



May 9, 2022

The Honorable Carla Nelson
Chair, Senate Taxes Committee
3235 Minnesota Senate Building
95 University Avenue W.
Saint Paul, Minnesota 55155

Dear Chair Nelson:

I am writing on behalf of the Minnesota Department of Revenue today regarding House File 3669, as proposed to be amended by the delete all amendment. We appreciate the work this committee has done to assemble this bill; however, we have strong concerns about the fiscal impact of this bill and the long-term financial stability of the state.

When Governor Walz and Lt. Governor Flanagan proposed their budget in February and revised supplemental budget in March, they prioritized expanding economic opportunities for all Minnesotans; supporting children and families; and protecting Minnesotans' health, safety, and well-being. The Governor also recommended investing in local jobs and projects through a proposed \$2.7 billion in bonding projects.

Given the responsible stewardship of Minnesota's budget, we have a remarkable opportunity to support the middle class, working families, and small businesses while also investing in public safety, health care, and education. Governor Walz understands that we can reduce costs and grow our economy while protecting the health and safety of Minnesotans and ensuring every child receives a high-quality education, no matter their race or zip code. This bill has a large price tag but does not increase the fairness of our tax system by helping low- to middle-income Minnesotans or allow for significant investments in public services as part of the rest of the budget.

Responding to Federal Changes

We all agree on the importance of responding to the federal tax changes enacted since our tax statutes were last updated in 2019. Individual taxpayers, CPAs, and businesses have all expressed the need to update our tax code to reduce complexity and compliance costs. This bill adopts the Governor's approach to update the general conformity date and provide important conformity for individuals and businesses. We look forward to continuing to work with members of the committee and stakeholders on the best approach to administer this update that could impact multiple years of returns and adjustments for taxpayers.

The Governor's budget proposes conforming with many of the tax changes made by the federal government over the past three years. At least six federal bills with tax changes have been enacted since our last general update of state tax laws. Adopting the federal changes for businesses and individuals provides an investment in Minnesota's tax system to ensure that it is stable, predictable, and less complex. Much of the state tax code is based on the federal calculation of income, so conforming with these federal tax changes will allow the benefit to flow through to state taxes.

Similar Tax Items

We appreciate that the committee has included a few of the Governor's items that will make a difference to families and businesses in their everyday lives.

The Governor's bill recognizes the challenges Minnesota parents face in paying for quality, affordable childcare by significantly increasing the income threshold and maximum credit amount for Minnesota's refundable Child and Dependent Care Credit. This change will lower taxes for more Minnesotans. We appreciate that this bill also increases the income threshold for this credit. Additionally, both bills expand eligibility for the refundable K-12 Education credit and update the measure of income to simplify calculation of the credit. However, it is disappointing that this bill does not invest more resources to support our working families through important and successful tax programs for lower- and middle-income taxpayers.

The bill contains the Governor and Lt. Governor's increase to the Angel Tax credit for tax year 2022. The Angel Tax credit provides incentive for investors or investment funds to put money into early-stage companies focused on high technology and new proprietary technology. The program has issued over \$100 million in credits to investors to spur economic growth.

We appreciate the inclusion of items from the department's policy and technical bill. One of our key strategies to achieve our mission is to engage in meaningful interaction with customers to provide superior service. During those interactions, we often hear or notice items in the tax code that could be clarified, updated, or corrected. These items may be small, but their important to ensure we are providing customers with the information, education, and services they need to efficiently navigate Minnesota's tax opportunities and obligations.

Administration's Priorities are not Included

It appears that a primary focus of the bill is an income tax rate cut. However, the tax cut will be largest for the wealthiest Minnesotans. Some middle-class families will not receive the full benefit of the rate cut. And Minnesota's lowest wage earners, who don't earn enough to file taxes but still pay sales taxes, property taxes, and excise taxes, will receive no benefit at all from the tax bill.

The bill also provides a subtraction for all Social Security income – benefiting the state's highest earners. Social Security recipients already pay tax on only a portion of their social security income. After the federal exclusion and Minnesota subtraction, about 53% of recipients pay no

state tax on benefits. Even the highest income seniors pay tax on only 85% of their social security income.

The bill provides relief for the wealthiest Minnesotans through changes to the estate tax by allowing a larger amount of the estate to go untaxed. This bill enacts portability for the Minnesota estate tax, allowing a second decedent spouse's estate to use any unused exclusion amount left over from the first decedent spouse's estate. In other words, this allows a second decedent's spouse estate to increase their general exclusion amount. In some cases, that may double the amount of the exclusion.

The bill does not include the Governor's proposal to streamline the sales and use tax exemption for building, construction, or reconstruction materials, supplies, and equipment for buildings and facilities used primarily by local government and nonprofits. Every year we see local governments advocating for a sales tax reimbursement or exemption for construction projects. This exemption would help local government dollars go further and provide property tax relief.

Other Areas of Concern

This bill conforms to the federal treatment of 529 plans to include tax benefits for K-12 private school tuition payments. The Governor and Lt. Governor have expressed concerns about extending public money to private schools, but this bill provides additional ways state government would reimburse individuals for private school tuition. The Governor and Lt. Governor oppose this provision. Additionally, the bill increases K-12 subtraction amount by 50 percent. The subtraction is a tax benefit does not have an income limit and can be used to offset private school tuition payments. This provides an increase to the funding of nonpublic schools, at a time when the state should instead be funding the significant needs for our public schools.

The bill includes a tax credit for employers that choose to provide paid family leave benefits to their employees. Paid family and medical leave is an important benefit that should be available to all workers. This bill's provision does not go far enough to provide sufficient incentive for employers or meaningful support for workers. The Governor's budget provides a Paid Family and Medical Leave Insurance program that would provide comprehensive benefits that workers can rely on.

This bill makes changes to the Pass-Through Entity (PTE) tax that was enacted last session and began in tax year 2021. As you may recall, the PTE tax was enacted as a workaround to the temporary federal cap on state and local tax deductions for individuals. The current PTE tax statute is based on compromise language we worked on with stakeholders in order to ensure the department could administer this type of workaround, the provision followed federal guidance, and the workaround provided the benefit to the intended parties under the guidance.

This bill expands the types of entities that can make the election and changes the calculation of the PTE tax. We have concerns with the provisions that increase the complexity of the tax and related credit and expand the election. As with any new law enacted, especially when it's complex, we understand the need to update the law to ensure we are achieving the intent. We have engaged with stakeholders on these changes and are committed to working with and continuing the conversation with stakeholders and members on suggested changes to the pass-through entity tax.

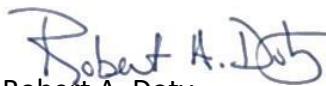
We are concerned about the financial impact of this bill. The repeal of the statewide general levy will cost the state \$1.5 billion a biennium once it is phased and that is not reflected on the spreadsheet since it falls outside of the budget window.

Closing

The department would like to reaffirm our commitment to making sure policies included in the final tax bill can be administered. We are still reviewing the bill and may share additional information on other issues as the bill moves forward. The department will also work with you and committee staff to ensure technical and administrative issues can be addressed. Additionally, we will provide information about the administrative costs for the changes in the bill.

We also will continue to press for tax relief for low- and middle-income Minnesotans.

Sincerely,



Robert A. Doty
Commissioner

Cc: Senator Ann H. Rest
Ranking Minority Member, Senate Tax Committee