MINNESOTA · REVENUE

February 18, 2003

The Minnesota Legislature
State Capitol
St. Paul, Minnesota

Dear Legislators,

I am pleased to present the Governor's budget proposal as it relates to reducing and reforming local government aid expenditures and changing state tax laws. These changes reflect the Governor's commitment to balancing the state budget, restoring reserves, reducing the rate of growth in state expenditures, and protecting basic services and high-priority programs without increasing taxes.

Changes in Local Government Aids

Aid to Cities

The Governor recommends that aid to cities in fiscal years 2004-05 be $1.07 billion. This represents a $435 million or 29 percent reduction from previous forecast. These reductions focus on Local Government Aid (LGA), and in some cases Market Value Credits. Recognizing that calendar 2003 local budgets are already set, the aid reductions are "back-loaded" with 32 percent of the total reduction in calendar 2003, and 68 percent in calendar 2004. The Governor also recommends strict levy limits for calendar 2004 to ensure that the aid reductions result in local spending adjustments instead of property tax increases. However, city property taxes can exceed the limit with voter approval.

To accommodate the recommended reductions without tax increases, cities will need to reduce total spending by an average of 3.8 percent in 2003, and 7.4 percent in 2004. Budgetary impacts are relatively uniform, and are capped at 5 percent and 9.5 percent of estimated total revenues for 2003 and 2004 respectively.

The Governor recommends that LGA for calendar 2005 be distributed through a new need/capacity formula that applies certain criteria that will be released by the Administration shortly. The new formula will be developed in consultation with city officials. The funding level for LGA in 2005 will be contingent on enactment of an acceptable formula.

Aid to Counties

The Governor recommends that county aid be $722.8 million in the 2004-05 biennium. This represents a reduction of $189.4 million or 20 percent from previous forecast. These changes will consist of reductions in such programs as HACA, Family Preservation Aid, County Criminal Justice Aid, Attached Machinery Aid, and Out-of-Home Placement Aid and, if needed, the Market Value Credit. Similar to cities, county aid reductions are back-loaded to FY2004. In calendar year 2004, most existing county aid programs are ended and a single new aid program with a formula based on both need and capacity is created

On a budgetary basis, these changes will require county budget reductions averaging 1.6 percent in 2003, and 2.8 percent in 2004, with budget reductions capped at 2 percent of total revenues in 2003, and 3 percent in 2004. The funding level for county aids in calendar years 2005 and 2006 will be contingent on reform.

There are also some aid changes that effect townships, special districts, and schools. Under the aids category, the Governor is also recommending repeal of the small Used Oil Filter Refund program.

Commissioner's Office
Mail Station 7100
St. Paul, MN 55146-7100

Tel: 651-296-3403
Fax: 651-297-5309
Minnesota Relay (TTY) 711

Tax Changes

Tax-Free Zones

The Governor's major tax initiative this session will be a proposal for tax free zones called Job Opportunity Building Zones or JOBZ. The details of this proposal will be released separately, however, we are including a placeholder budget initiative at this time.

In order to spark economic development in economically struggling areas of Minnesota, the Governor is proposing the creation of up to 10 tax-free zones. Individual and business activities within these zones will enjoy broad exemptions from individual and corporate income taxes, sales taxes on building materials, equipment and vehicles used in the zone and property taxes on improvement to land in the zone. This proposal is based on successful plans enacted in recent years in Pennsylvania and Michigan.

Eligible areas include cities, counties and towns outside the seven-county Metro area that are suffering economic distress. To gain tax-free zone designation, interested eligible local governments will develop an economic development plan. The plans will be submitted to the Commissioner of Trade and Economic Development during a fixed application period. The Commissioner will evaluate all submitted plans and grant tax-free zone status to up to 10 areas, based on need and likelihood of success, as measured by criteria such as the quality of the development plan and local public and private support for the plan.

At present, the proposal is estimated to save businesses and individuals a total of $5.5 million during fiscal years 2004-2005.

Other tax initiatives being recommended by the Governor include:
- Permanent extension of the current accelerated June sales tax payment;
- Changes in the disposition of lottery in lieu of sales tax payments;
- Changes in the dedication of the cigarette tax, moving the dedication away from the future resources fund and toward medical education research at both the University of Minnesota and the Department of Health;

The Governor is also recommending that funds now in the medical education endowments be transferred to the general fund to restore budgetary reserve quickly.

I look forward to working with you as we begin to debate and address these very important actions.

Sincerely,

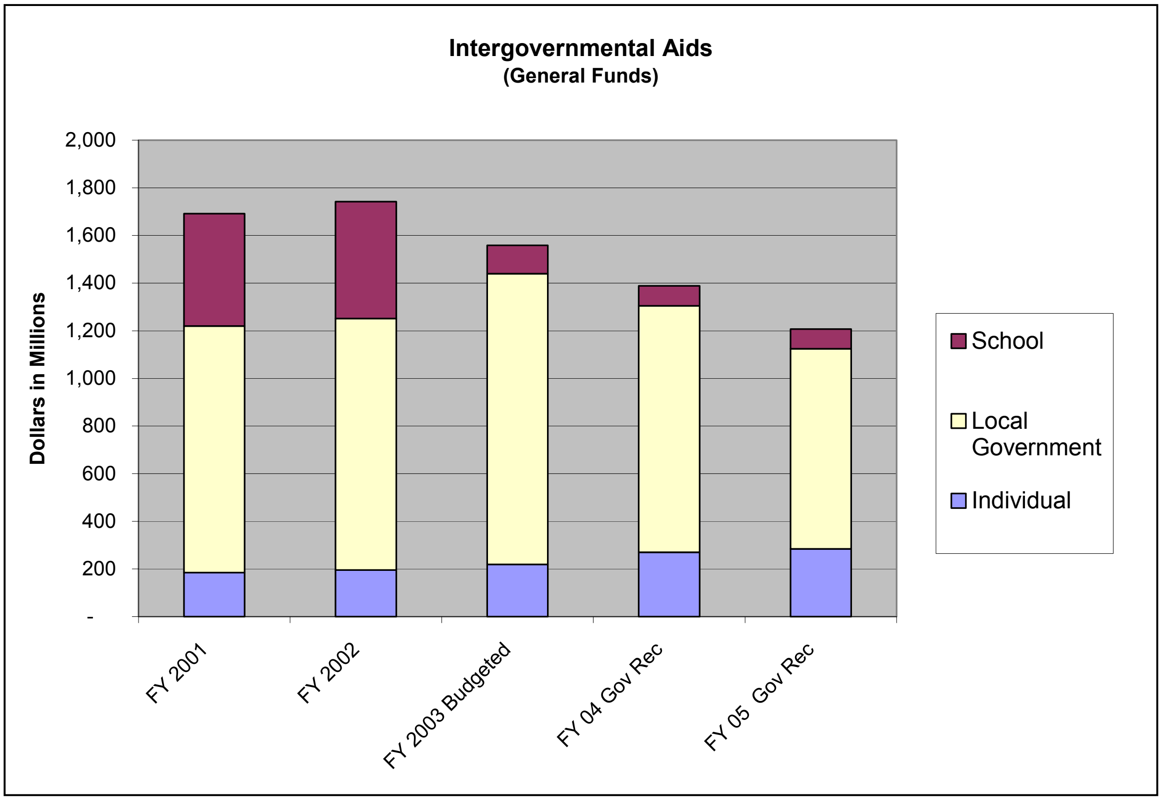
Daniel A Salomone

Dan Salomone

Summary of Intergovernmental Aids (General Fund)

dollars in $000s

	FY 2001	FY 2002	FY 2003 Governor Supp Rec	FY 04 Governor Supp Rec	FY 05 Governor Supp Rec
Total	**1,722,792**	**1,779,747**	**1,598,932**	**1,420,383**	**1,238,709**
Individuals	**184,790**	**195,154**	**219,031**	**270,213**	**284,042**
RENTERS CREDIT	115,389	118,961	129,996	134,941	137,891
PROPERTY TAX REFUND	68,189	72,851	87,949	117,055	129,962
PROPERTY TAX REFUND - TARGETED	1,163	3,293	1,036	14,400	11,800
USED OIL & FILTER REFUND	49	49	50	-	-
FOREST LAND CREDIT PROGRAM	-	-	-	3,817	4,389
School	**471,809**	**490,746**	**118,595**	**83,449**	**82,852**
RESIDENTIAL HMSTD MV CREDIT	-	-	57,658	68,883	68,100
EDUCATION HOMESTEAD CREDIT	387,811	404,992	41,257	305	34
DISPARITY REDUCTION AID	10,365	10,393	7,518	8,480	8,696
EDUCATION AGRICULTURAL CREDIT	41,381	54,199	5,512	-	-
AGRIC HMSTD MV CREDIT	-	-	3,198	4,857	5,062
HMSTD AGR CREDIT AID (HACA)	29,655	18,333	1,720	-	-
ATTACHED MACHINERY AID	836	836	810	-	-
BORDER CITY CREDIT	1,199	1,423	358	368	422
TACONITE AID REIMBURSEMENT	561	561	561	533	533
DISASTER CREDIT	-	8	3	23	5
ENTERPRISE ZONE CREDIT	1	1	-	-	-
County, City, Town & Special Districts	**1,034,957**	**1,055,911**	**1,224,515**	**1,034,078**	**840,113**
LOCAL GOVERNMENT AID (LGA)	394,939	411,926	564,991	466,063	352,616
RESIDENTIAL MV CREDIT	-	-	257,927	231,137	208,172
HOMESTEAD AGR CREDIT AID (HACA)	471,634	470,327	207,461	134,471	18,641
AID TO POLICE & FIRE (Pension)	59,391	56,228	63,272	68,533	74,948
CRIMINAL JUSTICE AID	29,411	30,575	31,600	32,476	-
FAMILY PRESERVATION AID	21,721	22,644	23,406	23,991	-
PERA AID (Pension)	14,774	14,586	14,586	14,586	14,586
AGRICULTURAL MV CREDIT	-	-	14,354	18,089	18,089
DNR-PILT (appr - DNR, exp - DOR)	*-*	*11,779*	*12,053*	*12,230*	*12,407*
DISPARITY REDUCTION AID	13,022	13,015	9,924	10,924	11,024
POLICE & FIRE AMORTIZATION (Pension)	9,461	11,062	9,288	9,252	7,883
SUPPLEMENTAL TACONITE AID	559	570	4,768	4,887	5,009
WASHBURN-CROSBY PROJECT	-	-	2,600	-	-
ATTACHED MACHINERY AID	2,382	2,382	2,382	-	-
BORDER CITY CREDIT	3,419	3,970	2,760	4,147	4,559
TIF DEFICIT AID	1,020	1,988	35	-	-
FLOOD RELIEF-PROPERTY TAX AID	-	-	157	-	-
INDIAN CASINO COUNTY AID	734	693	693	693	693
PUBLIC DEFENDER COSTS	-	285	480	492	500
LOW INC HOUSING AID	614	1,604	1,646	1,843	-
SENIOR DEFFERAL	-	93	124	189	236
DISASTER CREDIT	-	26	8	75	-
COUNTY NEED CAPACITY AID	-	-	-	-	110,750
REGIONAL TRANSIT BOARD AID	1,864	2,154	-	-	-
FARM AID	9	1	-	-	-
CHARITY CARE AID	10,000	-	-	-	-
ENTERPRISE ZONE CREDIT	3	3	-	-	-
Non Aid Items in Fund Balance Category	**31,236**	**37,936**	**36,791**	**32,643**	**31,702**
POLITICAL CONTRIBUTION REFUND	5,198	4,485	5,000	2,334	1,600
ORE PROD TAX REPLACEMENT AID	-	12,967	7,291	7,659	7,345
TAX REFUND INTEREST	26,038	20,484	24,500	22,500	22,700
TAX FREE ZONES (Agency Appr)	-	-	-	150	57


Intergovernmental Aids
(General Funds)
Dollars in Millions
2,000
1,800
1,600
1,400
1,200
1,000
800
600
400
200
-
FY 2001
FY 2002
FY 2003 Budgeted
FY 04 Gov Rec
FY 05 Gov Rec
School
Local Government
Individual

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	($140,729)	($294,000)	($270,000)	($290,000)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($140,729)	($294,000)	($270,000)	($290,000)

Recommendation

The Governor believes that cities, like all agencies, programs, organizations, and individuals that depend on state financial resources from the State, must share the burden of solving the current budget problem. All must be prepared to exist with reduced state resources.

The Governor recommends that in the 2004-05 biennium local aid payments to cities be $1.07 billion. This represents a reduction of $435 million or 29%. For most cities, this reduction is limited to the Local Government Aids (LGA) program and in some cases Market Value Credit payments. Recognizing that calendar 2003 local budgets are already set, the Governor is recommending that the reductions in the first year of the biennium be limited to roughly one-third of the total. This will give cities additional time to plan for the larger reductions in the second year of the biennium. The Governor is also recommending strict levy limits (with referendum override) for calendar year 2004 and beyond. This will ensure that to the maximum extent possible, the state aid reductions will result in local spending adjustments instead of property tax increases.

Background

Minnesota has a long history of supplementing local government revenues with state general fund aid payments. Advocates of state aid payments have advanced several reason for this financial relationship including:

- state aid payments help communities with limited property wealth to provide basic local services without undue property tax burden;
- state aid payments help offset the cost of state mandates; and
- state aid payment helps limit overall property tax burden.

Critics of the current aid system have also advanced several criticism including:

- state aid distribution formulas are often not based on need but on historical spending patterns;
- state aid programs do not have specific objectives or accountability measures; and
- state aid drive increased spending by local governments not reduced property taxes.

It is important to note, for this budget recommendation, local aids is a subset of many different state payments to cities. The state paid aids considered in this budget initiative are those included in the forecast and general fund balance under the heading of Intergovernmental Aids. These are paid to cities by the Department of Revenue. It does not include things like local transportation aid (paid by MnDOT) or other payments by other state agencies.

FY 2004 / Calendar 2003

Because local budgets, including property tax levies and anticipated aids, are already set, cities will be forced to make up aid reductions with spending reductions. Because this will put cities in a reactive mode, the Administration decided that the aid reductions should be “back loaded” (FY 04 reduction would be substantially less then FY 05 reduction).

The Administration also rejected a straight percentage of aid as the basis of the reduction because it would not share the burden of the reduction as widely as possible. Under the straight percentage scenario, cities with budget highly dependent on aids would take very large cuts, while cities with small or no reliance on aids would face minimal or no reductions. Local *“aids”* represent only the state-paid portion of the overall property tax revenue system while *“levy plus aids”* represents the total revenues of the overall property tax system. The

Administration decided that the fairest basis on which to allocate reductions to cities was levy plus aids rather then aids only.

In allocating the calendar 2003 city aid reductions, the Administration started by calculating **9.3% of calendar year 2003 levy plus aid**. This was generally smaller then the reductions proposed for state agencies and other state services. This initial reduction was then compared to that cities' total revenues as stated in the most recent State Auditor reports (generally 2000 or 2001). In this context, *Total revenues* exclude local unit grants and borrowing but includes "net" transfers from enterprise funds. Three separate "caps" were imposed in determining the final aid reduction. These were:

- **5.0% of total revenue** for cities with populations over 1,000
- **3.5% of total revenues** for cities under 1,000
- **3.5% of total revenues** for cities with a three-year average levy plus aid growth rate less than 2%.

Once the final aid reduction is determined for each city, the reduction is applied first to anticipated LGA payments and then to anticipated Market Value Credit payments if necessary.

FY 2005 / Calendar 2004

Because local budgets are not set for this year, cities have more opportunity to plan for aid reductions and the associated spending adjustment required. Therefore, the Administration has recommended a larger reduction in this year.

In CY 04, the Administration started by developing individual city reduction target based on percent of total revenue as presented in the latest State Auditor report (rather then levy plus aid). The Administration decided this basis would be most comparable to other agencies, institutions, and programs facing General Fund reductions. The individual targets were established using the following parameters:

- **9.5% of total revenues** for cities with population greater than 1,000
- **8.0% of total revenue** for cities with populations less than 1,000
- **8.0% of total revenues** for cities with a three year levy plus aid growth rate of less then 2.0%

To set a policy direction on LGA, the Administration then calculated a minimum CY 04 LGA payment by distributing $250 million under the current LGA formula (excluding grand-fathered and including specific caps for first class cities).

The difference between the current CY 03 LGA for each city and the CY 04 minimum payment, calculated above, create a maximum LGA reduction amount for each city. If the maximum LGA reduction amount exceeds the initial targeted reduction (percent of OSA revenue stated above), then the city's CY04 LGA reduction equals the targeted amount. If the maximum LGA reduction is less than the initial targeted reduction, then the city's CY 04 LGA reduction equals the maximum LGA reduction, and the city's Market Value Credit payment will also be reduced until the combined LGA plus Market Value Credit reduction equals the targeted reduction amount or the Market Value Credit payment is zero.

The Administration believes that these reductions can and should be absorbed by the cities through spending restraint rather than raising property taxes. To ensure this, the Administration is recommending strict levy limits for CY 04. The Administration recognizes that this may be impossible for some cities, so it is recommending that these levy limits could be superceded by referendum, as allowed under current law.

Relationship to Base Budget

	2004 Base Budget	2004 Governor's Rec	Change	2005 Base Budget	2005 Governor's Rec	Change
Cities						
AID TO LOCAL GOVERNMENT	586,849	466,063	(120,786)	607,616	352,616	(255,000)
RESIDENTIAL HMSTD MV CREDIT	87,407	67,464	(19,943)	84,139	45,139	(39,000)
AID TO POLICE & FIRE (Pension)	54,566	54,566	-	59,528	59,528	-
LOCAL P&F AMORT AID (Pension)	8,795	8,795	-	7,426	7,426	-
PERA AID (Pension)	5,352	5,352	-	5,352	5,352	-
LOW INC HOUSING AID	1,843	1,843	-	-	-	-
BORDER CITY CREDIT	1,099	1,099	-	1,209	1,209	-
LOCAL P&F AMORT (Vol Fire Pension)	457	457	-	457	457	-
AGRIC HMSTD MV CREDIT	258	258	-	258	258	-
DISASTER CREDIT	26	26	-	-	-	-
	746,652	**605,923**	**(140,729)**	**765,985**	**471,985**	**(294,000)**
			-18.8%			-38.4%

The table above shows how all of the city aids categorized as Intergovernmental aids are affected in both years of the biennium by the Governor's recommendation. The table below puts the Governor's recommendation into the overall context of the city's total revenues and total budget.

Governor's Proposed CY 2003
City Aid Reduction
As a Percent of
Total City Revenues (OSA)

	Cities	
Percent Change	**Number**	**Percent**
Less than 1.0%	18	2.1%
1.0% --- 3.5%	119	14.0%
3.5% --- 5.0%	554	64.9%
At 5.0% cap	162	19.0%
Total	853	100.0%

Average -- 3.8% of total revenues

Governor's Proposed CY 2004
City Aid Reduction
As a Percent of
Total City Revenues (OSA)

	Cities	
Percent Change	**Number**	**Percent**
Less than 3.0%	65	7.6%
3.0% --- 5.0%	54	6.3%
5.0% --- 8.0%	524	61.4%
8.0% --- 9.5%	20	2.3%
At 9.0% cap	190	22.3%
Total	853	100.0%

Average -- 7.4% of total revenues

Change Item: ELIMINATE ATTACHED MACHINERY AID - SCHOOLS

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	($ 810)	($ 810)	($ 810)	($ 810)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($ 810)	($ 810)	($ 810)	($ 810)

Recommendation

As part of overall Local Aid Reform, the Governor recommends the elimination of the Attached Machinery Aid program. This program provides aid payments to a very few local governments. In the Governor's opinion, this program has outlived the purpose for which it was created.

The repeal of this program will affect aid payments to twelve individual school districts. The potential negative levy impacts of this change will be offset by positive changes in the K-12 bill in all but one district.

Background

The Attached Machinery Aid program was created in the early 1970s. It was designed to reimburse certain local governments for local revenue lost when attached business machinery was exempted from property tax. The actual machinery originally compensated for, in all likelihood, no longer exists. It has likely been replaced with new equipment, yet the old aid payments continue.

A limited number of counties and school districts now receive this aid. This change item addresses only the public school impact of this change.

Relationship to Base Budget

The table below illustrates the repeal of attached machinery aid in the context of the other general fund property tax aids received by school districts for both years of the biennium. This does not include basic state paid general education aids paid by Department of Education.

	2004 Base Budget	2004 Governor's Rec	Change	2005 Base Budget	2005 Governor's Rec	Change
Schools						
DISPARITY REDUCTION AID	8,480	8,480	-	8,696	8,696	-
BORDER CITY CREDIT	368	368	-	422	422	-
ATTACHED MACHINERY AID	810	-	(810)	810	-	(810)
TACONITE AID REIMB	533	533	-	533	533	-
EDUCATION HOMESTEAD CREDIT	305	305	-	34	34	-
RESIDTL HMSTD MV CREDIT	68,883	68,883	-	68,100	68,100	-
AGRIC HMSTD MV CREDIT	4,857	4,857	-	5,062	5,062	-
DISASTER CREDIT	23	23	-	5	5	-
	84,259	**83,449**	**(810)**	**83,662**	**82,852**	**(810)**
			-1.0%			-1.0%

To get an idea of how these changes affect the individual school districts, two comparisons are useful. The first is the attached machinery aid as a percent of Adjusted Net Tax Capacity (ANTC). For the twelve affected school districts, the average change is 0.9% of ANTC, and it ranges from 0.3% of ANTC to 2.6% of ANTC. Six districts are below 1% of ANTC, four are between 1% and 2% of ANTC, and two are over 2% of ANTC.

The second comparison is the attached machinery aid on a per-pupil basis. On a per pupil basis, the average change due to repeal of attached machinery aid is $30.64, and it ranges from $10.33 to $86.96. Using a $7,633 estimate for the current year per pupil revenues per student, the average is 0.4% of revenues, and the range is 0.1% to 1.1%.

Change Item: COUNTY AIDS REDUCTION AND REFORM

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	($65,011)	($124,382)	($34,200)	($38,500)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($65,011)	($124,382)	($34,200)	($38,500)

Recommendation

The Governor believes that counties, like all agencies, programs, organizations, and individuals that depend on state financial resources from the State, must share the burden of solving the current budget problem. All must be prepared to exist with reduced state resources.

The Governor recommends that in the 2004-05 biennium local aid payments to counties be $738.8 million (including PILT). This represents a reduction of $189.4 million or 20% from the current forecasted amount. Because of the counties unique role in delivering many state programs and services and because of pressures the counties will face in other areas of the budget, the Governor has recommended that local aid reductions for counties be less than those for cities.

Recognizing that calendar 2003 local budgets are already set, the Governor is recommending that the reductions in the first year of the biennium be limited to roughly one-third of the total. This will give counties additional time to plan for the larger reductions in the second year of the biennium. The Governor is also recommending strict levy limits (with referendum override) for calendar year 2004 and beyond. This will ensure that to the maximum extent possible, the state aid reductions will result in local spending adjustments instead of property tax increases.

The Governor recommends two reform pieces along with the overall reduction. One is the repeal of attached Machinery Aid. The second is the consolidation of a number separate formula driven aid programs into a single program with a formula based on both need and capacity. The aid programs that the Governor is recommending for consolidation include Homestead and Agricultural Credit Aid (HACA), mobile home HACA, Out of Home Placement Aid, Criminal Justice Aid, and Family preservation Aid. In consolidating HACA, all component needed to protect the county court takeover, now in law, will be preserved (either as HACA or a new program).

Background

Minnesota has a long history of supplementing local government revenues with state general fund aid payments. Advocates of state aid payments have advanced several reasons for this financial relationship including:

⇒ State aid payments help communities with limited property wealth to provide basic local services without undue property tax burden.

⇒ State aid payments help offset the cost of state mandates.

⇒ State aid payment helps limit overall property tax burden.

Critics of the current aid system have also advanced several criticism including:

⇒ State aid distribution formulas are often not based on need but on historical spending patterns.

⇒ State aid programs do not have specific objectives or accountability measures.

⇒ State aid drives increased spending by local governments not reduced property taxes.

It is important to note, for this budget recommendation, local aids is a subset of many different state payments made to counties. The state paid aids considered in this budget initiative are those included in the forecast and general fund balance under the heading of Intergovernmental Aids. These are paid to cities by the Department of Revenue. It does not include other county payments such as local highway payments, human services support payments, public health and corrections programs and grants paid by other agencies.

Change Item: COUNTY AIDS REDUCTION AND REFORM

The Attached Machinery Aid program was created in the early 1970s. It was designed to reimburse certain local governments for local revenue lost when attached business machinery was exempted from property tax. The actual machinery originally compensated for, in all likelihood, no longer exists. It has likely been replaced with new equipment, yet the old aid payments continue. A limited number of counties and school districts now receive this aid. The Governor is recommending repeal of this aid program.

FY 2004 / Calendar 2003
Because local budgets, including property tax levies and anticipated aids, are already set, counties will be forced to make up aid reductions with spending reductions. Because this will put cities in a reactive mode, the Administration decided that the aid reductions should be "back loaded" (FY 04 reduction would be substantially less then FY 05 reduction).

The Administration also rejected a straight percentage of aid as the basis of the reduction because it would not share the burden of the reduction as widely as possible. Under the straight percentage scenario, counties with budget highly dependent on aids would take very large cuts, while counties with smaller on aids would face minimal reductions. Local *"aids"* represent only the state-paid portion of the overall property tax revenue system while *"levy plus aids"* represents the total revenues of the overall property tax system. The Administration decided that the fairest basis on which to allocate reductions to counties was levy plus aid rather then aids only.

In allocating the calendar 2003 city aid reductions, the Administration started by calculating **3.2% of calendar year 2003 levy plus aid**. This was substantially smaller then the reductions proposed for state agencies and other state services. This initial reduction was then compared to that county's total revenues as stated in the most recent State Auditor reports (generally 2000). In this context, *total revenues* exclude local unit grants and borrowing but includes "net" transfers from enterprise funds. Two separate "caps" were imposed in determining the final aid reduction. These were:

- 2.0% of total revenue for all counties; and
- 1.5% of total revenues for counties with a three-year average levy plus aid growth rate less than 2%.

Once the final aid reduction is determined for each county, the reduction is applied first to Attached machinery Aid, HACA, Family Preservation Aid, County Criminal Justice Aid, and then to anticipated Market Value Credit payments if necessary.

FY 2005 / Calendar 2004
Because local budgets are not set for this year, counties have more opportunity to plan for aid reductions and the associated spending adjustment required. Therefore, the Administration has recommended a larger reduction in this year.

For counties in CY 04, the Administration also used a levy plus aid base approach. The Administration started by calculating **6.0% of calendar year 2003 levy plus CY 04 aid**. Again, this was substantially smaller then the reductions proposed for state agencies and other state services. This initial reduction was then compared to that county's total revenues as stated in the most recent State Auditor report. Again, two separate "caps" were imposed in determining the final aid reduction. These were:

- 3.0% of total revenue for all counties; and
- 2.5% of total revenues for counties with a three-year average levy plus aid growth rate less than 2%.

Once the final aid reduction is determined for each county, the reduction is applied first to the newly created need capacity, and then to anticipated Market Value Credit payments if necessary.

The Administration believes that these reductions can and should be absorbed by the counties through spending restraint rather than raising property taxes. To ensure this, the Administration is recommending strict levy limits for CY 04. The Administration recognizes that this may be impossible for some counties, so it is recommending that these levy limits could be superceded by referendum, as allowed under current law.

Relationship to Base Budget

	2004 Base Budget	2004 Governor's Rec	Change	2005 Base Budget	2005 Governor's Rec	Change
Counties						
HOMESTEAD AGR CREDIT AID-HACA	197,100	134,471	(62,629)	140,205	18,641	(121,564)
RESIDENTIAL HMSTD MV CREDIT	142,478	142,478	-	142,842	142,842	-
CRIMINAL JUSTICE AID	32,476	32,476	-	33,282	-	(33,282)
FAMILY PRESERVATION AID	23,991	23,991	-	24,591	-	(24,591)
AGRIC HMSTD MV CREDIT	13,034	13,034	-	13,034	13,034	-
AID TO POLICE & FIRE (Pension)	12,578	12,578	-	13,899	13,899	-
DNR-PILT *(appr- DNR, exp - DOR)*	12,230	12,230	-	12,407	12,407	-
DISPARITY REDUCTION AID	10,212	10,212	-	10,282	10,282	-
PERA AID (Pension)	8,446	8,446	-	8,446	8,446	-
SUPPLEMENTAL TACONITE AID	4,887	4,887	-	5,009	5,009	-
ATTACHED MACHINERY AID	2,382	-	(2,382)	2,382	-	(2,382)
BORDER CITY CREDIT	2,200	2,200	-	2,420	2,420	-
INDIAN CASINO COUNTY AID	693	693	-	693	693	-
PUBLIC DEFENDER COSTS	492	492	-	505	505	-
SENIOR DEFFERAL	189	189	-	236	236	-
DISASTER CREDIT	49	49	-	-	-	-
COUNTY NEED CAPACITY AID	-	-	-	-	110,750	110,750
OUT OF HOME PLACEMENT AID	-	-	-	53,313	-	(53,313)
	463,437	**398,426**	**(65,011)**	**463,546**	**339,164**	**(124,382)**
			-14.0%			-26.8%

The table above shows how all of the county aids categorized as Intergovernmental aids are affected in both years of the biennium by the Governor's recommendation. The table below puts the Governor's recommendation into the overall context of the county's total revenues and total budget.

Governor's Proposed CY 2003 City Aid Reduction
As a Percent of Total County Revenues (OSA)

	Cities	
Percent Change	**Number**	**Percent**
Less than 1.0%	5	5.7%
1.0% --- 2.0%	80	92.0%
At 2.0% cap	2	2.3%
Total	87	100.0%

Average -- 1.6% of total revenues

Governor's Proposed CY 2004City Aid Reduction
As a Percent of Total County Revenues (OSA)

	Cities	
Percent Change	**Number**	**Percent**
Less than 2.0%	6	6.9%
2.0% --- 3.0%	47	54.0%
At 3.0% cap	34	39.1%
Total	87	100.0%

Average -- 2.8% of total revenues

Change Item: TOWN and SPECIAL DISTRICT AID REDUCTION

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	($5,300)	($7,300)	0	0
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($5,300)	($7,300)	0	0

Recommendation

The Governor believes that townships and special districts, like all agencies, programs, organizations, and individuals that depend on state financial resources from the State, must share the burden of solving the current budget problem. All must be prepared to exist with reduced state resources.

The Governor recommends that in the 2004-05 biennium local aid payments to townships be $ 31.3 million. This represents a reduction of $7.3 million or 19%. For townships, this reduction is limited to the Market Value Credit payments. Recognizing that calendar 2003 local budgets are already set, the Governor is recommending that the reductions in the first year of the biennium be limited to roughly one-third of the total. This will give townships additional time to plan for the larger reductions in the second year of the biennium.

The Governor recommends that in the 2004-05 biennium local aid payments to special districts be $33.3 million. This represents a reduction of $5.3 million or 13.7%. For special districts, this reduction is limited Market Value Credit payments.

Background

Minnesota has a long history of supplementing local government revenues with state general fund aid payments. Advocates of state aid payments have advanced several reason for this financial relationship including:

- State aid payments help communities with limited property wealth to provide basic local services without undue property tax burden.
- State aid payments help offset the cost of state mandates.
- State aid payment helps limit overall property tax burden.

Critics of the current aid system have also advanced several criticism including:

- State aid distribution formulas are often not based on need but on historical spending patterns.
- State aid programs do not have specific objectives or accountability measures.
- State aid drive increased spending by local governments not reduced property taxes.

The Administration used percent of total levy as the basis for distributing the cuts as widely and as fairly as possible for both townships and special districts. In FY 04/CY03, the basis was 2.0% of levy for townships and 1.5% of levy for special districts. In FY 05/CY04, the basis was 3.0% of levy for townships, and 2.0% of levy for special districts.

Relationship to Base Budget

Townships:

	2004 Base Budget	2004 Governor's Rec	Change	2005 Base Budget	2005 Governor's Rec	Change
Townships						
RESIDENTIAL MV CREDIT	13,627	10,727	(2,900)	13,759	9,359	(4,400)
AGRIC HMSTD MV CREDIT	4,376	4,376		4,376	4,376	
DISPARITY REDUCTION AID	712	712		742	742	
AID TO POLICE & FIRE (Pension)	466	466		500	500	
PERA AID (Pension)	42	42		42	42	
	19,223	**16,323**	**(2,900)**	**19,419**	**15,019**	**(4,400)**
			-15.1%			-22.7%

Special Districts

	2004 Base Budget	2004 Governor's Rec	Change	2005 Base Budget	2005 Governor's Rec	Change
Special Districts						
RESIDENTIAL HMSTD MV CREDIT	12,868	10,468	(2,400)	13,732	10,832	(2,900)
AID TO POLICE & FIRE	923	923	-	1,021	1,021	-
BORDER CITY CREDIT	848	848	-	930	930	-
PERA AID (Pension)	746	746	-	746	746	-
AGRIC HMSTD MV CREDIT	421	421	-	421	421	-
	15,806	**13,406**	**(2,400)**	**16,850**	**13,950**	**(2,900)**
			-15.2%			-17.2%

Change Item: REPEAL USED OIL FILTER REFUND PROGRAM

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	(50)	(50)	(50)	(50)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	(50)	(50)	(50)	(50)

Recommendation

The Governor recommends that the Used Oil Filter Refund Program be ended as part of the overall reform and reduction of local government aids and credits. The program is outside of the core mission of the Department of Revenue.

Background

This program, enacted in Laws of Minnesota 1998, Chapter 389, Article 16, Section 16, was created as a supplement to a used oil reimbursement program operate by the commissioner of the pollution control agency. The reimbursement program is funded from the contaminated used motor oil reimbursement account in the environmental fund.

This refund program is operated by the commissioner of revenue. It is limited to 200 applicants with a maximum refund of $250. Though it is grouped with local aids and credits within the general fund balance, it is actually a payment to individuals and businesses. This program is a “refund” in name only. The refund is not tied to a specific tax. In fact, while the petroleum related taxes and used oil fees are generally dedicated to special funds, these payments are made from the general fund. It is probably more appropriate to consider this a grant program rather then a refund program.

Relationship to Base Budget

This program is a tiny portion of the local aids and credit budget. It’s $100,000 biennial cost is less than 0.01% of the over $3 billion the state spends on local aids and credits.

Statutory Change: MS 325E.112, subd. 2a. repealed.

Background

The Governor's budget proposal includes several changes to state reserves and tax law. The table found below summarizes the items in the Tax Bill. Detailed change items describing these proposals can be found in the following pages.

Some tax-related items can also be found in other parts of the budget. Changes to the dedication of a portion of the Motor Vehicle Sales Tax (MVST) are discussed in the Department of Public Safety budget. Changes in the Health Care Access Fund and its consolidation into the General Fund are discussed in the Human Services budget.

Governor's FY 2004-2005 Proposal
($ 000s)

	FY 2004	FY 2005	FY 2006	FY 2007
General Fund:				
June Accelerated Sales Tax:				
Repeal Sunset	$154,720	$9,930	$8,880	$7,660
Increase to 85%	$20,600	$1,300	$1,200	$1,000
Include Excise taxes at 85%	$17,100	$200	$300	$300
Transfer Endowments to General Fund	$1,029,071			
Cigarette Tax: Change Disposition	($24,247)	($24,126)	($24,005)	($23,885)
Lottery In-Lieu Tax: Change Disposition	$3,338	$3,338	$3,338	$3,338
Job Opportunity Building Zones (JOBZ)	($1,560)	($3,117)	($4,087)	($5,347)
Allow Correction of Statewide Property Levy	$5,400	$6,700	$3,600	$3,600
Fee for Practitioners Filing Paper Returns	$1,200	$800	$800	$800
Eliminate State Fair Admission Sales Tax Dedication	$800	$800	$900	$900
Accelerate Remmitance of June Mortgage and Deed Taxes	$14,700	$1,400	$1,100	$1,100
Change Campaign Checkoff *Revenue Portion Only*	$600	$600	$600	$600
Expand MCE Non-tax Debt Collection Powers	$1,300	$1,300	$2,100	$2,100
Modify Political Contribution Refund	$2,666	$3,200	$3,333	$3,200
Delay Interest Start on Cap Equip Refunds by 90 Days	$2,500	$2,700	$3,200	$3,700
General Fund Total	**$1,228,188**	**$5,025**	**$1,259**	**($934)**

Governor's FY 2004-2005 Proposal
($ 000s)

	FY 2004	FY 2005	FY 2006	FY 2007
Other Funds:				
Change Disposition of Cigarette Tax				
Minnesota Future Resources Fund	($6,928)	($6,893)	($6,859)	($6,824)
Academic Health Center Special Revenue Fund	$22,515	$22,403	$22,291	$22,179
Medical Education/Research Costs Special Revenue Fund	$8,660	$8,616	$8,573	$8,530
Subtotal	$24,247	$24,126	$24,005	$23,885
Change Disposition of Lottery In-Lieu Tax				
Game and Fish Fund	($1,669)	($1,669)	($1,669)	($1,669)
Natural Resources Fund	($1,669)	($1,669)	($1,669)	($1,669)
Subtotal	($3,338)	($3,338)	($3,338)	($3,338)
Expand MCE Non-tax Debt Collection Powers	$1,700	$1,700	$900	$900
Other Funds Total:	**$22,609**	**$22,488**	**$21,567**	**$21,447**

Note: All estimates based on the February

Minnesota Department of Revenue
Tax Research Division
7-Mar-03

TAX LAW CHANGES

Change Item: CHANGE IN LOTTERY IN LIEU OF SALES TAX DEPOSITS

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$3,338	$3,338	$3,338	$3,338
Other Fund				
Expenditures	0	0	0	0
Revenues	($3,338)	($3,338)	($3,338)	($3,338)
Net Fiscal Impact	0	0	0	0

Recommendation
The Governor recommends that the portion of the payment made by the State Lottery to the Department of Revenue in lieu of sales tax on lottery tickets now deposited in the general fund be increased from its current 12.9 percent to 26 percent. This change means that the special funds now receiving the benefits of this dedication will be facing a reduction of approximately 15% annually.

Background
Under current law, Lottery game retailers do not collect and remit sales tax on lottery game tickets at the point of purchase. Instead, the Lottery makes monthly payments of 6.5 percent of its total ticket sales directly to the Department of Revenue "in lieu of sales tax." Currently this amounts to about $30 million annually.

The statute also has a formula for how these in lieu of sales tax payments must be allocated and deposited to specific funds. Currently, 12.9 percent is deposited in the general fund and 87.1 percent is distributed, under formula, to several special purpose natural resources funds. These funds include the Heritage Enhancement Account, State Parks and Trails, Metro Parks, Local Trails, and a fund for selected zoos.

Relationship to Base Budget
The Governor is recommending that the portion deposited in the general fund be increased from 12.1 percent to 26 percent. This will increase non-dedicated general fund revenues by $3.3 million annually.

Revenues going to the other funds will be decreased by a like amount. There is no change being recommended for the distribution formula among the other funds, therefore, each of the individual natural resource funds will take a proportional share of the overall reduction. This change will require spending reductions of approximately 15 percent in these dedicated funds. This reduction is comparable to what most state agencies are facing in their general fund operations.

Activities recommended in these specific natural resource areas under the reduced funding levels are discussed in more detail in the Natural Resources budget presentation.

Statutory Change: MS 297A.94

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$600	$600	$600	$600
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($600)	($600)	($600)	($600)

Recommendation

The Governors recommends that contributions to the state's elections campaign fund be changed from a state funded $5 check off on the Minnesota income tax return to a taxpayer designated contribution of up to $25 for individuals and up to $50 for married couples. The amount designated by taxpayers on the income tax form would reduce their refund or be added to the amount of their payment due.

The table above represents only revenue changes. Expenditure changes associated with this item are discussed under Campaign Finance Board budget.

Background

Under current law, an individual may designate on the state income tax form that $5 go to help candidates for state offices pay campaign expenses. An individual can choose to designate that the $5 go to a political party or the state general campaign fund. If taxpayers choose the general campaign, the $5 is distributed among candidates of all major political parties. Designating $5 to the fund does not reduce an individual's income tax refund or increase the amount of their payment. The designation is financed through the state general fund. In effect, this is an indirect state appropriation to political parties and candidates of state offices.

Under the Governor's proposal, individuals would have the opportunity to contribute to the election campaign fund or political parties by designating an amount on the state income tax and property tax refund returns. The amount designated would reduce an individual's refund or be added to the amount of their payment. The maximum amount donated would be $25 for an individual or $50 for a joint return. This is the same funding mechanism that is in place for the Nongame Wildlife Contribution under M.S. 290.43.

Relationship to Base Budget

Under the Governor's proposal, the revenue collected by the proposed check-off is considered "new general fund revenue" which is somewhat counter-intuitive. Under the old system, the entire tax obligation was collected but a portion was subtracted for a special purpose. In essence, the non-dedicated portion of the tax collection was the net after the check-off was removed. Under the new system, the same tax obligation will exist and be collected as non-dedicated revenues, and new check-off money is added on top of that basic revenue collection.

We are also assuming that when the tax status of the check-off is changed, and number of people utilizing the check-off will be reduced. We have made a simple assumption that only half of the people will continue to use the program. Therefore, we are assuming that the new revenues associated with the check-off will be approximately $600,000 annually. We have made no attempt to adjust the total for the individuals and couples who will now utilize the check-off at the higher limits.

Key Measures

♦ Number of participants and amount designated to political parties and the general campaign fund.

Statutory Change: M.S. 10A.31.

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[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: COUNTY MORTGAGE & DEED TAX ACCELERATION

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$14,700	$1,400	$1,100	$1,100
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($14,700)	($1,400)	($1,100)	($1,100)

Recommendation

The governor recommends that county treasurers remit to the Department of Revenue two business days before June 30 of each year the state's portion (97 percent) of deed tax and mortgage registry tax collected from June 1 to June 25 and the estimated taxes to be collected from June 25 – June 30. The remaining amount of the tax receipts collected in June would be due on August 20. Failure to timely remit the receipts collected in June would result in a late payment penalty of 10 percent.

This proposal would accelerate the payment of the deed tax and mortgage registry tax.

Background

Both the mortgage registry and deed taxes are imposed under Chapter 287. The mortgage registry tax is .23 percent of the debt or portion of a debt secured by any recorded mortgage of real property in Minnesota. The deed tax generally is .33 percent of the net consideration given for a property. County treasurers collect the deed tax when the purchasers record the deed or other instrument conveying real property. State law requires that 97 percent of the tax receipts be remitted to the Commissioner of Revenue for deposit into the general fund, and that 3 percent be deposited in the county revenue fund. County treasurers must remit the state's portion of the taxes received in any month to the commissioner by the 20th day of the following month. Section 287.12 governs the payment of the mortgage registry tax. Section 287.29 covers payment of the deed tax.

The counties receive the tax payments when they accept the documents to be recorded. This proposal requires county treasurers to remit deed and mortgage registry tax receipts collected from June 1 to June 25 and the estimated taxes to be collected from June 25 – June 30 to the commissioner two business days before June 30.

Relationship to Base Budget

This proposal would accelerate the payment of the deed tax and mortgage registry tax.

Key Measures

- Total dollar amount of deed mortgage registry taxes collected and remitted in June of each year.

Statutory Change: M.S. 287.12, M.S. 287.31 and M.S. 287.29

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues				
Delay Program End date	$154,720	$9,930	$8,880	$7,660
Expand from 75% to 85%	$20,600	$1,300	$1,200	$1,000
Add Excise at 85% level	$17,100	$200	$300	$300
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($192,420)	($11,430)	($10,380)	($8,960)

Recommendation

The Governor recommends that the accelerated June sales tax payment obligation be changed in three ways:

- The expiration of the accelerated June sales tax payment, now scheduled for June 2004, be permanently delayed,
- The percent of the payment obligation required be increased from 75% to 85% of the estimated June liability, and
- The acceleration be expanded to tobacco products, cigarettes and liquor excise taxes at the 85% level.

Background

Under current law, businesses generally pay their sales tax obligation to the Department of Revenue by the 20th of the following month. However, certain businesses that collect sales tax are required to pay 75% of their estimated June liability two business days before June 30. Under current law, the June 2003 sales tax liability was the last accelerated payment covered under this policy.

At one time, excise taxes on items such as cigarettes and liquor were also included under this accelerated payment policy, but they were removed back in 2001.

Relationship to Budget

Each of these three changes increase the size of the June accelerated payment, which creates a one-time influx of money into the state General Fund. There are also smaller but positive growth “tails,” associated with the general growth in sales tax collections expected under the latest forecast.

Statutory Change: M.S. 289A.60, subd. 15, M.S. 297F.09 subd. 1, M.S. 297G.09

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: ELIMINATE STATE FAIR ADMISSION SALES TAX DEDICATION

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$800	$800	$900	$900
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($800)	($800)	($900)	($900)

Recommendation

The Governor recommends that sales tax collected on admission to events at the State Fair be deposited in the General Fund. Currently, sales tax on admission at State Fair events is retained by the Fair Board and used to support State Fair activities.

Background

Under current law, the state fair board is allowed to retain the sales tax on admissions to the fairgrounds and events sponsored by the fair board during the fair, such as grandstand events. The sales tax is not remitted to the state provided that the fair board uses matching funds to complete capital improvements to the fair grounds. The proposal would require the state fair board to remit all sales taxes to the state after June 30, 2003, with the taxes going to the general fund.

Key Measures

- State Fair General Fund Collections.

Statutory Change: M.S. 37.13, subd. 2 and M.S. 289A.31, subd. 7

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: EXPAND COLLECTION POWERS FOR NON TAX DEBT

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$1,300	$1,300	$2,100	$2,100
Other Fund				
Expenditures	0	0	0	0
Revenues	$1,700	$1,700	$900	$900
Net Fiscal Impact [1]	($3,000)	($3,000)	($3,000)	($3,000)

Recommendation
The governor recommends that the Department of Revenue be granted the authority to use the same procedures for collecting delinquent non-tax debts as it uses for collecting delinquent taxes. Non-tax debtors would have the same collection due process rights and notices afforded tax debtors.

Background
Currently the Department of Revenue must first obtain a judgment* before it can make use of the full range of collection methods it uses to collect tax debt. Obtaining a judgment is a manually intensive, time-consuming activity that contributes little to the collection process. Of the total number of judgments sought by the department, only 7% chose to dispute their debt. Only 5% of the non-tax debts actually had a court hearing, and the state prevailed in 90% of those cases. In addition, the department does not pursue a judgment in many cases because the costs associated with the judgment are greater than the debt owed. In those circumstances, the department encourages the debtor to pay voluntarily and relies on the Revenue Recapture Program.

By eliminating the need for a judgment the department can be more efficient and effective in collecting the non-tax debts; increasing non-tax debt collections by at least $3 million each year.

**Child support and student loans are exempt from the judgment requirement.*

Relationship to Base Budget
This proposal allows the Department of Revenue to collect non-tax debt more effectively and efficiently.

Key Measures
- ♦ Increase amount of non-tax debt collected by the department each year.
- ♦ Increase in the number of non-tax debt cases closed each year.

Statutory Change: 16D.08

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: JOB OPPORTUNITY BUILDING ZONES

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	$150	$57	$57	$57
Revenues	($1,410)	($3,060)	($4,030)	($5,290)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	$1,560	$3,117	$4,087	$5,347

Recommendation

The Governor recommends the establishment of several Job Opportunity Building Zones in economically depressed areas of the state. The program, called JOBZ, will establish specific geographical areas where taxes will be waived as an economic development tool.

Background

The plan would be to give businesses operating in these JOBZ areas an exemption from state and local property taxes, corporate franchise tax and sales tax exemptions certain business related purchases. The JOBZ proposal is modeled on plans recently enacted in Pennsylvania and Michigan.

Up to ten JOBZ zones would be located primarily in greater Minnesota. They would be both geographically and time limited. A proposal and selection process would be used to select the initial JOBZ zones. At the end of the tax exemption period, it is hoped that permanent business and job development, and the increased tax revenues it would produce in the future, will offset the temporary revenue losses.

Relationship to Base Budget

The numbers presented above are the best estimates available at this time (Expenditures based on HF3DE2, Revenues HF3DE3). They recognize that there will be state cost at Department of Revenue and Department of Trade and Economic Development related to establishing and monitoring the zones, and granting and monitoring tax exemption activities. Under budget scoring rules, there will be a negative general fund revenue impact because taxes currently specified in law would be waived for the new businesses. The exact extent of business development and associated revenue loss is highly speculative.

Key Measures

- Number of zones established.
- Number of new business startups in those zones
- Employment and property value growth.

Statutory Change: Several specific exemptions to the current tax law will be presented.

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: PAPER FILING FEE FOR COMMERCIAL PREPARERS

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$1,200	$800	$800	$800
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($1,200)	($800)	($800)	($800)

Recommendation

The Governor recommends that a fee of $5 per income tax return be imposed on professional tax preparers who are required by state law to file returns electronically but file by paper.

Background

Since 2000, the law has encouraged electronic filing by requiring tax preparers to file electronically, if they file a certain number of returns. The number is based on how many returns the preparer submitted in the previous year. In 2000, the threshold was 500 state income tax returns in the prior year; in 2001, it was 250 returns, and in 2002, 100 returns. However, current law provides for no penalty or fee for tax preparers who fail to comply with the law.

Overall, it costs the Department of Revenue about $5 per return to process a paper income tax return, while an electronic return only costs $1.24 to process. Under the Governor's proposal, tax preparers would pay a fee to reimburse the state for the added cost.

Relationship to Base Budget

This change permits the state to receive funds for the additional costs it incurs for processing paper tax returns that should have been filed electronically.

Key Measures

- ♦ Number of tax returns filed by paper that should have been filed electronically.
- ♦ Amount of fees collected.

Statutory Change: M.S. 289A.08, subd.16

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: STATEWIDE LEVY CORRECTION AUTHORITY

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$5,400	$6,700	$3,600	$3,600
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($5,400)	($6,700)	($3,600)	($3,600)

Recommendation

The Governor recommends giving the Department of Revenue the authority to annually adjust the Statewide Property Tax rate to account for any errors and omissions from the previous year. This authority would be parallel to local governments who have authority or flexibility in making these types of adjustments.

Background

Under current law, the total amount of the Statewide Property Tax is set in law. This amount is spread over the assessed value of business and certain seasonal recreation property, as reported by county auditors, to establish a statewide rate intended to collect the amount specified in law.

Unfortunately, there are sometimes errors or omission in the tax base value reported by the county auditors. For example, both Hennepin and Ramsey county property valuation reports included metropolitan airport property in the base that should have been specifically excluded. This incorrectly increased the commercial base on which the total levy was distributed, and therefore, created an artificially low rate for everyone else. The result was that the Statewide Levy did not raise the legally specified amount of revenue.

In addition, the timing of the property tax assessment and certification process also creates difficulties. Often taxpayers appeal valuation and assessments to either local authorities or the Board of Equalization. If the decision making board reduces their assessment after the statewide levy rate has been calculated, statewide levy receipts will again fall below expected values.

Local governments are given latitude to correct tax levies for these routine problems at the local level. No such authority was given to the State relative to the Statewide Levy.

Alternatives Considered

Leaving the situation as it is now basically ensures that the Statewide Levy specified in law will never be actually achieved.

Statutory Change: M.S. 275.025, subd. 1

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Change Item: TRANSFER ENDOWMENTS AND DEDICATE CIGARETTE TAX

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues				
Transfer from Medical Education Endowments	1,029,071			
Dedication of Cigarette Tax	(24,247)	(24,126)	(24,005)	(23,885)
Other Fund				
Expenditures	0	0	0	0
Revenues				
MN Future Resources Fund	(6,928)	(6,893)	(6,859)	(6,824)
Academic Health Center at U of M	22,515	22,403	22,291	22,179
Medical Educ. Research at Dept of Health	8,660	8,616	8,573	8,530
Net Fiscal Impact [1]	(1,029,071)	0	0	0

Recommendation

The Governor recommends that the $446.682 million currently in the Tobacco Use and Prevention Endowment and the $582.389 million currently in the other Medical Education Endowments be transferred to the General Fund in FY 2004.

The Governor also recommends that the $0.02 per pack dedication of the cigarette tax now directed to the Minnesota future resources fund be repealed and be directed to the General Fund. Beginning July, 2003 the Governor recommends that $0.065 of the per pack tax be dedicated to fund the work of the Academic Health Center at the University of Minnesota, and that $0.025 of the per pack tax be dedicated to fund medical education and research activities at the Department of Health. This will help ensure a consistent funding stream for the programs in the future.

Relationship to Base Budget

The Governor is recommending that the $446.682 million currently in the Tobacco Use and Prevention Endowment and the $582.389 million currently in the other medical education endowments be transferred to the General Fund in FY 2004.

It is anticipated that the $0.065 dedication of the cigarette tax will generate $22.5 million annually for medical education activities at the Academic Health Center, and the $0.025 dedication of the cigarette tax will generate $8.6 million for medical education activities at the Department of Health. The activities that will be funded by the dedicated funding sources are discussed in greater detail in the Higher Education budget document and the Health and Human Services budget document. This budget page presents only the tax implications of this budget item.

Statutory Change: 297F.10, subd. 1.

[1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	($2,666)	($3,200)	($3,333)	($3,200)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($2,666)	($3,200)	($3,333)	($3,200)

Recommendation

The Governor recommends changing the current Political Contribution Refund program from full reimbursement to 50% reimbursement. This will reduce the state cost of the program while continuing Minnesota's tradition of public campaign financing.

Background

Under current law, individuals and married couples are eligible to receive a cash refund for contributions made to candidates for state office and political parties. The maximum refund is $50 for an individual and $100 for a married couple. Only contributions to candidates that have signed an agreement with the Minnesota Campaign Finance and Public Disclosure Board to abide by the state's campaign spending limit law qualify for the refund. To receive the refund, applicants must file Form PCR with the Minnesota Department of Revenue by April 15 of the year following the contributions. Each application for the refund must include an original receipt issued by the candidate or political party receiving the contribution. The amount necessary to pay the refunds is appropriated to the Commissioner of Revenue.

The current program, in effect, results in an indirect state appropriation to political parties and candidates for a state office. Modifying the program would result in individuals or married couples receiving a 50% reimbursement for their contribution. Right now, individuals or married couples receive no such reimbursement for contributions made to candidates for local elected offices or federal offices.

Relationship to Base Budget

Currently, as a 100% refund program, the PCR program costs the state approximately $5 million per year. It is assumed that if the program moves to a 50% reimbursement, some of the current contributors will choose not to contribute. The budget estimate assumes that one-third of the current users will no longer contribute through the Political Contribution Refund program, while two-thirds will continue to participate.

In addition, in the first year of the estimate is reduced by 20% to reflect that the date of enactment will be after some refund applications have been submitted.

Alternatives Considered

Full repeal.

Statutory Change: M.S. 290.06, subd. 23.

Change Item: CERTAIN SALES TAX REFUNDS - DELAY INTEREST START DATE

Preliminary Proposal

Fiscal Impact ($000s)	FY 2004	FY 2005	FY 2006	FY 2007
General Fund				
Expenditures	0	0	0	0
Revenues	$2,500	$2,700	$3,200	$3,700
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact [1]	($2,500)	($2,700)	($3,200)	($3,700)

Recommendation

The Governor recommends that interest normally paid on Capital Equipment and certain purchaser Sales Tax refunds should not begin to accrue until 90 days after the refund claim is filed. This will reduce General Fund expenditures and bring interest accrual into alignment with current administrative practices. Effective for claims filed on or after the day following final enactment.

Background

One of the items presented to address the budget short fall in FY 2003 was delaying the payment of Capital Equipment Refunds by 90 days. Eventually this was achieved administratively, not legislatively. However, under current law interest generally still accrues beginning with the day the refund claim is filed even though the refund is not paid until 90 days later. This creates an automatic interest expense for these refunds.

Unlike the payment delay, the interest rate accrual date cannot be set administratively; it must be set by legislation.

Relationship to Base Budget

This change will save the state General Fund approximately $2.7 million per year.

Statutory Change: M.S. 289A.56 subd.4, M.S. 297A.75 subd. 4

[1] [1] Net fiscal impact equals expenditure change minus revenue change. Positive numbers can be expenditure increases or revenue decreases. Negative numbers can be expenditure reductions or revenue increases.