MINNESOTA · REVENUE

January 25, 2005

The 2005 Minnesota Legislature:

I am pleased to announce Governor Pawlenty's tax initiatives targeted at reducing the rising costs of health care, encouraging job creation, promoting family farm preservation, assisting our Minnesota families serving in the armed forces and preventing additional complexity for taxpayers.

One of the most important bills passed by Congress in 2003 and 2004 was the Medicare Prescription Drug, Improvement and Modernization Act of 2003. This bill includes a tax deduction for contributions made by individuals to a health savings account and an employer exclusion for federal government payments made to employers who keep their prescription drug plans for retired employees. Health Savings Accounts allow individuals to make tax-deductible contributions into these accounts and provide for tax-free distributions if the money is used to pay for medical expenses. The Governor is recommending that the Health Savings Account changes be adopted retroactive to the beginning of 2004.

Businesses headquartered in Minnesota compete in a global market and need to be competitive in order to create and retain jobs here. In recent years our competitor states in the midwest have created a competitive tax advantage for their headquartered companies by disregarding the companies' property and payroll in computing the corporate income tax. To level the playing field, the Governor is proposing to do the same for Minnesota's multi-state corporations.

Our state's dairy industry, once the backbone of Minnesota agriculture, is losing hundreds of millions of dollars in related economic activity and this raises concerns about the long-term viability of dairy production in this state. To help revitalize this industry, the Governor is proposing an investment tax credit intended to assist dairy operators in modernizing and investing in their production facilities.

The Governor is recommending two changes that would help Minnesota military families including our National Guard and military reservists. One change would exempt from state income tax income earned by National Guard members called to service by the Governor within the state. The second change would provide a deduction for unreimbursed travel expenses incurred to attend out of town Reserve meetings.

The Governor is recommending that Minnesota adopt a large portion of federal income and corporate franchise tax changes passed by the Congress in 2003 and 2004 and confined the remaining federal changes to a small number of easily calculated modifications. This will prevent additional complexity from being added to an already complex tax system and ease the burden on taxpayers.

The Governor is proposing other tax initiatives to address key needs. These include increasing the Bioscience Zone exemptions cap, establishing an International Development Cargo Zone, and expanding the Senior Property Tax Deferral program.

I look forward to working with you to help get these initiatives passed for the benefit of our citizens and businesses.

Respectfully,

Daniel A. Salomone
Commissioner

Summary of Intergovernmental Aids (General Fund) - FY 2004 - 2007

Dollars in $000s	FY 2004	FY 2005 Budget	FY 2006 Gov Rec	FY 2007 Gov Rec
TOTAL	1,426,020	1,357,843	1,451,639	1,438,353
Individuals	**289,321**	**307,953**	**324,577**	**318,511**
Renters' Credit	143,381	147,027	149,200	121,600
Property Tax Refund	129,799	150,760	168,000	185,695
Property Tax Refund - Targeted	14,558	8,360	5,390	9,130
Forest Land Credit Program	1,583	1,806	1,987	2,086
School	**81,499**	**85,300**	**77,852**	**75,104**
Residtn Hmstd MV Credit	67,412	69,881	62,281	59,356
Disparity Reduction Aid	8,072	8,415	8,629	8,736
Ag Hmstd MV Credit	4,950	5,442	5,295	5,316
Border City Credit	567	888	1,008	1,057
Taconite Aid Reimbursement	0	561	561	561
Prior Year Credits	0	110	78	78
Disaster Credit/Rev	16	3	0	0
Education Homestead Credit	229	0	0	0
Hmstd Ag Credit Aid - HACA	115	0	0	0
Attached Machinery Aid	138	0	0	0
County, City, Town and Special District	**1,024,989**	**931,303**	**1,022,060**	**1,017,388**
City Aid	464,942	437,513	436,718	436,558
Residential Hmstd MV Credit	229,145	219,279	222,818	216,517
PERA Aid (Pension)	14,585	14,568	14,568	14,568
Aid to Police and Fire (Pension)	69,868	78,808	84,135	90,721
Police & Fire Amortization (Pension)	12,952	11,638	11,638	11,638
County Program Aid	0	111,620	204,793	204,793
Hmstd Ag Credit Aid - HACA	134,621	0	0	0
Criminal Justice Aid	32,201	0	0	0
Family Preservation Aid	23,884	0	0	0
Court Takeover Aid	0	15,024	3,135	0
Court MOE Aid	0	2,080	1,506	0
County Transition Aid	0	0	1,392	928
Ag Hmstd MV Credit	18,427	18,887	18,849	18,849
Disparity Reduction Aid	10,959	10,705	10,981	10,981
Supplemental Taconite Hmstd Credit	4,896	4,999	4,999	4,999
Attached Machinery Aid	403	0	0	0
Border City Credit	4,413	4,412	4,587	4,817
Existing Low Income Hsg Aid	1,997	189	237	315
Indian Casino County Aid	675	675	685	685
Public Defender Costs	464	595	707	707
Disaster Credit/Rev	54	0	0	0
Prior Year Credits	503	311	311	311
Wetlands Reimbursement Credit	0	0	1	1
DNR-PILT (appr-DNR, exp DOR)[1]	*12,703*	*13,028*	7	*9*
Non-aid Items in Fund Balance	**30,211**	**33,287**	**27,150**	**27,350**
Political Contribution Refund	5,248	5,100	500	0
Ore Prod Tax Replacement Aid	7,589	3,920	8,200	8,300
Tax Refund Interest	17,374	24,267	18,450	19,050

[1]PILT payments are not included in fund totals for the purposes of this report.

Change Item: Adjustment to Renters' Credit

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	($30,800)	($41,100)	($41,500)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	($30,800)	($41,100)	($41,500)

Recommendation

The Governor recommends reducing the percentage of rent deemed to be property taxes, for purposes of computing property tax refunds for renters, from 19% to 16% in FY 2007 and 15% in FY 2008 and beyond. This will reduce this figure to a level that is closer to the actual average tax burden of rental property relative to rent while maintaining the administrative and policy advantages of basing renter refunds on a flat percentage rather than on actual property tax amounts.

Background

The renter property tax refund program, or renters' credit, is a state-paid refund that provides tax relief to renters whose rent is high relative to their incomes. While renters do not pay property taxes directly, owners of rental property pay property taxes and a portion of those taxes is presumed to be passed along to renters through higher rent payments.

In 1997 the legislature converted the renter refund program from being based on a calculation of actual tax as a percent of rent to being based on 18% of rent. The 18% estimate, based on Department of Revenue data at the time, was only slightly greater than the average tax as a percent of rent. The 1998 legislature raised this percentage to 19%.

Under current law, "rent constituting property tax" is assumed to equal 19% of rent paid. If rent constituting property tax exceeds a threshold percentage of the renter's income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. The definition of household income used for this program is a broad measure that includes most types of income, including most forms of public assistance. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

Tax reforms enacted in 2001 phased-in class rate reductions for most apartment property. It is difficult to directly measure the influence that declining apartment property taxes have on rent levels since rent levels are ultimately set by the market based on numerous factors. Further, any impact would likely vary by region and market segment. Nonetheless, a Department of Revenue analysis of rents and taxes for residential rental property suggests that actual property tax as percentage of rent is, on average, below 15%.

By lowering the percentage of rent constituting property tax to a level that more closely reflects actual property tax levels, the renter refund program will more closely parallel the homeowner property tax refund program, which bases refund amounts on the actual amount of property taxes paid relative to income. Continuing to base refunds on a uniform definition of rent constituting property tax will avoid the more cumbersome and costly administration (for both the state and property owners) associated with the renter refund program that was in place prior to 1997, which based renter refunds on actual taxes.

Relationship to Base Budget

The changes proposed by the Governor will reduce forecasted expenditures for renter refunds by approximately 20% in FY 2007 and 25% per year in FY 2008 and thereafter. Under the proposal, the average refund amount is expected to decline from $554 for tax year 2004 (paid in FY 2006) to $465 for tax year 2005 (paid in FY 2007). The number of renter refunds is expected to decline from 274,875 to 262,241 over the same period.

Statutory Change: Minn. Stat. § 290A.03, subd. 11

Change Item: Delay Full MVC Reimbursement to Selected Cities

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	($19,300)	($19,000)	0	0
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($19,300)	($19,000)	0	0

Recommendation
The Governor recommends extending temporary reductions in market value credit reimbursements to selected cities for two additional years (FY 2006 and FY 2007). Reduction amounts would parallel FY 2004 and FY 2005 reductions for those cities that had their MVC reimbursements reduced as part of the local government aid reforms.

Background
Residential homesteads benefit from a state-funded market value homestead credit. The credit amount is equal to 0.4% of market value up to a maximum credit of $304 (this occurs at $76,000 in value). The credit increases for homes up to $76,000 in market value, and then begins to phase down. Homes valued above $411,000 receive no credit. Rather than issuing a separate reimbursement to each taxpayer, the credit is given as a subtraction from gross tax on the taxpayer's property tax statement. The state then reimburses local governments for the relevant amount of credits.

In 2003, the legislature enacted significant reforms to the local government aid formula for cities. Those reforms substantially improved the distribution of city aid while also making permanent reductions in the funding level for city aid as part of the state budget deficit solution. In an effort to ensure that all cities contributed to the deficit solution, cities that received little or no local government aid were subject to temporary reductions in their market value credit reimbursements. Extending those temporary reductions for two additional years is consistent with the need to address ongoing budget shortfalls in a manner that treats local governments fairly, while also recognizing the state's long-term commitment to market value credit reimbursements.

Under the proposal, 103 cities would have their market value credit reimbursements reduced. The amount of the reduction will be equal to the amount by which that city's market value credit reimbursement was reduced in 2003, provided that the reimbursement amount cannot be less than zero. The temporary reductions will average 3.4% of total 2003 spending for the 103 cities. Full market value credit reimbursements will resume beginning with credits granted in 2007, and reimbursed in 2008.

Statutory Change: Uncodified section of 273.1384

Change Item: Correct MVHC Calculations for Fractional Homesteads

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	($500)	($500)	($500)
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	($500)	($500)	($500)

Recommendation

The Governor recommends a correction in the market value homestead credit calculation for homesteads that are only partially owned by the occupant. The correction would prevent homesteads used as a permanent residence by only one of multiple owners from receiving a larger credit than a similarly valued full homestead.

Background

The market value homestead credit was enacted as part of the 2001 property tax reforms. The credit amount is equal to 0.4% of market value up to a maximum credit of $304 (this occurs at $76,000 in value). The credit begins phasing out at $76,000, and keeps decreasing until homes valued above $411,000 receive no credit. This formula means a normal home valued at $100,000 receives a larger credit than a home valued at $200,000.

The language enacted in 2001 specifies that the credit be computed based on the homestead portion of the property. This creates a level of unfairness for “fractional” homesteads. For example, a home valued at $200,000 but occupied by only one of its owners (50% ownership) would have its credit computed on only $100,000 in market value. As a result, the owner would receive a larger credit, and thus pay less property tax, than a property valued at $200,000 and occupied by all owners.

This proposal would amend the language enacted in 2001 to require that the credit for partial homesteads be initially computed as if the property were a full homestead (occupied by all its owners) but then be prorated by the fraction of ownership.

Relationship to Base Budget

This change has a very small budgetary impact reducing market value credit payments by about $500,000 per year. This represents less then 0.2% of the roughly $300 million spent annually on the market value credit program. There are an estimated 3,600 fractional homesteads statewide.

Statutory Change: Minn. Stat. § 273.1384, subd. 1

Change Item: Add Special Assessments to Senior Deferred Property Tax Program

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	$19	$25	$32
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	$19	$25	$32

Recommendation

The Governor recommends that all special assessments and other charges listed on the property tax statement of qualified senior citizens be eligible for the senior deferral program. This will cost the state less than $50,000 per year in reimbursement costs. It will simplify administration for the counties and provide a small benefit to senior citizens.

Background

The senior deferral program allows qualified senior citizens to defer a portion of their homestead property tax that exceeds 3% of their income until the time the house is sold. All deferred property taxes must be paid at the point of sale or transfer of ownership. During the period of deferral, the state reimburses the local jurisdiction for lost property tax revenues.

Under current law only specific property taxes listed on the tax statement qualify for deferral. Special assessments and other charges do not qualify. This requires the home county to do extra calculations in determining what qualifies for the program.

Relationship to Base Budget

This change has a very small budgetary impact. There are currently about 120 senior citizen households that use the program costing the state approximately $300,000 in annual reimbursements. This will be less than a 10% increase in the cost of the program, and is not expected to expand the number of participants.

Statutory Change: Minn. Stat. § 290B.05, subd. 3

Change Item: Eliminate Political Contribution Refund Program

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	($4,000)	($6,500)	($4,800)	($5,100)
Revenues	0	0	0	0
Other Fund				
Expenditures				
Revenues	0	0	0	0
Net Fiscal Impact	($4,000)	($6,500)	($4,800)	($5,100)

Recommendation
The Governor recommends that the Political Contribution Refund (PCR) program be eliminated.

Background
Under the current PCR program, political contributions made by Minnesotans to qualifying political candidates up to a total of $50 per person (or $100 per couple) in any calendar year can be refunded to the contributor. Political candidates are provided with special forms to document their contributions. This documentation is sent to the Department of Revenue, and a refund check is sent to the original donor. In essence, the contributor is donating state General Fund money to a political candidate. The program is supported through an open appropriation from the General Fund.

Relationship to Base Budget
The General Fund savings attributable to the proposed change is forecasted to vary slightly from year to year depending upon the number of qualifying elections scheduled in the state in that year.

Statutory Change: Minn. Stat. § 290.06, subd. 23
Minn. Stat. § 270A.03, subd. 7
Minn. Stat. § 289A.01, subd. 6
Minn. Stat. § 289A.50, subd. 1
Minn. Stat. § 10A.322, subd. 4

Summary of Proposed Tax Law Changes (General Fund)
Governor's Recommendations
($000s)

	Actual FY 2004	Forecast FY 2005	FY 2006 Gov Rec	FY 2007 Gov Rec
Individual Income Tax - forecast base	5,709,584	6,109,600	6,459,200	6,916,300
Quarterly Withholding for Non-Resident P'ships/S-corps			14,200	900
Withholding Tax from Contractors at the Source			2,000	2,000
Livestock Investment Credit				(2,900)
Fully Deduct Long Term Health Insurance Premiums			(300)	(330)
Federal Conformity			(5,345)	1,585
Exempt National Guard In-state Income			(42)	(42)
TOTAL - INDIVIDUAL INCOME TAX			**6,469,713**	**6,917,513**
Corporate Income Tax - forecast base	628,048	765,100	688,500	691,400
BioScience Zone Cap			(1,000)	
International Development Zone				(700)
Federal Conformity			(35)	400
Foreign Operating Corporations			1,300	980
Transition to Sales Only Apportionment				(1,800)
TOTAL - CORPORATE INCOME TAX			**688,765**	**690,280**
Sales Tax - forecast base	4,100,864	4,199,427	4,344,461	4,388,943
Up-Front Payment of Sales Tax on Leased Cars			27,100	15,500
Cigarette Sales Tax - Improve Compliance			8,050	2,700
Vendors Selling to the State Must Collect Use Tax			680	2,730
Define Industrial Production in the Case of Gas Pipelines			1,600	3,200
Continue Rental Motor Vehicle Tax			4,740	14,580
Replace Alcoholic Beverage Excess Sales Tax with Gross Receipts Tax			24,830	60,040
TOTAL - SALES TAX			**4,411,461**	**4,487,693**
Insurance Gross Earnings Tax - forecast base	258,683	277,000	290,900	304,000
Clarify Stop-Loss Policies and Taxability			1,400	3,700
TOTAL - INSURANCE GROSS EARNINGS TAX			**292,300**	**307,700**

Change Item: Quarterly Withholding for Non-Resident Partnerships & S-Corps

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$14,200	$900	$950	$1,000
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($14,200)	($900)	($950)	($1,000)

Recommendation
The Governor recommends that partnerships and S-corporations pay non-resident withholding on a quarterly basis rather than on an annual basis.

Background
Currently, Minnesota law requires almost all taxpayers to pay their Minnesota income tax as the income is earned during the tax year thru either quarterly estimated tax payments or wage withholding. The only exception to this situation is non-residents who generate their Minnesota source income from a partnership or S-corporation that does business in Minnesota. These non-residents are allowed to pay their Minnesota tax as late as 2½ months after the tax year has ended (March 15th for S-corporation shareholders and April 15th for partners).

The Governor's proposal puts these non-residents on the same pay-as-you-go footing as all resident taxpayers and non-residents who generate their Minnesota source income from wages or non-flow thru types of business.

Relationship to Base Budget
Going to a quarterly system would get these revenues into the state sooner. Under this proposal, half of the FY 2007 withholding associated with non-resident partners ($5.6) and half of the withholding associated with non-resident shareholders of S-corps ($8.3) will be shifted into FY 2006. Approximately $1 million annually will be shifted forward because of natural growth projected in the corporate tax.

Statutory Change: Minn. Stat. § 289A.20, subd. 2

TAX LAW CHANGES

Change Item: Withholding Tax from Contractors at the Source

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$2,000	$2,000	$2,000	$2,000
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($2,000)	($2,000)	($2,000)	($2,000)

Recommendation

The Governor recommends requiring construction contractors to withhold state income tax from payments to all self-employed individuals who are hired as sub-contractors – both residents and non-residents. Under the Governor's proposal, a contractor would withhold two percent from all payments made to sole proprietors and would issue a Form 10999 at the end of each year showing the amount withheld. Sole proprietors due a refund of taxes withheld would receive it by filing the appropriate income tax forms. The new requirements would be effective for payments made after June 30, 2005.

Background

This proposal addresses one of the more serious non-compliance problems of unreported income by self-employed construction workers.

The department has documented problems in collecting the tax liabilities of sole proprietors, especially non-resident contractors in the construction industry. In a non-statistical internal project matching 2001 census bureau 1099 data and warehouse data on Schedule C specialty trade contractors, the department identified many non-resident subcontractors with 1099 income from Minnesota employers that never filed Minnesota income tax forms. Even with very conservative techniques, such as excluding all employers who had both W2 and 1099 activity and excluding all special trades contractors organized as S-Corps, partnerships, or C-Corps, department staff identified approximately 2,000 non-resident contractors with approximately $85 million in income that never filed Minnesota income tax forms reporting that income. The department believes the scope of the problem is actually much greater than this.

For sole proprietors, the department's only link to their earned income is the 1099 form which is not submitted directly to the state. Form 1099 data are only available from federal IRS tapes, and the data are very old by the time they are available to the department for review. As a result, there are serious questions about how complete the data are. Old and incomplete income data make normal compliance activities very difficult with sole proprietors. This is especially true with non-residents. Addresses change and locating people outside the state is time consuming and difficult. Furthermore, even though the aggregate problem is large, the tax owed by an individual contractor may be small and not cost-effective to pursue.

Under the Governor's proposal, income tax would be withheld from each payment made to a sole proprietor as it is for an employee. The new requirement would be limited to the construction industry by use of specific industry code numbers (NAICS codes). Nothing in the Governor's proposal would prevent sole proprietors that qualify for refunds from getting them through normal means. It would, however, help insure that all sole proprietors in the construction industry pay the tax they owe.

Relationship to Base Budget

Because this is such a difficult area in which to collect reliable data, the department acknowledges that the $2 million predicted in new revenue is more speculative than most of its other estimates.

Statutory Change: Adding a new subdivision to Minn Stat. § 290.92

TAX LAW CHANGES

Change Item: Livestock Investment Credit

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	0	($2,900)	($3,500)	($4,000)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	$2,900	$3,500	$4,000

Recommendation

The Governor recommends the creation of a Livestock Investment Credit to provide economic incentives for dairy farmers. He is recommending a 10% tax credit (capped at $30,000 total investment over six years) for new investments in dairy farms.

Background

Dairy farming in Minnesota faces serious economic challenges. In the current economic environment, dairy farmers are reluctant to make new capital investments in their farms and facilities. The Governor believes a limited tax credit will help stimulate capital investment in this sector, helping dairy farmers sustain or grow production.

Relationship to Base Budget

The tax credits would mean a revenue loss to the General Fund.

Key Measures

Because this creates a new credit, the Department of Revenue will be able to report on the number of people claiming the credit and the total cost of the credit. Measuring the credit's effectiveness in stimulating growth in the dairy industry will depend on the Department of Agriculture's ability to track changes in the number and size of dairy farms and on changes in Minnesota's milk production.

Statutory Change: New sections of statutes.

Change Item: Fully Deduct Long-Term Health Insurance Premiums

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	($300)	($330)	($360)	($400)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$300	$330	$360	$400

Recommendation
The Governor recommends changing the long-term health insurance credit to create more equitable tax treatment between self-employed individuals and other taxpayers.

Background
Current Minnesota law allows a self-employed person to deduct and receive a Minnesota tax benefit for the full amount they pay for long-term health insurance. This group also is allowed to claim a Minnesota tax credit of 25% of this same amount. Other taxpayers, on the other hand, can only claim these long-term health insurance payments as an itemized deduction, which may or may not provide them a tax benefit. They can get the 25% credit also, but it must be reduced by any benefit gained by claiming the itemized deduction for the premium.

This difference in treatment is unfair and would be remedied by the proposed change.

A side benefit of this change is making the purchase of long-term health insurance more attractive to a large group of taxpayers (employees) and will make the computation of the 25% credit for long term health insurance less complicated.

Relationship to Base Budget
The revenue loss for this proposal is relatively small. If this proposal did not have a revenue impact, it would be considered a minor technical change.

Statutory Change: Minn. Stat. § 290.0672, subds. 1 and 2.

Change Item: Federal Conformity

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	($5,380)	$1,985	$8,165	$4,885
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$5,380	($1,985)	($8,165)	($4,885)

Recommendation

The Governor recommends that Minnesota's tax laws be amended to conform to recently enacted federal tax laws to the maximum extent affordable within current budget limitations.

The conformity provisions with budget impact would include:

- Military Family Tax Relief Act of 2003 (retroactive)
- Medicare Prescription Drug, Improvement, and Modernization Act of 2003
  - ⇒ Health savings account provision (retroactive)
  - ⇒ Income exclusion to employers with retiree prescription drug plans (begins 1/1/06)
- Working Families Tax Relief Act of 2004
  - ⇒ Uniform definition of qualifying child for various provisions (1/1/05)
  - ⇒ Include combat pay in earned income for earned income credit/working family credit
  - ⇒ Extension of expiring provisions to tax year 2004 and 2005
    - Enhanced deduction for computer donations
    - Deduction for up to $250 for teacher expenses
    - Delay phase-out of clean fuel vehicle deduction.
- The American Job Creation Act of 2004 (all provisions except)
  - ⇒ Standard deduction increase for married couples
  - ⇒ Disposition of transmission property to implement FERC restructuring
  - ⇒ Option to deduct either state and local income tax **or** state sales tax from federal tax

Background

In Minnesota, 2.4 million individuals file individual income tax returns each year. In our tax filing system, individuals are required to correctly compute and pay the correct amount of Minnesota individual income tax. This system only works effectively if the computation of the income tax for the vast majority of taxpayers is easy enough that the taxpayer can simply compute the correct amount of Minnesota tax.

Under the current Minnesota law the starting point for computing the Minnesota income tax is "federal taxable income" as defined in the Internal Revenue Code of 1986 as amended through June 15, 2003. Technically this means any taxpayer who has an item of income or a deduction which is changed because of post June 15, 2003 federal changes in the code needs to completely recompute their federal taxable income before they can even start their Minnesota return. For taxpayers in this position the recomputation of federal taxable income will be a difficult task even with the help of a tax professional.

Differences in the current Code, enacted since June 15, 2003, would place at least 80,000 Minnesota taxpayers into this recomputation situation for the 2004 tax year and at least 500,000 in 2005. In general, it has been the position of past administrations and past legislatures to conform to the federal tax code as soon as possible and to the maximum extent possible. Keeping the Minnesota system aligned is often called "federal conformity." Federal conformity is not automatic. The legislature is required to act to incorporate new federal changes into the Minnesota tax laws. The Governor's proposal adopts the current code for all of these taxpayers and eliminates the need for them to recompute their federal taxable income.

Change Item: Federal Conformity

Relationship to Base Budget

The conformity initiative recommended by the Governor has a net impact of reducing General Fund revenues in the first biennium by $3.4 million. This is a very small change in the context of total income and corporate franchise tax collected during this period.

Statutory Change: Various

Change Item: Exempt National Guard In-state Income

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures				
Revenues	($42)	($42)	($42)	($42)
Other Fund				
Expenditures				
Revenues	0	0	0	0
Net Fiscal Impact	$42	$42	$42	$42

Recommendation
The Governor recommends that income earned by National Guard members while on active duty in the state be exempt from state income tax. The proposal would apply to wages earned with the National Guard when it is called into service in Minnesota by the Governor to assist with events such as floods, tornadoes and missing persons.

Background
This change would make the state policy regarding taxation of state active duty pay consistent with the state's policy regarding federal active duty pay. Estimated salary expenditures of $750,000 distributed among 850 returns would be exempted.

Relationship to Base Budget
The recommendation would result in only a very small change in income tax collections.

Statutory Change: Minn. Stat. § 290.01, subd. 19(b)

Change Item: Increase BioScience Zone Tax Benefit Cap

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	($1,000)	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$1,000	0	0	0

Recommendation
The Governor recommends making an additional $1,000,000 in certain tax credits available to qualified businesses located in approved biotechnology and health science industry zones.

Background
Minnesota Statutes 469.330 through 469.341 outline the parameters of the current Biotechnology and Health Science Industry Zone program. Much like JOBZ, it grants certain tax benefits to businesses that agree to locate or expand within the designated zone and abide by program rules. The Commissioner of the Department of Employment and Economic Development administers both programs, designating zones, setting rules, negotiating business agreements, and processing applications for tax benefit.

Unlike JOBZ, however, the legislation that created the Biotechnology and Health Science Industry Zone program capped the amount of possible tax incentives. The original program capped total tax credit benefits under the program in the FY 04-05 biennium at $1,000,000. There was no provision for awarding tax benefit in future years.

Relationship to Base Budget
This would provide the same amount of tax incentives for FY 2006-07 as were available in FY 2004-05.

Statutory Change: Minn. Stat. § 469.335, paragraph (c)

Change Item: International Development Zone

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	0	($700)	($1,050)	($1,050)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	$700	$1,050	$1,050

Recommendation

The Governor recommends enacting legislation to create an International Development Zone. This International Development Zone will provide business tax incentives similar to the current Job Opportunity Building Zones. The Commissioner of the Department of Employment and Economic Development would administer the zone.

Background

There is specific interest in developing a state-of-the-art air cargo consolidating and shipping zone convenient to the Minneapolis/St Paul International Airport. This zone would benefit the state in two ways. First, there would be the direct job growth and economic activity provided by businesses that locate or expand within the zone. Second, it would provide an opportunity for MSP to expand into a major shipping airport.

Relationship to Base Budget

State revenues will be reduced because of the various tax exemptions.

Statutory Change: New sections in statute.

TAX LAW CHANGES

Change Item: Foreign Operating Corporations

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$1,300	$980	$650	$500
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($1,300)	($980)	($650)	($500)

Recommendation

The Governor recommends that corporations claiming Foreign Operating Corporation (FOC) status be required to have substantial economic substance in a foreign country to qualify for current Minnesota FOC tax treatment. Additional revenues expected to be generated through enforcement of the current and amended FOC provisions in law are discussed as part of the Department of Revenue's operating budget.

Background

FOCs were created in 1988 Minnesota law to provide equal tax treatment between domestic and foreign subsidiaries. A recent Tax Court decision broadened the FOC tax treatment to corporations with no property or payroll in a foreign country. Under this proposal, to qualify as an FOC, a corporation would have to demonstrate actual economic substance in a foreign country by meeting two specific criteria. First, the corporation would have to have at least 80% of its property and payroll outside the U.S. and, secondly, the corporation would have to satisfy minimum foreign property and payroll thresholds.

Relationship to Base Budget

The proposed amendment to Minnesota tax law would yield ongoing return to the General Fund through the corporate income tax, although the amount would level off as existing corporations come into compliance with the law.

Statutory Change: Minn. Stat. § 290.01

Change Item: Transition to Sales Only Apportionment

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	0	($1,800)	($7,600)	($15,200)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	0	$1,800	$7,600	$15,200

Recommendation

The Governor recommends changing the method of apportionment under the Minnesota corporate franchise tax from a three factor formula to one based exclusively on sales. He recommends that this new formula be phased in over an eight year period starting with taxable years beginning after December 31, 2006.

Background

Many multi-state corporations generate income in more than one state. For these corporations, some formula must be used to determine what portion of the total income should be taxed by each individual state. This is called an apportionment formula.

The current apportionment formula in Minnesota is based on three individual factors:

- Percent of sales within the state – 75%
- Percent of payroll within the state – 12.5%
- Percent of property within the state – 12.5%

The current trend in many states is to adopt or move toward an apportionment formula based totally on percent of sales within the state. The states that have done so believe this encourages businesses to expand within their state. A simple illustration of this can be seen by looking at two companies that have the same amount of total income and the same percent of sales in Minnesota. The one with the greatest percentage of property and payroll in Minnesota (relative to percent of sales) will pay a higher corporate tax.

Businesses would be affected by this change in one of three ways:

- Businesses with all sales, property, and payroll in Minnesota will be unaffected.
- Businesses whose Minnesota sales factor is lower than the average of their current property and payroll factor will pay less corporate tax. An example would be a business that has all of its property and payroll in Minnesota, but makes most of its sales in other states.
- Businesses with all their property and payroll in other states, but have a large portion of their sales in Minnesota will pay more corporate tax.

There are currently seven states including Iowa, Illinois, Missouri, and Nebraska using single sales as their apportionment formula. In 2003, Wisconsin and Oregon enacted laws phasing in single sales apportionment.

Relationship to Base Budget

The current Minnesota corporate franchise tax is projected to collect about $700 million annually over the next four years. When the sales only apportionment is fully phased in (2013), it is expected to reduce corporate franchise tax collection by approximate $40-50 million annually.

Statutory Change: Minn. Stat. § 290.191, subds. 2 and 3

Change Item: Up Front Payment of Sales Tax on Leased Motor Vehicles

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$27,100	$15,500	$1,400	$1,100
Other Fund				
Expenditures				
Revenues	0	0	0	0
Net Fiscal Impact	($27,100)	($15,500)	($1,400)	($1,100)

Recommendation
The Governor recommends that current law be amended to treat a lease for a motor vehicle (including a business vehicle) as a single sale with the sales tax on the sum of all anticipated lease payments due at the time the lease is executed. This would be effective on all leases entered into on or after July 1, 2005.

Background
Lease payments for motor vehicles are subject to the general Minnesota state sales tax and any applicable local sales taxes rather than the Motor Vehicle Sales Tax.

Current law treats motor vehicle leases as a series of sales with the sales tax due at the time each lease payment is made. The same amount of sales tax revenue, therefore, is generated by the transaction, but, currently, it is received over time (typically 24-36 months).

Relationship to Base Budget
The recommended change would have a significant impact in the first year as sales tax payments for new leases are aggregated and paid on the date the lease is signed at the same time that monthly payments continue to be received only on older leases. By 2008, absent significant changes in consumer behavior or alternative financing mechanisms, the annual receipts are projected to level off as nearly all leases come into compliance with the new law.

Statutory Change: Minn. Stat. § 297A.61, subds. 4 and 7

TAX LAW CHANGES

Change Item: Improve Compliance with Cigarette Sales Tax

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$8,050	$2,700	$2,700	$2,700
Other Fund				
Expenditures				
Revenues	0	0	0	0
Net Fiscal Impact	($8,050)	($2,700)	($2,700)	($2,700)

Recommendation

The Governor recommends that the sales tax on cigarettes be replaced with a gross receipt tax of similar size collected from distributors (like the current cigarette tax). The change would both move up the point at which the tax is collected to an earlier stage of the cigarette distribution process and reduce the number of vendors responsible for collecting the tax.

Background

The sales tax on cigarette purchases is currently collected at the retail level by thousands of retailers, while the cigarette tax itself is paid at the distributor level. The sales tax on cigarettes (retail) suffers from substantial under-reporting and non-compliance because of the difficulty associated with monitoring so many retail outlets.

While it is not possible to quantify the exact number of retailers not remitting the proper amount of sales tax on the sale of cigarettes, or the dollar amount of tax not being collected, the Department of Revenue does have substantial evidence that the underpayment of sales tax on cigarettes is a significant problem. In a sample of 25 completed cigarette sales tax audits, auditors found unreported sales of $40,204,635, representing additional tax, penalty and interest of $3,298,387, an average of $131,395 per audit.

If the tax is moved to the distributor level, retailers will be unable to avoid the tax because it will be worked into the basic cost of the product they purchase from distributors.

Relationship to Base Budget

The recommended change is projected to have two budgets impacts:

- There will be a one-time increase of $5.8 million in revenue in FY 2006 because collecting the tax from distributors rather than retailers will move the payments up by one month. One-twelfth of collections will be shifted into an earlier year.
- There will be an ongoing benefit to the General Fund of approximately $2.7 million annually attributable to better tax compliance. Retailers will be unable to avoid the tax, and distributors are monitored more closely.

The $2.7 million estimate used above is based on a conservative DOR estimate that 4% of cigarettes are now sold without the proper sales tax being collected or remitted.

Statutory Change: Minn. Stat. § 297A.67, subd. 32 and § 297F.25

Change Item: Vendors Selling to State Must Collect Use Tax

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$680	$2,730	$4,300	$4,410
Other Fund				
Expenditures				
Revenues	0	0	0	0
Net Fiscal Impact	($680)	($2,730)	($4,300)	($4,410)

Recommendation

The Governor recommends that the Department of Administration stop awarding purchase contracts to any out-of-state businesses that do not register to collect and remit Minnesota sales tax on taxable goods sold in the state. Businesses that want the benefits of state contracts will have to agree to collect Minnesota sales tax. This provision only applies to executive and legislative branches of state government. It does not apply to the judicial branch or to state colleges and universities.

Background

Currently, remote sellers that do not have nexus in Minnesota are not required to collect and remit Minnesota sales or use tax on sales shipped into Minnesota. As people increase purchasing from internet or catalogue companies, more traditional taxable products are being sold without collecting Minnesota sales tax. This trend toward using the internet to avoid paying sales tax is contributing to the erosion of the state's sales tax base.

This initiative would provide an incentive for out-of-state companies who want to do business with state government to collect and remit Minnesota sales tax on all in-state sales. If they decide not to, they will lose their state government customers. All Minnesota state agencies currently pay sales or use tax on taxable purchases regardless of vendor location or practice.

Nine other states have similar legislation.

Relationship to Base Budget

The revenues from this proposal are small relative to the statewide sales tax collection base. However, they will grow into the future as more out-of-state companies choose to comply with this new provision.

Statutory Change: Minn. Stat. § 16C.03

Change Item: Define Industrial Production in the Case of Gas Pipelines

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$1,600	$3,200	$3,200	$3,200
Other Fund				
Expenditures				
Revenues	0	0	0	0
Net Fiscal Impact	($1,600)	($3,200)	($3,200)	($3,200)

Recommendation

The Governor recommends that current law be amended to clarify that a gas pipeline company that primarily transports gas is not engaged in industrial production and, therefore, does not qualify for capital equipment refunds or the industrial production exemption.

Background

The Minnesota Supreme Court, in *Great Lakes Gas Transmission LP v. Commissioner of Revenue (2002)*, supported the finding of the Tax Court that the consumption of fuel in compressors along a natural gas pipeline is exempt from use tax as material consumed in the industrial production of goods to be sold ultimately at retail.

The change will clarify the original legislative intent.

Relationship to Base Budget

The clarification recommended by the Governor would provide for a small on-going increase in revenue to the General Fund.

Statutory Change: Minn. Stat. § 297A.25, subd. 9

Change Item: Continue the Rental Motor Vehicle Tax

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$4,740	$14,580	$15,300	$16,090
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($4,740)	($14,580)	($15,300)	($16,090)

Recommendation
The Governor recommends continuing the current sales tax on short-term car rentals as recommended in previous legislation. The current 12.7% sales tax on short-term rentals is scheduled to revert to 6.5% on January 1, 2006.

Background
The current sales tax on short-term car rentals in Minnesota is 12.7% while it is 6.5% for most other products and services. This effectively creates an excess sales tax increment of 6.2%. In order to comply with the national Streamline Sales Tax Project (SSTP), legislation was passed to sunset this excess increment on December 31, 2005. The SSTP board has since decided to exclude sales and leases of motor vehicles from the SSTP agreement. Minnesota; therefore, does not need to lower rate for SSTP compliance.

That same legislation that created the sunset, Laws of Minnesota, First Special Session, Chapter 5, Art 12, Sec 91 also directs,

> "The commissioner of revenue, in consultation with interested parties from the industry, shall prepare a plan to replace the current sales tax on short-term motor vehicle rentals under Minnesota Statute, section 297A.64, with a single tax or fee on motor vehicle rentals …."

The Governor's proposal would raise exactly the same amount of revenue as the increment that was scheduled to sunset. There will be no additional revenue raised.

Relationship to Base Budget
The long-standing industry specific tax of 12.7% collects approximately $30 million annually. The 6.2% "excess" increment of this tax is responsible for slightly less than half this total.

Statutory Change: 2001 Minn. Laws. 1st Spec. Sess., Ch. 5, Art 12, Sec 95.

Change Item: **Replace Alcoholic Beverage Excess Sales Tax with Gross Receipts Tax**

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$24,830	$60,040	$61,870	$63,150
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($24,830)	($60,040)	($61,870)	($63,150)

Recommendation

The Governor recommends replacing the current excess sales tax increment (2.5%) for liquor with a gross receipts tax of equal value as recommended in previous legislation. The current 9.0% sales tax on liquor is scheduled to revert to 6.5% on January 1, 2006.

Background

The current sales tax on liquor sold in Minnesota is 9.0% while it is 6.5% for most other products and services. This effectively creates an excess sales tax increment of 2.5%. In order to comply with the national Streamline Sales Tax Project, legislation was passed to sunset this excess increment on December 31, 2005.

That same legislation, Laws of Minnesota, First Special Session, Chapter 5, Art 12, Sec 90 also directs,

> "The commissioner of revenue, in consultation with interested parties from the alcohol beverage industry, shall prepare a plan to replace the current higher sales tax on liquor and beer under Minnesota Statute, section 297A.62, subdivision 2, and the liquor tax under Minnesota Statutes, chapter 297G, with a single tax on liquor …"

The Governor's proposal will raise exactly the same amount of revenue as the increment that was scheduled to sunset. There will be no additional revenue raised.

Relationship to Base Budget

The excess increment (2.5% of 9.0%) of this long-standing industry-specific tax produces about $60 million annually.

Statutory Change: Minn. Stat. § 295.75 (new section)".

Change Item: Clarify Stop-Loss Policies and Taxability

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$1,400	$3,700	$4,500	$5,400
Other Fund				
Expenditures	0	0	0	0
Revenues	$800	$2,300	$2,700	$3,300
Net Fiscal Impact	($2,200)	($6,000)	($7,200)	($8,700)

Recommendation
The Governor recommends clarifying the definition of direct business in the provisions governing the insurance premiums tax. The change would clarify that premiums related to stop-loss coverage are subject to the insurance premiums tax and would be effective for insurance premiums received after December 31, 2005.

Background
Stop-loss insurance is insurance sold to employers with self-insured employee health plans. Typically, the policies pay benefits when the employer's total expenses exceed a certain level or the expenses for a particular individual exceed a certain level.

Minnesota Statutes Chapter 297I imposes a tax on gross premiums from direct business in this state. The issue is whether stop-loss insurance is direct business between an insurance company and an insured party, the employer, or indirect business, that is, the insurance company reinsuring an insurance product offered by the employer. Reinsurance is defined as insurance sold by one insurance company to another. This would clarify that insurance sold by an insurance company to an entity other than an insurer is direct business.

Relationship to Base Budget
This proposal will add a relatively small amount of revenue to both the General Fund and the Health Care Access Fund.

Statutory Change: Minn. Stat. § 297I.01.

Change Item: Exempt TRICARE Payments from MnCare Provider Tax

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Other Fund				
Expenditures	0	0	0	0
Revenues	($1,730)	($1,410)	($1,500)	($1,580)
Net Fiscal Impact	$1,730	$1,410	$1,500	$1,580

Recommendation

The Governor recommends that the MinnesotaCare tax statute be amended to add a specific exemption for payments received from the TRICARE program. The exemption would not extend to deductibles and copays.

Background

TRICARE is a federally funded health care plan for active, reserve, and retired U.S. military personnel, and their dependants. The MinnesotaCare taxes generally do not apply to payments received directly from the federal government. This change would specifically exempt federal payments under TRICARE from MinnesotaCare taxes. The exemption would not extend to out-of-pocket payments received from plan participants or any supplementary payments not received directly from the federal government.

Statutory Change: Minn Stat. § 295.53, sub 1(a).

Other Revenue Initiatives (General Fund)
Governor's Recommendations

	FY 2006	FY 2007	FY 2008	FY 2009
Scholarship Credit- Corporate Tax[1]		(3,500)	(3,750)	(3,750)
Department of Environmental Protection[2]	(347)	(550)	(801)	(1,077)
Gaming Option[3]	200,000		114,000	114,000
Pawlenty-Molnau Transportation Initiative[4]			(62,690)	(128,760)

[1] Corporate tax credit to be proposed in separate legislation by the Minnesota Department of Education
[2] Net impact to the General Fund of the re-allocation of Solid Waste Sales Tax proceeds to the Environmental Fund and the re-attribution of expenses associated with the proposed new Department of Environmental Protection to the Environmental Fund.
[3] Proceeds from a proposed Metro Partnership Casino to be proposed in separate legislation.
[4] Constitutional amendment to be proposed in separate legislation.

Change Item: Scholarship Tax Credit

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	$250	$250	$250	$250
Revenues	0	($3,500)	($3,750)	($3,750)
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$250	$3,750	$4,000	$4,000

Recommendation

The Governor recommends expanding education choices for children by allowing a tax credit to corporations contributing to scholarship granting organizations that provide financial aid to low- and moderate-income families to help cover the cost of tuition at K-12 private schools.

The details of this recommendation will be included in separate legislation carried by the Minnesota Department of Education.

Statutory Change: Amend MS 290.01, subd. 19c. Add new statute.

SOLID WASTE TAX CHANGES

Change Item: Department of Environmental Protection

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	($11,760)	($11,760)	($11,760)	($11,760)
Revenues	($12,107)	($12,310)	($12,561)	($12,837)
Other Fund				
Expenditures	$11,760	$11,760	$11,760	$11,760
Revenues	$12,107	$12,310	$12,561	$12,837
Net Fiscal Impact	$0	$0	$0	$0

Recommendation

This is part of the Governor's recommendation to establish a Department of Environmental Protection. He recommends that the department should be funded, in part, with a portion of the proceeds from the Solid Waste Management Tax currently deposited in the General Fund that would be re-directed to the Environmental Fund. Specifically, he recommends that $33,760,000, or 70% of the total tax remitted, be deposited into the Environmental Fund. Currently, $22,000,000, or 50% of total tax remitted goes to the Environmental Fund with the balance accruing to the General Fund.

The details of this recommendation are included in the Office of Environmental Assistance (OEA) portion of this budget.

Statutory Change: Minn. Stat. § 290.01, Subd. 6b

Change Item: Metro Partnership Casino

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0	0	0
Revenues	$200,000	0	$114,000	$114,000
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	($200,000)	0	($114,000)	($114,000)

Recommendation

The Governor proposes legislation to create a partnership between the Minnesota Lottery and those federally recognized tribal governments that choose to participate for the purpose of establishing a single metro area casino. This legislation would allow an entity created by participating tribes to open the casino in collaboration with the Minnesota Lottery. Revenues will be distributed among the tribes, the State of Minnesota, the host community and programs for problem gaming mitigation. The location of the facility would be determined by the Lottery Director, in consultation with the partnering tribes, based on an application process by willing host communities.

Relationship to Base Budget

A management company selected or formed by the tribal entity would be subject to an initial licensing fee of $200 million. The fee would be paid to the state and deposited in the General Fund. Depending upon when the casino begins operation, additional revenues would likely accrue to the state during the first biennium, but are not reflected above.

The Minnesota Lottery would be paid a fee to operate the gaming machines and other lottery games at the new casino. Revenues generated at the casino would be subject to an “in-lieu sales tax,” the proceeds from which would accrue to the General Fund.

Statutory Change: New legislation; various existing statutes

Additional Information

In addition to the above referenced legislation, the Governor also proposes to negotiate an additional compact under Minn. Stat. § 3.9221 that would apply to the current casinos operated on reservation land by tribes that elect to partner (as described above) with the state. The issues that are likely to be considered in these compact negotiations are:

- The term of the agreement, proposed to be 20 years
- Additional games such as craps, roulette, “live” Keno, and simulcast pari-mutuel horse racing
- Higher limits for slot machine payouts than those allowed under the current compact
- Authority for “spinning reel” slot machines
- New technologies including networked machines and multi-casino jackpots
- An exclusive territory within which the state agrees not to authorize additional casinos
- A revenue sharing payment by the tribal governments from a participating tribe’s current casinos to the state, on a sliding scale fee basis to be negotiated. Proceeds to the state from revenue sharing would go to the General Fund and are not reflected above.

MOTOR VEHICLE SALES TAX CHANGES

Change Item: The 2005 Pawlenty/Molnau Transportation Initiative

Fiscal Impact ($000s)	FY 2006	FY 2007	FY 2008	FY 2009
General Fund				
Expenditures	0	0		
Revenues	0	0	($62,690)	($128,760)
Other Fund				
Expenditures				
Revenues	0	0	$62,690	$128,760
Net Fiscal Impact	0	0	0	0

Recommendation
The Governor recommends that the state commit to a major investment program for transportation. As part of this package, the Governor is proposing a constitutional dedication of 100% of the Motor Vehicle Sales Tax (MVST) to transportation, phased in over five years beginning in FY 2008.

Background
Currently, MVST revenues are deposited in the state's General Fund and approximately 54% is distributed by statute to highways and transit. This proposal would allow voters in the 2006 general election to decide if the state should dedicate the entire amount to highways and transit, with 60% going to the state Highway Users Tax Distribution Fund and 40% going for metro and Greater Minnesota transit. This dedication would be phased in over five years.

Alternatives Considered
The needs addressed in this proposal are real and must be addressed with increased spending for transportation. Traditionally, increased funding needs have been addressed by raising the gas tax or vehicle registration fees.

Statutory Change: Article XIV, Minnesota Constitution