

# Tax Expenditure Budget

FY 2024-2027

Eric Willette  
Tax Research Division  
Minnesota Department of Revenue

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The report is posted on the Department of Revenue website at:  
<https://www.revenue.state.mn.us/tax-expenditure-reports>

# Outline






- Purpose and History
- “Tax Expenditure” as a Concept
- Defining the Reference Tax Base
- Using the Tax Expenditure Budget
- Overview and What’s New in 2024 report
- Examples
- Scope of Tax Expenditures

Tax Expenditures are statutory provisions which reduce the amount of revenue that otherwise would be generated by granting special and selective tax relief to a subset of taxpayers

# Purpose and History of Report

- Estimates impact of 327 statutory provisions across 16 state and local tax types which grant *special and selective tax relief* to a subset of taxpayers
- Tax Expenditures touch on virtually every area of public policy
- Enables regular legislative review of government benefits that are ongoing law and not part of the biennial budget process
- First published in 1985

## “Tax Expenditure” as a Concept

- If the only goal were to raise revenue, then it would be best to have a broad income tax base & low rates.
- But state policy makers want to...
  - encourage home ownership  Mortgage Interest Deduction
  - help pay for child care  Child Care Credit
  - recognize/reward combat veterans  Combat Credit
  - increase business start-ups  Angel Investment Credit
  - help beginning farmers buy land &/or farm assets  Beginning Farmer Credit
- Could design a direct expenditure program to meet each of these goals.

# Defining a Tax Expenditure

We include a provision in the Tax Expenditure Budget if:

1. Tax applies statewide
2. Provides preferential treatment
3. Has a revenue impact
4. Is not subject to an alternative tax
5. Is not counted as a direct expenditure
6. Legislature has authority to impose tax
7. It is included in the report's definition of the tax base

See pages  
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# Tax Expenditures ≠ Direct Expenditures

- No line in the biennial budget
- No regular review process (this is changing!)
- Most have no limit on growth over time (“auto-pilot”)
- Authorized by tax committees
- Often limited public access to program information
- Difference of perception: “Cut taxes” rather than “Increase government spending”

# Defining the Reference Tax Base

Reference Tax Base defined in chapter introductions

- Income Taxes: *Income from all sources less expenses that are reasonable & necessary to generate that income*
  - deduction allowed only for “true” depreciation
  - personal & dependent exemptions & standard deduction assumed part of basic tax structure
  - graduated rates & different tax brackets by filing status assumed part of basic tax structure
  - for corporate tax, equal-weight apportionment & throwback rule
- Sales Tax: Base includes all final purchases of tangible goods or services
  - business purchases of capital equipment are in the base



# Using the Tax Expenditure Budget

TEB can give guidance on how to broaden a tax base to reduce rates

Three Cautions:

1. Repeal of some tax expenditures would increase complexity (e.g. Federal Conformity items)
2. Repeal of some tax expenditures would cause compliance challenges
3. Tax expenditures interact so can't add estimates together

## Interactions among Tax Expenditure Items

Example: Repealing multiple itemized deductions raises less than the sum of the estimates shown separately

Simple sum (items 1.3.02–1.3.07):	\$189.8 mill.
Adjust for interactions:	<u>-58.4 mill.</u>
Tax expenditure for all combined:	\$131.4 mill.

## What's new in 2024

- New chapter for Cannabis Gross Receipts Tax enacted in 2023
- 15 new tax expenditures, 4 removed
- 2021 law that created the Tax Expenditure Review Commission also added new components to the report:
  - Objective statements, as defined by statute (14) or TERC (45)
  - Revenue-neutral rate change
  - Incidence analyses of 53 major sales and income tax expenditures
- High inflation and extra year since last report

## Examples

### 1.6.01 (p.86)

### Marriage Credit

#### Legal Citation

Minnesota Statutes, Section 290.0675

#### Description of Current Law

A nonrefundable credit is allowed against the individual income tax for a married couple filing a joint return if both spouses have earned income or taxable pension or taxable social security income and their income situation results in a “marriage penalty” due to the size of the state income tax brackets. The credit compensates for the extent to which the income tax is higher due to the tax brackets for a joint return compared to the two spouses filing as single persons.

The credit is based on two variables: the joint taxable income of the couple and the earned income (including taxable pension and social security income) of the lesser-earning spouse. For tax year 2023, the credit does not apply unless taxable income is at least \$44,000 and the earned income of the lesser-earning spouse is at least \$28,000. The maximum credit for 2023 is \$1,710.

#### History

This credit was enacted in 1999 and was last modified in 2013.

#### Number of Taxpayers

An estimated 422,200 returns will claim this credit in tax year 2023.

#### Objective Statement (new)

**Objective Statement:** The objective of the Marriage Credit is to reduce marriage penalties resulting from Minnesota income tax rate brackets for qualified two-earner married couples who file a joint return.

#### Revenue Neutral Rate (new)

**Revenue Neutral Rate:** If the tax expenditure were repealed, each income tax rate could be reduced by 0.045 percentage points, to 5.305%, 6.755%, 7.805%, and 9.805%.

#### Dollar Impact

Fiscal Year	2024	2025	2026	2027
State General Fund	\$98,100,000	\$102,800,000	\$107,300,000	\$112,200,000

## 1.6.01 Marriage Credit continued

### Incidence Analysis (new)

**Incidence:** The following table shows the incidence of the tax expenditure, based on the 2021 incidence database.

Resident by Population Decile	Total Individual Income Tax	Tax Change	Share of Tax Change	Count
\$15,544 & Under	-\$12,885,164	\$10,960	0.0%	24
\$15,545 - \$24,961	-\$8,897,060	*	*	*
\$24,962 - \$35,168	\$50,299,493	\$16,176	0.0%	70
\$35,169 - \$45,808	\$162,527,171	\$41,060	0.0%	121
\$45,809 - \$58,014	\$329,724,240	\$9,155	0.0%	39
\$58,015 - \$73,668	\$536,303,127	\$52,781	0.1%	699
\$73,669 - \$95,360	\$819,647,313	\$2,390,730	2.4%	21,009
\$95,361 - \$127,780	\$1,210,630,834	\$17,519,092	17.9%	100,588
\$127,781 - \$183,475	\$1,954,222,647	\$34,823,052	35.5%	165,363
\$183,476 & Over	\$8,869,633,832	\$39,314,500	40.1%	103,942
<b>Nonresidents</b>	<b>\$961,801,005</b>	<b>\$3,922,494</b>	<b>4.0%</b>	<b>30,345</b>
<b>All</b>	<b>\$14,873,000,000</b>	<b>\$98,100,000</b>	<b>100%</b>	<b>422,200</b>

\*Fewer than 10 returns. Amounts were combined with an adjacent cell.

### 1.6.07 Child and Working Family Credits incidence (pp. 91-92)

<b>Resident by Population Decile</b>	<b>Total Individual Income Tax</b>	<b>Tax Change</b>	<b>Share of Tax Change</b>	<b>Count</b>
\$15,544 & Under	-\$12,885,164	\$73,511,094	10.3%	106,006
\$15,545 - \$24,961	-\$8,897,060	\$127,368,132	17.9%	126,913
\$24,962 - \$35,168	\$50,299,493	\$181,478,197	25.5%	137,144
\$35,169 - \$45,808	\$162,527,171	\$160,841,736	22.6%	73,224
\$45,809 - \$58,014	\$329,724,240	\$117,638,939	16.5%	44,592
\$58,015 - \$73,668	\$536,303,127	\$37,514,502	5.3%	13,882
\$73,669 - \$95,360	\$819,647,313	\$3,909,380	0.5%	1,794
\$95,361 - \$127,780	\$1,210,630,834	\$1,534,810	0.2%	1,018
\$127,781 - \$183,475	\$1,954,222,647	\$413,643	0.1%	65
\$183,476 & Over	\$8,869,633,832	\$259,417	0.0%	158
<b>Nonresidents</b>	\$961,801,005	\$8,230,151	1.2%	11,804
<b>All</b>	<b>\$14,873,000,000</b>	<b>\$712,700,000</b>	<b>100%</b>	<b>516,600</b>

#### 4.1.01 (p.136)

#### Food Products

##### Legal Citation

Minnesota Statutes, Section 297A.67, Subd. 2

##### Description of Current Law

Food and food ingredients for human consumption are generally exempt from the sales tax. Included in the exemption are substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, which are consumed for their taste or nutritional value.

The exemption does not include chewing gum, alcoholic beverages, tobacco, or dietary supplements. The exemption does not apply to food and drinks served by a restaurant or prepared food. Prepared food is either food sold in a heated state or heated by the seller, two or more food ingredients mixed or combined by the seller for sale as a single item, or food sold with eating utensils provided by the seller. However, bakery items, ready-to-eat meat and seafood, and foods that require cooking are exempt.

##### History

The exemption for food products was included when the sales and use tax was enacted in 1967. Candy and soft drinks were included in the exemption until 1982. This provision was last modified in 2006. Food sold through vending machines was added to the exemption in 2017.

##### Revenue-Neutral Rate (new)

**Revenue Neutral Rate:** If the tax expenditure were repealed, the general sales and use tax could be reduced to 5.896%.

##### Dollar Impact

Fiscal Year	2024	2025	2026	2027
All Funds	\$1,404,000,000	\$1,450,800,000	\$1,507,700,000	\$1,554,900,000



#### 4.1.01 Food Products continued

**Incidence:** The following table shows the incidence of the tax expenditure, based on the 2021 incidence database.

<b>Resident by Population Decile</b>	<b>Sales &amp; Use Tax</b>	<b>Tax Change</b>	<b>Share of Tax Change</b>
\$15,544 & Under	\$275,989,456	\$85,063,851	6.1%
\$15,545 - \$24,961	\$321,365,571	\$92,379,230	6.6%
\$24,962 - \$35,168	\$369,752,647	\$99,851,569	7.1%
\$35,169 - \$45,808	\$417,394,917	\$106,471,064	7.6%
\$45,809 - \$58,014	\$465,046,347	\$114,715,348	8.2%
\$58,015 - \$73,668	\$526,644,412	\$124,214,028	8.9%
\$73,669 - \$95,360	\$641,957,246	\$141,614,154	10.1%
\$95,361 - \$127,780	\$802,412,748	\$166,688,819	11.9%
\$127,781 - \$183,475	\$988,123,559	\$190,716,078	13.6%
\$183,476 & Over	\$2,041,065,136	\$240,712,884	17.1%
<b>Nonresidents</b>	<b>\$1,605,124,031</b>	<b>\$41,572,975</b>	<b>3.0%</b>
<b>All</b>	<b>\$8,454,900,000</b>	<b>\$1,404,000,000</b>	<b>100%</b>

# The Scope of Tax Expenditures

## Number of Tax Expenditures by Tax:

• <b>Individual Income Tax</b>	<b>108</b>
• Corporate Franchise Tax	34
• Estate Tax	6
• <b>General Sales &amp; Use Tax</b>	<b>92</b>
• Motor Vehicle Sales Tax	18
• Excise Taxes (motor fuels, alcohol, tobacco)	16
• Mortgage & Deed Taxes	8
• Gambling Taxes	6
• Insurance Taxes	11
• Property Taxes	12
• Motor Vehicle Registration Tax	10
• Air-Flight Property & Registration Taxes	2
• Cannabis Gross Receipts Tax	<u>4</u>
<b>TOTAL</b>	<b>327</b>

# Income Tax Expenditures

	\$ millions
Gross Revenue	23,764.8
Tax Expenditures with significant administrative barriers to repeal	6,624.1
Other Tax Expenditures	2,267.7
Net Revenue	14,873.0

Repealing the Tax Expenditures that cause few or no administrative problems would allow the rates to be changed:

	Current	Alternative
1 <sup>st</sup> Bracket	5.35%	4.55%
2 <sup>nd</sup> Bracket	6.8%	5.75%
3 <sup>rd</sup> Bracket	7.85%	6.65%
4 <sup>th</sup> Bracket	9.85%	8.35%

# Corporate Franchise Tax Expenditures

	\$ millions
Gross Revenue	5,019.5
Tax Expenditures with significant administrative barriers to repeal	265.9
Other Tax Expenditures	1,582.4
Net Revenue	3,171.2

Repealing the Tax Expenditures that cause few or no administrative problems would allow the rates to be changed:

	Current	Alternative
Rate	9.8%	6.55%

# Sales Tax Expenditures

	\$ millions
Gross Revenue	18,925.7
Tax Expenditures by Government, Nonprofits, & Businesses	5,749.3
Tax Expenditures by Consumers (primarily)	4,721.9
Net Revenue	8,454.5

Repealing the Tax Expenditures  
that are consumer (primarily)  
goods & services:

	Current	Alternative
Rate	6.875%	4.425%

# Property Tax Expenditures

- Tax expenditures result in tax shifts, not changes in tax levels
- Largest tax expenditures are classification & exemptions
  - Classification system determines how tax levies are shared among types of property
- Report does not include property exempted under federal law or the MN Constitution (schools & churches)

# PROPERTY TAX CLASSIFICATION SYSTEM & ALTERNATIVE TAX BASES

Total State and Local Levies  
Tax shift under uniform tax base

Farm Homestead HGA	-1%
Farm Homestead Land	+114%
Farm Non-Homestead	+26%
Timber	+97%
Seasonal Rec. Res.	+8%
Residential Homesteads	+20%
Residential Non-Homesteads	+17%
Apartments	+12%
Commercial -Ind 1st Tier	-24%
Commercial -Ind 2nd Tier	-46%
Comm. Seasonal Rec.	+8%
Public Utility Real	-41%
Railroad	-50%
Mineral	-46%
Personal	-50%
Total Real & Personal Property	-0%

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the TEB



# Summary

- Provides public transparency on state policies enacted through the tax code
- Identifies state tax policies that may complement or conflict with direct spending programs and regulations
- Identifies avenues to broaden a tax base to raise revenues or reduce rates
- Provides legislative Tax Expenditure Review Commission (TERC) with baseline information about tax expenditures
- TERC's ongoing work is to conduct evaluations of the effectiveness of individual tax expenditures

# QUESTIONS?

[Eric.Willette@state.mn.us](mailto:Eric.Willette@state.mn.us)