; and~~

~~(11)~~ (10) the exclusion allowed under section 139A of the Internal Revenue Code for federal subsidies for prescription drug plans.

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

Sec. 10. Minnesota Statutes 2005 Supplement, section 290.01, subdivision 19b, is amended to read:

Subd. 19b. **Subtractions from federal taxable income.** For individuals, estates, and trusts, there shall be subtracted from federal taxable income:

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

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

(3) the amount paid to others, less the amount used to claim the credit allowed under section 290.0674, not to exceed $1,625 for each qualifying child in grades kindergarten to 6 and $2,500 for each qualifying child in grades 7 to 12, for tuition, textbooks, and transportation of each qualifying child in attending an elementary or secondary school situated in Minnesota, North Dakota, South Dakota, Iowa, or Wisconsin, wherein a resident of this state may legally fulfill the state's compulsory attendance laws, which is not operated for profit, and which adheres to the provisions of the Civil Rights Act of 1964 and chapter 363A. For the purposes of this clause, "tuition" includes fees or tuition as defined in section 290.0674, subdivision 1, clause (1). As used in this clause, "textbooks" includes books and other instructional materials and equipment purchased or leased for use in elementary and secondary schools in teaching only those subjects legally and commonly taught in public elementary and secondary schools in this state. Equipment expenses qualifying for deduction includes expenses as defined and limited in section 290.0674, subdivision 1, clause (3). "Textbooks" does not include instructional books and materials used in the teaching of religious tenets, doctrines, or worship, the purpose of which is to instill such tenets, doctrines, or worship, nor does it include books

or materials for, or transportation to, extracurricular activities including sporting events, musical or dramatic events, speech activities, driver's education, or similar programs. For purposes of the subtraction provided by this clause, "qualifying child" has the meaning given in section 32(c)(3) of the Internal Revenue Code;

(4) income as provided under section 290.0802;

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

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

(7) 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;

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

(9) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (7), or 19c, clause (15), in the case of a shareholder of a corporation that is an S corporation, an amount equal to one-fifth of the delayed depreciation. For purposes of this clause, "delayed depreciation" means the amount of the addition made by the taxpayer under subdivision 19a, clause (7), or subdivision 19c, clause (15), in the case of a shareholder of an S corporation, minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. The resulting delayed depreciation cannot be less than zero;

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

(11) the amount of compensation paid to members of the Minnesota National Guard or other reserve components of the United States military for active service performed in Minnesota, excluding compensation for services performed under the Active Guard

Reserve (AGR) program. For purposes of this clause, "active service" means (i) state active service as defined in section 190.05, subdivision 5a, clause (1); (ii) federally funded state active service as defined in section 190.05, subdivision 5b; or (iii) federal active service as defined in section 190.05, subdivision 5c, but "active service" excludes services performed exclusively for purposes of basic combat training, advanced individual training, annual training, and periodic inactive duty training; special training periodically made available to reserve members; and service performed in accordance with section 190.08, subdivision 3;

(12) the amount of compensation paid to Minnesota residents who are members of the armed forces of the United States or United Nations for active duty performed outside Minnesota;

(13) an amount, not to exceed $10,000, equal to qualified expenses related to a qualified donor's donation, while living, of one or more of the qualified donor's organs to another person for human organ transplantation. For purposes of this clause, "organ" means all or part of an individual's liver, pancreas, kidney, intestine, lung, or bone marrow; "human organ transplantation" means the medical procedure by which transfer of a human organ is made from the body of one person to the body of another person; "qualified expenses" means unreimbursed expenses for both the individual and the qualified donor for (i) travel, (ii) lodging, and (iii) lost wages net of sick pay, except that such expenses may be subtracted under this clause only once; and "qualified donor" means the individual or the individual's dependent, as defined in section 152 of the Internal Revenue Code. An individual may claim the subtraction in this clause for each instance of organ donation for transplantation during the taxable year in which the qualified expenses occur;

(14) in each of the five tax years immediately following the tax year in which an addition is required under subdivision 19a, clause (8), or 19c, clause (16), in the case of a shareholder of a corporation that is an S corporation, an amount equal to one-fifth of the addition made by the taxpayer under subdivision 19a, clause (8), or 19c, clause (16), in the case of a shareholder of a corporation that is an S corporation, minus the positive value of any net operating loss under section 172 of the Internal Revenue Code generated for the tax year of the addition. If the net operating loss exceeds the addition for the tax year, a subtraction is not allowed under this clause;

(15) to the extent included in federal taxable income, compensation paid to a nonresident who is a service member as defined in United States Code, title 10, section 101(a)(5), for military service as defined in the Service Member Civil Relief Act, Public Law 108-189, section 101(2); ~~and~~

(16) international economic development zone income as provided under section 469.325~~.~~; and

(17) to the extent included in federal taxable income, a percentage of compensation received from a pension or other retirement pay from the government for service in the armed forces of the United States, up to a maximum amount. For taxable years beginning after December 31, 2005, and before January 1, 2007, the percentage is 25 percent and the maximum amount is $7,500; for taxable years beginning after December 31, 2006, and before January 1, 2008, the percentage is 50 percent and the maximum amount is $15,000; for taxable years beginning after December 31, 2007, and before January 1, 2009, the percentage is 75 percent and the maximum amount is $22,500; and for taxable years beginning after December 31, 2008, the percentage is 100 percent and there is no maximum amount.

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

Sec. 11. Minnesota Statutes 2005 Supplement, section 290.01, subdivision 31, is amended to read:

Subd. 31. **Internal Revenue Code.** Unless specifically defined otherwise, "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through ~~April 15~~ December 31, 2005.

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

Sec. 12. Minnesota Statutes 2005 Supplement, section 290.06, subdivision 2c, is amended to read:

Subd. 2c. **Schedules of rates for individuals, estates, and trusts.** (a) The income taxes imposed by this chapter upon married individuals filing joint returns and surviving spouses as defined in section 2(a) of the Internal Revenue Code must be computed by applying to their taxable net income the following schedule of rates:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) the numerator is the individual's Minnesota source federal adjusted gross income as defined in section 62 of the Internal Revenue Code and increased by the additions required under section 290.01, subdivision 19a, clauses (1), (5), (6), (7), (8), and (9), and reduced by the Minnesota assignable portion of the subtraction for United States government interest under section 290.01, subdivision 19b, clause (1), and the subtractions under section 290.01, subdivision 19b, clauses (9), (10), (14), (15), ~~and~~ (16), and 17, after applying the allocation and assignability provisions of section 290.081, clause (a), or 290.17; and

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

amounts specified in section 290.01, subdivision 19b, clauses (1), (9), (10), (14), (15), ~~and~~ (16), and (17).

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

Sec. 13. Minnesota Statutes 2004, section 290.06, is amended by adding a subdivision to read:

Subd. 33. **Dairy investment credit.** (a) A dairy investment credit is allowed against the tax due under this chapter equal to ten percent of the amount paid or incurred by the taxpayer, on the first $500,000 of qualifying expenditures made in the qualifying period.

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

(1) freestall barns;

(2) fences;

(3) watering facilities;

(4) feed storage and handling equipment;

(5) milking parlors;

(6) robotic equipment;

(7) scales;

(8) milk storage and cooling facilities;

(9) bulk tanks;

(10) manure pumping and storage facilities;

(11) digesters; and

(12) equipment used to produce energy.

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

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

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

(e) The $50,000 maximum credit applies at the entity level for partnerships, S corporations, trusts, and estates as well as at the individual level. In the case of married individuals, the credit is limited to $50,000 for a married couple.

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

Sec. 14. Minnesota Statutes 2005 Supplement, section 290.0675, subdivision 1, is amended to read:

Subdivision 1. **Definitions.** (a) For purposes of this section the following terms have the meanings given.

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

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

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

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

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

(d) "Earned income of lesser-earning spouse" means the earned income of the spouse with the lesser amount of earned income as defined in paragraph (b) for the taxable year minus the sum of (i) the amount for one exemption under section 151(d) of the Internal Revenue Code and (ii) one-half the amount of the standard deduction under section 63(c)(2)(A) and (4) of the Internal Revenue Code ~~minus one-half of any addition required under section 290.01, subdivision 19a, clause (10), and one-half of the addition which would have been required under section 290.01, subdivision 19a, clause (10), if the taxpayer had claimed the standard deduction~~.

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

Sec. 15. **[290.0677] CITIZENSHIP CREDIT.**

Subdivision 1. **Credit allowed.** A taxpayer who is not a dependent, as defined in Internal Revenue Code, sections 151 and 152, is allowed a credit against the tax imposed by this chapter in the amount of qualified citizenship expenses incurred for a qualified individual.

Subd. 2. **Limitations on credit.** The maximum credit allowed a taxpayer and the taxpayer's spouse under this section is $300 per year. The credit is not allowed if the sum of the taxpayer's and taxpayer's spouse's income, as defined in section 290.067, subdivision 2a, exceeds $30,000. For a taxpayer who is not a Minnesota resident for the entire year, the maximum credit must be allocated using the percentage calculated in section 290.06, subdivision 2c, paragraph (e).

Subd. 3. **Qualified individual.** A "qualified individual" is the taxpayer, the taxpayer's spouse, or an individual who qualifies as a dependent of the taxpayer under sections 151 and 152 of the Internal Revenue Code. These individuals are only qualified individuals from the time the individual submits an I-485 Application to Register Permanent Residence or at the time the individual enters the United States on an immigrant visa, to the time the individual becomes a naturalized United States citizen.

Subd. 4. **Qualified citizenship expense.** Qualified citizenship expenses are limited to:

(1) filing fees, both application and biometric fingerprint fees, paid to United States Citizenship and Immigration Services in connection with an N-400 naturalization application for a qualified individual; and

(2) amounts paid for enrollment of a qualified individual over the age of 18 at the beginning of the year in an English language class offered by a school district in Minnesota or a school that has been approved as a licensed school by the state of Minnesota.

Subd. 5. **Credit to be refundable.** If the amount of credit that the taxpayer is eligible to receive under this section exceeds the taxpayer's tax liability under this chapter, the commissioner shall refund the excess to the taxpayer.

Subd. 6. **Appropriation.** An amount sufficient to pay the refunds required by this section is appropriated to the commissioner from the general fund.

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

Sec. 16. Minnesota Statutes 2005 Supplement, section 290.091, subdivision 2, is amended to read:

Subd. 2. **Definitions.** For purposes of the tax imposed by this section, the following terms have the meanings given:

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

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

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

(i) the charitable contribution deduction under section 170 of the Internal Revenue Code:

(A) for taxable years beginning before January 1, 2006, to the extent that the deduction exceeds 1.0 percent of adjusted gross income;

(B) for taxable years beginning after December 31, 2005, to the full extent of the deduction.

For purposes of this clause, "adjusted gross income" has the meaning given in section 62 of the Internal Revenue Code;

(ii) the medical expense deduction;

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

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

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

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

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

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

less the sum of the amounts determined under the following:

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

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

(3) the amount of investment interest paid or accrued within the taxable year on indebtedness to the extent that the amount does not exceed net investment income, as

defined in section 163(d)(4) of the Internal Revenue Code. Interest does not include amounts deducted in computing federal adjusted gross income; and

(4) amounts subtracted from federal taxable income as provided by section 290.01, subdivision 19b, clauses (9) to ~~(16)~~ (17).

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

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

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

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

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

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

Sec. 17. Minnesota Statutes 2005 Supplement, section 290.191, subdivision 2, is amended to read:

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

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

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

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

of the taxpayer's total payrolls paid or incurred in connection with the trade or business during the tax period.

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

Taxable years beginning during calendar year	Sales factor percent	Property factor percent	Payroll factor percent
2007	~~78~~ 80	~~11~~ 10	~~11~~ 10
2008	~~81~~ 85	~~9.5~~ 7.5	~~9.5~~ 7.5
2009	~~84~~ 90	~~8~~ 5	~~8~~ 5
2010	~~87~~ 95	~~6.5~~ 2.5	~~6.5~~ 2.5
2011	~~90~~ 100	~~5~~ 0	~~5~~ 0
~~2012~~	~~93~~	~~3.5~~	~~3.5~~
~~2013~~	~~96~~	~~2~~	~~2~~
~~2014~~ and later calendar years	~~100~~	~~0~~	~~0~~

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

Sec. 18. Minnesota Statutes 2005 Supplement, section 290A.03, subdivision 15, is amended to read:

Subd. 15. **Internal Revenue Code.** "Internal Revenue Code" means the Internal Revenue Code of 1986, as amended through ~~April 15~~ December 31, 2005.

EFFECTIVE DATE. This section is effective for property tax refunds based on property taxes payable on or after December 31, 2005, and rent paid on or after December 31, 2004.

Sec. 19. Minnesota Statutes 2005 Supplement, section 291.005, subdivision 1, is amended to read:

Subdivision 1. **Scope.** Unless the context otherwise clearly requires, the following terms used in this chapter shall have the following meanings:

(1) "Federal gross estate" means the gross estate of a decedent as valued and otherwise determined for federal estate tax purposes by federal taxing authorities pursuant to the provisions of the Internal Revenue Code.

(2) "Minnesota gross estate" means the federal gross estate of a decedent after (a) excluding therefrom any property included therein which has its situs outside Minnesota, and (b) including therein any property omitted from the federal gross estate which is includable therein, has its situs in Minnesota, and was not disclosed to federal taxing authorities.

(3) "Personal representative" means the executor, administrator or other person appointed by the court to administer and dispose of the property of the decedent. If there is no executor, administrator or other person appointed, qualified, and acting within this state, then any person in actual or constructive possession of any property having a situs in this state which is included in the federal gross estate of the decedent shall be deemed to be a personal representative to the extent of the property and the Minnesota estate tax due with respect to the property.

(4) "Resident decedent" means an individual whose domicile at the time of death was in Minnesota.

(5) "Nonresident decedent" means an individual whose domicile at the time of death was not in Minnesota.

(6) "Situs of property" means, with respect to real property, the state or country in which it is located; with respect to tangible personal property, the state or country in which it was normally kept or located at the time of the decedent's death; and with respect to intangible personal property, the state or country in which the decedent was domiciled at death.

(7) "Commissioner" means the commissioner of revenue or any person to whom the commissioner has delegated functions under this chapter.

(8) "Internal Revenue Code" means the United States Internal Revenue Code of 1986, as amended through ~~April 15~~ December 31, 2005.

(9) "Minnesota adjusted taxable estate" means federal adjusted taxable estate as defined by section 2011(b)(3) of the Internal Revenue Code, increased by the amount of deduction for state death taxes allowed under section 2058 of the Internal Revenue Code.

EFFECTIVE DATE. This section is effective for estates of decedents dying after December 31, 2005.

Sec. 20. Minnesota Statutes 2004, section 297A.71, is amended by adding a subdivision to read:

Subd. 37. **Construction materials and supplies; certain resorts.** Construction materials and supplies used or consumed in physically expanding or making capital improvements to a resort classified as class 1c or 4c, under section 273.13, subdivision 22 or 25, including any portion of a 1c or 4c resort classified as class 3 under section 273.13, subdivision 24, are exempt, up to a maximum refund of $10,000 in each calendar year for each resort. 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.

EFFECTIVE DATE. This section is effective for sales and purchases made after June 30, 2006.

Sec. 21. Minnesota Statutes 2005 Supplement, section 297A.75, subdivision 1, is amended to read:

Subdivision 1. **Tax collected.** The tax on the gross receipts from the sale of the following exempt items must be imposed and collected as if the sale were taxable and the rate under section 297A.62, subdivision 1, applied. The exempt items include:

(1) capital equipment exempt under section 297A.68, subdivision 5;

(2) building materials for an agricultural processing facility exempt under section 297A.71, subdivision 13;

(3) building materials for mineral production facilities exempt under section 297A.71, subdivision 14;

(4) building materials for correctional facilities under section 297A.71, subdivision 3;

(5) building materials used in a residence for disabled veterans exempt under section 297A.71, subdivision 11;

(6) elevators and building materials exempt under section 297A.71, subdivision 12;

(7) building materials for the Long Lake Conservation Center exempt under section 297A.71, subdivision 17;

(8) materials, supplies, fixtures, furnishings, and equipment for a county law enforcement and family service center under section 297A.71, subdivision 26;

(9) materials and supplies for qualified low-income housing under section 297A.71, subdivision 23; ~~and~~

(10) materials, supplies, and equipment for municipal electric utility facilities under section 297A.71, subdivision 35; and

(11) materials and supplies for qualified resorts under section 297A.71, subdivision 37.

EFFECTIVE DATE. This section is effective for sales and purchases made after June 30, 2006.

Sec. 22. Minnesota Statutes 2005 Supplement, section 297A.75, subdivision 2, is amended to read:

Subd. 2. **Refund; eligible persons.** Upon application on forms prescribed by the commissioner, a refund equal to the tax paid on the gross receipts of the exempt items must be paid to the applicant. Only the following persons may apply for the refund:

(1) for subdivision 1, clauses (1) to (3), the applicant must be the purchaser;

(2) for subdivision 1, clauses (4), (7), and (8), the applicant must be the governmental subdivision;

(3) for subdivision 1, clause (5), the applicant must be the recipient of the benefits provided in United States Code, title 38, chapter 21;

(4) for subdivision 1, clause (6), the applicant must be the owner of the homestead property;

(5) for subdivision 1, clause (9), the owner of the qualified low-income housing project; ~~and~~

(6) for subdivision 1, clause (10), the applicant must be a municipal electric utility or a joint venture of municipal electric utilities; and

(7) for subdivision 1, clause (11), the owner of the resort.

EFFECTIVE DATE. This section is effective for sales and purchases made after June 30, 2006.

Sec. 23. Minnesota Statutes 2005 Supplement, section 297A.75, subdivision 3, is amended to read:

Subd. 3. **Application.** (a) The application must include sufficient information to permit the commissioner to verify the tax paid. If the tax was paid by a contractor, subcontractor, or builder, under subdivision 1, clause (4), (5), (6), (7), (8), (9), ~~or~~ (10), or (11), the contractor, subcontractor, or builder must furnish to the refund applicant a statement including the cost of the exempt items and the taxes paid on the items unless otherwise specifically provided by this subdivision. The provisions of sections 289A.40 and 289A.50 apply to refunds under this section.

(b) An applicant may not file more than two applications per calendar year for refunds for taxes paid on capital equipment exempt under section 297A.68, subdivision 5.

EFFECTIVE DATE. This section is effective for sales and purchases made after June 30, 2006.

Sec. 24. **NET INCOME; FEDERAL CONFORMITY.**

For tax years beginning after December 31, 2004, and before December 31, 2006, the definition of "net income" in Minnesota Statutes, section 290.01, subdivision 19, must be interpreted by the Department of Revenue to conform to the position taken by the Internal Revenue Service in Revenue Notice 2005-68.

2006 GOVERNOR'S TAX BILL SUMMARY

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

Bill Date: March 13, 2006
Summary Date: March 16, 2006

Property Tax Levy Limit Overview

The bill provides property tax levy limitations for taxes payable in calendar year 2007 for counties and for cities of over 2,500 populations. In general, the limits are equal to the local unit's property tax levy for taxes payable in 2006 plus an inflationary increase and an increase for the growth in the number of households within the local unit. The limits are also adjusted up if the local unit will receive less in certain state paid aids in 2007 as compared to 2006, and are adjusted downward if the local unit will be receiving more of those state aids in 2007.

Section 1. Levy Year. Amends Minn. Stat. § 275.70 to add the new subd. 2a, to define "levy year" or "taxes levied in" as the year in which the taxes voted by the local governmental unit are to be certified to the county auditor under Minn. Stat. § 275.07, subd. 1(a). Effective the day following final enactment.

Section 2. Special Levies. Amends Minn. Stat. § 275.70, subd. 5, to change the special levies that are allowed for taxes payable in 2007. Special levies are those amounts that may be levied outside of, or in addition to, the unit's levy limitation. Special levies for payments to the state armory commission, for matching funds under certain federal or state grant programs, for abatements under Minn. Stat. § 469.1815, for certain employer contribution payments, for operations of a lake improvement district, to repay certain transportation related state or federal loans, for certain transitional amounts related to the state takeover of court administration costs, for certain police and firefighter relief associations, for storm sewer improvement district costs, and to fund the prevention of cruelty to animals are stricken. Special levies will be allowed to pay debt service, property taxes levied against referendum market value, the unreimbursed costs of natural disasters, errors in the prior year's levy, and the operation and maintenance of qualified county jails. Effective the day following final enactment.

Section 3. Levy Limit Base. Amends Minn. Stat. § 275.71, subd. 2, to define the levy limit base as the sum of the local unit's total property tax levy for taxes payable in 2006 plus the aid amounts the local unit was certified to receive in 2006 under Minn. Stat. §§ 298.28, 298.282 and 477A.011 to 477A.03, less the amounts that would have qualified for special levies under the new laws. Effective the day following final enactment.

Section 4. Adjusted Levy Limit Base. Amends Minn. Stat. § 275.71, subd. 4, to define the adjusted levy limit base as the unit's levy limit base plus a percentage increase for annual inflation computed from the most recent implicit price deflator for government expenditures and investment, and a percentage increase for the growth, if any, in the number of households within the local unit. Effective the day following final enactment.

Section 5. Property Tax Levy Limit. Amends Minn. Stat. § 275.71, subd. 5, to define the levy limitation for taxes payable in 2007 for the applicable local units of government. Except for allowable adjustments for annexations and service delivery changes, the levy limit is equal to the adjusted levy limit base minus the amounts the local unit will receive in state aid in 2007 under Minn. Stat. §§ 298.28, 298.282, and 477A.011 to 477A.014, and minus the estimated amount of wind energy production tax revenues the local unit will receive in 2007. Effective the day following final enactment.

Section 6. Authorization to Use Special Levy for Costs of Natural Disaster. Amends Minn. Stat. § 275.74, subd. 2, to update a cross reference to the new clause-number for the special levy allowed in the case of unreimbursed costs for natural disasters. Effective the day following final enactment.

Federal Update Overview

Minnesota income and franchise tax is based on "federal taxable income" (FTI) for regular Minnesota tax purposes; "federal alternative minimum taxable income" (AMTI) for Minnesota alternative minimum taxable income; "federal adjusted gross income" (AGI) for household income used for the Minnesota dependent care credit, education credit, and property tax refund; and "earned income" for the Working Family Credit. Present Minnesota law references these federal concepts through April 15, 2005.

Since April 15, 2005, the federal government has enacted three laws that modified the definitions of FTI, AMTI, AGI, and earned income.

The Energy Tax Incentives Act of 2005, Public Law 109-58, enacted August 8, 2005, generally provided for the acceleration of the deduction of capital expenditures for companies providing energy and energy services to U. S. consumers and was generally effective for expenses incurred under contracts entered into after April 11, 2005.

The Katrina Emergency Tax Relief Act of 2005, Public Law 109-73, enacted September 23, 2005, provided additional tax incentives for individuals and corporations to give to charity for contributions after August 25, 2005, and before January 1, 2006, and additional tax relief to victims of the hurricane. Generally effective between August 25, 2005 and January 1, 2007.

The Gulf Opportunity Zone Act of 2005, Public Law 109-135, enacted December 21, 2005, provides similar tax provisions available under the Hurricane Katrina bill to Hurricane Rita and Wilma victims and charitable givers. Further, this new law allows additional section 179 expensing or 50 percent bonus depreciation on business property placed in service in the areas damaged by Hurricane Katrina (between August 28, 2005 and December 31, 2007, for equipment and December 31, 2008, for structures).

Section 7. Federal Update of Minnesota Administrative Provisions. Amends Minn. Stat. § 289A.02, subd. 7, to incorporate certain federal administrative provisions as defined in the Internal Revenue Code as amended through December 31, 2005. Because none of the three federal acts enacted since the last Minnesota update affect Minnesota administrative provisions, this change has no substantive effect.

Section 8. Federal Update to Minnesota Taxable Income. Amends Minn. Stat. § 290.01, subd. 19, to adopt all of the federal changes to federal taxable income made by the above three mentioned federal acts. The main federal changes in this area were:

- Electricity transmission and distribution assets depreciation recovery period is reduced from 20 years to 15 years for assets acquired under a contract entered into after April 11, 2005.

- The ability to amortize over 60 months rather than 15 years certain certified pollution control facility expenses used to control water and air pollution in plants in operation before 1976 was expanded to allow amortization over 84 months of air pollution control facility expense for facilities and equipment placed in service after April 11, 2005, even if the coal fired electric generating plant was first used after 1976.

- The old cap on currently deducting amounts placed in a segregated nuclear decommissioning fund is removed for tax years beginning after December 31, 2005.

- For property placed in service after August 8, 2005 and before January 1, 2012, as a new oil refinery or which increases output of an existing refinery, the taxpayer can deduct in the current year, 50 percent of the cost of the property instead of depreciating the cost over the ten year life of the refinery under the old law.

- Under old law, cooperatives could flow through in the form of dividends net income but not losses to the co-op members. Under the new law retroactively effective to tax years beginning after December 31, 2002 a co-op can elect to flow through to co-op members the expenses paid by the co-op to comply with highway diesel fuel sulfur control requirements.

- The depreciation recovery period for natural gas distribution pipelines was shortened from 20 years to 15 years for pipeline placed in service after April 11, 2005, and before January 1, 2011.

- The depreciation recovery period for natural gas gathering lines was shortened from 15 years to seven years for gathering lines placed in service after April 11, 2005.

- For commercial buildings placed in service after December 31, 2005, and before January 1, 2008, that meet certain energy efficiency requirements, or existing buildings that are remodeled in this period to reach those requirements, the building owner is allowed a deduction of up to $1.80 per building square foot (this deduction reduces the depreciable basis of the building). A unique feature of this provision is that in the case of a government-owned building, the deduction can be claimed by the designer of the building (this part of the change would be a permanent revenue loss).

- The yearly limits on charitable contribution deductions of ten percent of income for corporations and 50 percent of income for individuals was removed for cash charitable contributions made after August 27, 2005, but before January 1, 2006. For corporate contributions, the removal of the limit only applies to contributions to organizations providing relief from Hurricanes Katrina, Rita, and Wilma.

- The replacement period for requiring property destroyed by Hurricane Katrina without reporting gain on the destroyed property was increased to five years (old law was four years for residence destroyed in disaster and two years for everything else). Effective for property converted after August 24, 2005.

- Cancellation of nonbusiness debt occurring after August 24, 2005, and before January 1, 2007, for an individual harmed by Hurricane Katrina is excluded from income even if the taxpayer is not insolvent. Excluded income reduces tax attributes.

- For business assets placed in service in the Hurricane Katrina Gulf Opportunity Zone (extreme southern parts of Louisiana, southern two-thirds of Mississippi and extreme western, southern two-thirds of Alabama) after August 27, 2005 and before January 1, 2008, for equipment and before January 1, 2009, for structures, a number of accelerated deductions were made available. The limit on 179 expensing of personal property was increased by $100,000, 50 percent bonus depreciation is allowed for tangible personal property, structures, and computer software, current deductions of up to $20,000 of reforestation expenses are allowed, and deductions for 50 percent of demolition and debris removal expenses are allowed. (The revenue effect of the 179 expensing would be lessened by the current Minnesota add-back of federal 179 expense in excess of $25,000).

- Expenses for oil and gas geological or geophysical purposes are required to be deducted ratably over two years. Old law allowed deduction when the project was abandoned or the wells were drilled. Effective for expenses incurred in tax years beginning after August 8, 2005.

- The deduction for the purchase of clean fuel vehicles and fueling equipment sunsets after 2005 instead of after 2006.

- The phase out of the deduction of itemized deductions for individuals with federal adjusted gross income of over $72,975 ($145,950 for married, filing joint) does not apply to cash charitable contributions made after August 27, 2005, and before January 1, 2006.

- An individual who lets an individual displaced by Hurricane Katrina live with them free of charge for at least 60 days in the tax year is allowed a deduction of $500 per individual housed for tax years 2005 and 2006. The $500 deduction is limited to $2,000 total and the same displaced person cannot be claimed by the same taxpayer for more than one tax year.

- The deductible mileage rate for the charitable use of a vehicle used by a volunteer providing charitable relief to Hurricane Katrina victims after August 24, 2005, and before January 1, 2007, is increased from 14 cents per mile to 70 percent of the business mileage rate (charitable rate will vary between 29 cents and 34 cents depending on the time. Also, reimbursement by charities to volunteers up to the above amounts will allow the exclusion of the reimbursement in Katrina volunteer's income.

- The ability to donate a business's food inventory to a charity and deduct the cost basis plus one-half the normal price mark-up as a business expense was expanded from just C corporations to any type of entity (sole proprietorship, partnership, or S corporation) in the food business for contributions made after August 27, 2005 and before January 1, 2006.

- The ability of a C corporation to donate book inventory to a 501(c)(3) charity and deduct the cost basis plus one-half the normal mark-up was expanded to include books donated to public schools effective for book donations made after August 27, 2005 in a tax year ending after August 28, 2005 and before January 1, 2006.

- The greater of ten percent of federal adjusted gross income or $100 floor on deducting personal casualty losses was removed for casualty losses caused by Hurricane Katrina, Rita, or Wilma.

Effective for losses arising after August 24, 2005, for Katrina losses, after September 22, 2005, for Rita losses, and after October 22, 2005, for Wilma losses.

Section 11. Federal Update of Credits and Individual Alternative Minimum Tax. Amends Minn. Stat. § 290.01, subd. 31, to incorporate the federal changes from the three federal acts which impact Minnesota income and franchise tax provisions that are not part of the computation of the regular tax. For the Minnesota alternative minimum tax on individuals, trusts, estates and C corporations, the new changes to federal adjusted gross income listed in section 8 will apply to the computation of Minnesota alternative minimum taxable income. Similarly, the definition of "household income" used in computing the Minnesota Dependent Care Credit and Education Credit will adopt the same federal changes. The federal earned income, credit which Minnesota uses in part in computing the Working Family Credit, was changed for the 2005 tax year to allow an individual who lived in the Hurricane Katrina, Rita, or Wilma disaster areas to elect to use their 2004 earned income rather than 2005 earned income in calculating their 2005 credit. Finally, the federal definition of "qualified research expenses" which Minnesota uses to compute the Minnesota C corporation Research and Development Credit was changed, effective for amounts paid or incurred after August 8, 2005, to allow 100 percent of amounts paid to small businesses, universities and federal labs for qualified energy research as a qualifying research expense (old law allowed only 65 percent of amount paid). All of these federal changes would be effective for Minnesota at the same time they became effective federally.

Section 18. Federal Update of Property Tax Refund. Amends Minn. Stat. § 290A.03, subd. 15, to incorporate the new federal changes to federal adjusted gross income into the definition of "household income" used to determine the Minnesota Property Tax refund available to homeowners and renters. The Minnesota changes to household income would be effective at the same time the federal changes were effective.

Section 19. Federal Update of Estate Tax. Amends Minn. Stat. § 291.005, subd. 1, to move the date through which Minnesota incorporates the federal estate tax to December 31, 2005. Since there has not been a federal change in the estate tax since the last update, this change does not have any substantive effect.

Section 24. Hurricane Katrina Relief. Adopts the Internal Revenue Services' position that employee leave donations to charities providing Hurricane Katrina relief do not generate adjusted gross income to the employee donating the leave. Effective for the 2005 and 2006 tax years.

Other Individual and Corporate Franchise Tax Changes

Section 9. Standard Deduction Increase for Married Taxpayers. Amends Minn. Stat. § 290.01, subd. 19a, to allow the same standard deduction the federal government currently allows for married taxpayers. Further the standard deduction used for computing the addition for state income taxes deducted federally is increased to the current federal standard deduction level. Effective for tax years beginning after December 31, 2005.

Sections 10 and 16. Military Pension Subtraction. Minn. Stat. §§ 290.01, subd. 19b and 290.091, subd. 2, are amended to allow a subtraction from income for the Minnesota individual regular and alternative minimum tax, respectively, for pension or retirement income that are received for service in the armed forces of the United States. For 2006, the maximum subtraction is limited to 25 percent of up to $30,000 of military retirement income. For 2007, 50 percent is allowed; for 2008, 75 percent is allowed; and for 2009 and thereafter, 100 percent of all the military retirement income is allowed as a subtraction. Effective for tax years beginning after December 31, 2005.

Section 12. Nonresident Ratio for Computing Tax. Amends Minn. Stat. § 290.06, subd. 2c, to remove the new military pension subtraction from both the numerator and denominator of the ratio used to calculate a part year or nonresident individual's Minnesota income tax. This section also clarifies that numerous Minnesota nonrefundable credits are either prorated by the nonresident ratio or allowed in full in the case of credits generated by only Minnesota activity. Effective for the tax years beginning after December 31, 2005.

Section 13. Dairy Investment Credit. Minn. Stat. § 290.06 is amended to add a subdivision allowing a new nonrefundable credit against the taxes imposed by Minn. Stat. ch. 290. The credit equals 10 percent of the first $500,000 of qualifying expenditures for improvement of buildings or facilities or acquisition of equipment used for dairy cattle in Minnesota. Qualifying expenditures include: barns; fences; watering facilities; feed storage and handling equipment; scales; milking; robotic, and milk storage equipment; and manure management facilities including digesters and energy production equipment.

The credit is nonrefundable and may only be used to offset liability. Unused credit amounts may be carried forward for up to 15 tax years.

A taxpayer may claim the credit for expenditures made between December 31, 2005 and January 1, 2012. The maximum credit is $50,000; this maximum applies to entities such as partnerships and S corporations as well as to individual taxpayers. Effective for tax years beginning after December 31, 2005.

Section 14. Marriage Credit Standard Deduction Conformity. Amends Minn. Stat. § 290.0675, subd. 1, to increase the standard deduction used to compute the marriage credit increase to the current level of federal standard deduction for married taxpayers. Effective for tax years beginning after December 31, 2005.

Section 15. Citizenship Credit. Minn. Stat. ch. 290 is amended to allow a new refundable credit for non-citizens of the United States whose "household income" as used for the Minnesota dependent care and education credits is $30,000 or less (husband and wife's income are combined even if separate returns are filed). The credit which is limited to $300 per year is available for "qualified expenses" paid between the time the taxpayer starts the citizenship process by filing the federal Application to Register Permanent Residence to the time the taxpayer becomes a citizen of the United States. "Qualified expenses" are fees paid for enrolling the taxpayer, spouse, or any dependent of the taxpayer over age 18 in an English language class and the fees paid (to the federal government) for the application and finger printing required when submitting the federal N-400 naturalization application. For non-residents and part-year residents of Minnesota, the $300 maximum is prorated using a ratio of Minnesota income to federal adjusted gross income. Effective for tax years beginning after December 31, 2005.

Section 17. Apportionment of Income; Single Factor. Amends Minn. Stat. § 290.191, subd. 2, to accelerate the phase-in period for the apportionment of income by a single factor, sales. Amendments to subd. 2 provide for a generally applicable single factor apportionment phased in over five years. Effective for tax years beginning after December 31, 2006.

Taxable Year beginning during calendar year	Current Sales Percent Factor	Proposed Sales Percent Factor
2007	78	80
2008	81	85
2009	84	90
2010	87	95
2011	90	100
2012	93	100
2013	96	100
2014 and later years	100	100

Sales and Use Tax

Section 20. Resort Construction Materials. Amends Minn. Stat. § 297A.71, by adding a sales and use tax exemption for construction materials and supplies used in physically expanding or making capital improvements to class 1c and 4c resorts, including any portion of a resort classified as class 3 commercial property. The exemption would be administered as a tax refund and is limited to $10,000 of tax per resort per calendar year. The tax must first be paid, after which the owner may file a refund claim with the Department of Revenue. Effective for sales and purchases made after June 30, 2006.

Sections 21, 22, and 23. Refunds for Resorts. Amends Minn. Stat. § 297A.75, subds. 1, 2, and 3, to provide a mechanism for resorts to file sales tax refund claims and to provide that the refund claims must be filed by the resort owners. Effective for sales and purchases made after June 30, 2006.

MINNESOTA · REVENUE

Governor's Tax Bill

March 23, 2006

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 3603 (Krinkie)/ S.F. 3326 (Belanger)

	Fund Impact			
	F.Y. 2006	F.Y. 2007	F.Y. 2008	F.Y. 2009
		(000's)		
Federal Update				
Standard Deduction for Married Filers (Tax years 2006 - 2008)	$0	($28,700)	($14,800)	($6,500)
The Energy Tax Incentives Act of 2005*				
Individual Income Tax	($560)	($60)	$0	$40
Corporate Franchise Tax	($40)	($1,900)	($3,000)	($3,740)
Total	($600)	($1,960)	($3,000)	($3,700)
The Katrina Emergency Tax Relief Act of 2005*				
Individual Income Tax	($3,885)	$90	$65	$0
Corporate Franchise Tax	($320)	($120)	($10)	$0
Total	($4,205)	($30)	$55	$0
The Gulf Opportunity Zone Act of 2005*				
Individual Income Tax	($85)	($140)	($50)	$10
Corporate Franchise Tax	($300)	($410)	($200)	($20)
Total	($385)	($550)	($250)	($10)
Individual Income Tax				
Military Pension Subtraction, Phased In Over Four Years (1/1/06)	$0	($4,100)	($8,600)	($13,600)
Citizenship Tax Credit (1/1/06)	$0	($1,100)	($1,200)	($1,300)
Dairy Investment Credit** (1/1/06)	$0	($4,700)	($5,200)	($5,700)
Corporate Franchise Tax				
Accelerate Phase In to Single Sales Factor (1/1/07)	$0	($1,700)	($7,700)	($13,400)
General Sales and Use Tax				
Exemption for Improvements to Resorts, Limited to $10,000 Per Resort (7/1/06)	$0	($880)	($990)	($1,020)
General Fund Total	($5,190)	($43,720)	($41,685)	($45,230)

* Details for each federal bill are available separately.
** Also applies to the corporate franchise tax. Estimates include impact for both taxes.

March 23, 2006

EXPLANATION OF THE BI LL

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

REVENUE ANALYSIS DETAIL

Standard Deduction for Married Filers

- Simulation results are obtained using the House Income Tax Simulation (HITS 5.4) model. The simulations assume the same economic conditions used by the Minnesota Department of Finance for the forecast published in February 2006. The model uses a stratified sample of 2003 individual income tax returns compiled by the Minnesota Department of Revenue.
- Tax year 2006 was allocated to FY 2007. Tax years 2007 and 2008 were allocated 50/50 to fiscal years.
- An estimated 419,300 returns in tax year 2006 would experience a tax decrease.

Federal Update: The Energy Tax Incentives Act of 2005, The Katrina Emergency Tax Relief Act of 2005, The Gulf Opportunity Zone Act of 2005

- The estimates are based on the estimates for the federal legislation prepared by the Joint Committee on Taxation.
- If both the individual income and corporate franchise taxes would be affected, the federal estimates were divided between the two taxes.
- The federal estimates were apportioned to Minnesota based on a measure appropriate to the provision. For the Katrina Emergency Tax Relief and the Gulf Opportunity Zone Acts, the estimates were further adjusted to reflect the extent to which Minnesota taxpayers would likely be affected by the provision. No adjustment was made for provisions not limited to the hurricane disaster areas: suspending the limitations for qualified charitable contributions by individuals and extending the enhanced deduction for the contributions of food inventory and book inventory.
- Federal and state marginal rates were applied, and the estimates were converted from federal fiscal years to state fiscal years.

Military Pension Subtraction, Phased In Over Four Years

- According to information from the Department of Defense Statistical Report on the Military Retirement System for federal fiscal year 2004, the number of people receiving military retirement pay in Minnesota was 17,093 for a total amount of $248.4 million.
- Based on national data, it is assumed that 40% of retirees are officers with an average annual pension of $22,778, and 60% are enlisted personnel with an average annual pension of $11,429. The average pension for 2,523 survivors was $6,459.
- The average marginal rate was assumed to be 6%.
- Annual growth was estimated at 5%.
- Tax year impact was allocated to the following fiscal year.
- Approximately 17,000 to 18,000 taxpayers would be affected.

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REVENUE ANALYSIS DETAIL (Continued)

Citizenship Tax Credit

- Based on naturalization by occupation information from the U.S. Citizenship and Immigration Services office, it is assumed that 45% of persons in the naturalization process would have household incomes less than $30,000.
- It is assumed 25% of immigrants granted permanent residency will begin taking English as a second language (ESL) classes each year, at an average cost of $200 per class. It is assumed all individuals will take one ESL class each year for three years. The cost to the state for reimbursing ESL class fees will total $0.9 million in FY 2007.
- The N-400 application fee for naturalization is $330, plus a $70 biometrics fingerprint fee, for a total of $400 per application.
- According to the U.S. Citizenship and Immigration Services office, 7,713 immigrants in Minnesota became naturalized U.S. citizens in 2004. This represents a 10% average annual increase since 1998, which is assumed to continue. It is assumed two-thirds of these naturalized immigrants are members of a family and will claim the maximum $300 credit per family. The other one-third will also each claim a credit of $300.
- The cost to the state for reimbursing citizenship application fees will total $0.7 million in FY 2007. This estimate does not include immigrants applying for citizenship more than one time.
- The total estimate of $1.6 million is reduced 30% to account for the effect of the $300 cap on the overlap of immigrants taking ESL classes and applying for citizenship in the same year.
- Tax year impact was allocated to the following fiscal year.
- An estimated 7,500 individuals would be affected in TY 2006.

Dairy Investment Credit

- A similar credit was enacted in Wisconsin, effective for tax years 2004 through 2009. For 2004 returns filed in 2005, the total credit that offset tax was $12.22 million on 6,464 returns, for an average credit of $1,890 per return.
- The participation rate for dairy enterprises for the Wisconsin program was 40% in the first year. It was assumed that Minnesota would have a similar experience in the first year.
- It was assumed that the first-year cost for Minnesota would be 38.5% of the first-year cost in Wisconsin, which is the percentage of the number of dairy cows in Minnesota compared to the number in Wisconsin.
- Growth in the cost of the program is estimated at 10% annually, which would include price increases, increased participation, and any carryover of unused credit from a prior year.
- Tax year impact was allocated to the following fiscal year.
- The credit would be claimed for an estimated 2,200 farms for tax year 2006.

REVENUE ANALYSIS DETAIL (Continued)

Accelerate Phase In to Single Sales Factor

- The revenue estimate is based on data from returns filed in calendar year 2003.
- A program was run against corporate data to calculate the revenue impact from changing the weighting under current law to the proposed weighting for each tax year.
- Growth in overall corporate tax collections as projected by the Department of Finance in the February 2006 forecast is used to project future revenue losses.
- This law change also affects the apportionment of income generated by entities other than C corporations, mainly S corporations. The estimate was adjusted to include these businesses.
- Tax year impact was allocated 30/70 to fiscal years.
- About 9,000 corporations would be affected, including both tax increases and decreases.

Sales Tax Exemption for Improvements to Resorts, Limited to $10,000 of Tax Per Resort

- The estimate was based on information from Explore Minnesota Tourism (EMT; formerly Minnesota Office of Tourism) and resort industry representatives.
- It was estimated that there are 7,411 cabins at class 1c and 4c resorts that are likely to incur $10,000 or less in annual sales/use tax liability for capital projects. This figure was arrived at by excluding from the EMT total cabins at Indian casino resorts and cabins at large resorts.
- A cabin has an average life of 40 years. It was therefore estimated that 185 existing cabins will be replaced annually at an average cost of $75,000 per cabin.
- It was assumed that 75 new (expansion) cabins will be built per year at an average cost of $75,000. It was further assumed that 150 existing cabins will be upgraded per year at an average cost of $7,500.
- It was estimated that there are approximately 2,817 existing rooms at resorts subject to the $10,000 tax cap. The number of rooms was arrived at by excluding from the EMT total rooms at Indian casino hotels.
- It was assumed that 20% of the units will undergo capital improvements each year at an average per-unit cost of $2,000. It was further assumed that 70 new rooms will be constructed per year at an average cost of $35,000.
- All expenditures were multiplied by 60% to arrive at an estimate of the taxable materials and supplies portion (to exclude labor costs) and multiplied by the 6.5% sales and use tax rate.
- Annual growth was estimated at 3%.
- The estimates were converted to fiscal years. FY 2007 was adjusted for the effective date.
- There are approximately 900 Minnesota resorts that could qualify for the exemption.

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