Short Subjects

Minnesota House of Representatives, House Research

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John Williams

Updated: January 2006

Minnesota Speed Limits

Minnesota law sets speed limits on state and local highways and streets, and provides for the establishment of speed zones by the Department of Transportation (MnDOT).

Basic law

Minnesota's basic law on highway speeds is found in Minnesota Statutes, section 169.14, subdivision 1:

> *No person shall drive a vehicle on a highway at a speed greater than is reasonable and prudent under the conditions. Every driver is responsible for becoming and remaining aware of the actual and potential hazards then existing on the highway and must use due care in operating a vehicle.*

Statutory limits

Minnesota law sets out the following speed limits:

- Streets and highways in urban areas, 30 m.p.h.
- Interstate highways outside urbanized areas of 50,000 or more, 70 m.p.h.
- Interstate highways within urbanized areas of 50,000 or more, 65 m.p.h.
- Noninterstate freeways and expressways, 65 m.p.h.
- Other highways outside urban districts, 55 m.p.h
- Streets inside urban districts, 30 m.p.h
- Town roads in rural residential districts, 30 m.p.h.
- Alleys, 10 m.p.h.

An "urban district" is any segment of street or highway that is built up with structures less than 100 feet apart for a distance of a quarter-mile. A "rural residential district" is a segment of a town road with structures less than 300 feet apart for a distance of a quarter-mile.

Speed limits within cities are absolute, meaning that any speed in excess of them is automatically illegal. Elsewhere speed limits are "prima facie limits," meaning that any speed in excess of them is prima facie evidence that the speed was illegal. This means that there is a presumption that the excess speed is illegal but the presumption may be rebutted by other evidence.

Speed zones

MnDOT has the authority to establish speed zones in which the speed limit is higher or lower than the limits set in law. Speed zones are established after MnDOT conducts an engineering and traffic investigation that includes a segment's design, physical characteristics, traffic volume, accident history, and actual speeds. Generally, MnDOT believes that a speed limit at or near the "85th percentile speed" (the speed at or below which 85 percent of vehicles are traveling) is most likely to be the safest maximum limit.

Speed limits in speed zones are effective as soon as signs are erected. Like statutory limits, they are absolute limits within a city and prima facie limits outside cities.

Local authority

The authority of a city, county, or town over speed limits is limited, even on its own streets and highways. A local road authority may ask MnDOT to conduct an engineering and traffic investigation on a segment of local road, but the department makes the final determination on the speed limit on that segment.

There are a few exceptions to this general rule:

- On a residential roadway, defined as a segment up to a half-mile that is functionally classified as local, a local resolution may reduce the speed limit from 30 m.p.h. to 25 m.p.h.
- In school zones, defined as a segment of street or highway that abuts school grounds where children have access to the roadway or where a school crossing is established, a local road authority may prescribe a lower speed limit that is not less than 15 m.p.h. or more than 20 m.p.h. below the surrounding limit.
- On a park road within a local park a local authority may prescribe a lower speed limit that is not less than 15 m.p.h. or more than 20 m.p.h. below the surrounding limit.

Both MnDOT and local road authorities can set speed limits within their own highway work zones, to be effective while highway workers are on the job. A work zone speed limit cannot be less than 20 m.p.h. or reduce the speed limit in the work zone by more than 15 m.p.h. The maximum work zone speed limit is 55 m.p.h. on divided highways and 40 m.p.h. on other highways.

Speed violations

Under most circumstances, speeding is a petty misdemeanor punishable by a maximum penalty of a $300 fine. However, if a speeding violation is committed in such a manner as to endanger persons or property, it can be charged as a misdemeanor with maximum penalties of a $1,000 fine and 90 days in jail. Speeding violations of more than 20 m.p.h. over the legal limit result in a surcharge equal to the amount of the original fine, with a $25 minimum.

Minnesota does not have a point system on driver's licenses, but a third petty misdemeanor in a year can be charged as a misdemeanor, and a third misdemeanor in a year can result in a driver's license revocation. A speed of 100 m.p.h. or more results in at least a six-month license revocation.

Under the "Dimler amendment," named after its author, former Rep. Chuck Dimler, a violation of a 55 m.p.h. speed limit by not more than 10 m.p.h., or of a 60 m.p.h. limit by not more than 5 m.p.h., is not recorded on a motorist's driving record.

For more information: Contact legislative analyst John Williams at 651-296-5045.

HOUSE RESEARCH | Short Subjects

Nina Manzi and Lisa Larson Updated: January 2006

The K-12 Education Deduction and Credit: An Overview

What is the K-12 deduction?

A state income tax deduction is allowed for K-12 education-related expenses. The deduction is for up to \$2,500 for each dependent in grades 7-12, and up to \$1,625 for each dependent in grades K-6.

What expenses qualify for the deduction?

Qualifying expenses include the following:

- Tuition, including nonpublic school, after-school enrichment, academic summer camps, music lessons, and tutoring
- Textbooks, including instructional materials and supplies, musical instrument rental and purchase, and up to \$200 of computer hardware and educational software
- Transportation (paid to others for transporting children to school)

What is the tax benefit of the deduction?

A deduction reduces an individual's taxable income. The tax benefit depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has three marginal tax rates: 5.35 percent, 7.05 percent, and 7.85 percent. A taxpayer in the 5.35 percent bracket who claims a \$2,500 deduction will pay \$133.75 less in state income taxes (5.35% x \$2,500). A taxpayer in the 7.85 percent bracket with the same deduction will pay \$196.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. In tax year 2006, a typical married couple with two dependents would need to have \$22,350 of gross income before owing any state income tax.

How many people claim the deduction, and how much does it cost?

In 2006, an estimated 186,000 returns will claim the deduction at a cost to the state of \$14.6 million.

What is the K-12 education credit?

A state income tax credit is allowed for 75 percent of K-12 education-related expenses. The credit is for up to \$1,000 for each child in grades K-12, with parents allowed to allocate expenses among children as they choose. The credit is subject to an income-based phaseout. It begins to phase out when income exceeds \$33,500. For families claiming the credit for one or two children, it is fully phased out when income reaches \$37,500. The phaseout extends for an additional \$2,000 of income for each additional child claimed (i.e., to \$39,500 for three children, \$41,500 for four children, etc.)

What expenses qualify for the credit?

The same expenses qualify for the credit as for the deduction, except nonpublic school tuition does not qualify for the credit.

What is the tax effect of the credit?

The K-12 credit directly reduces tax liability and is fully refundable. If an individual's credit exceeds his or her liability, the excess is paid as a refund.

Can parents obtain loans to pay for educational services that qualify for the credit?

Parents may assign payment of the credit to participating financial institutions and tax-exempt foundations. In exchange, parents receive a loan that is paid directly to a third-party provider of educational services and programs. This allows very low-income families to purchase educational products and services in anticipation of receiving a credit when they file their tax return the following year, with the credit paid directly to the financial institution or foundation that accepted the assignment.

How many people claim the credit, and how much does it cost?

In tax year 2003, 61,259 Minnesotans claimed a total of $15.9 million in K-12 education credits. The average credit was $259.

How do taxpayers claim the deduction and credit?

Taxpayers claim the deduction on form M-1, the Minnesota income tax return. Taxpayers claiming the credit must complete form M1ED and attach it to their state tax return.

Have the deduction and credit been subject to legal challenge?

The constitutionality of the dependent education expense deduction was challenged in *Mueller v. Allen* in 1983. The U.S. Supreme Court upheld the statute authorizing the deduction in a 5-4 decision. The Court found that the deduction did the following:

- Offset parents' educational expenses and helped ensure an educated populace
- Helped ensure the financial health of nonpublic schools and relieved the financial burden on public schools
- Promoted "wholesome competition" between public and nonpublic schools and provided a high-quality education for all children

Minnesota's current K-12 education credit has not been subject to legal challenge.

What do other states provide in terms of income tax credits for education-related expenses?

To date, five states in addition to Minnesota provide income tax credits for education-related expenses: Arizona, Florida, Illinois, Iowa, and Pennsylvania (Puerto Rico provides a credit similar to those allowed in Arizona, Florida, and Pennsylvania.). **Arizona** gives taxpayers tax credits for contributions to school tuition organizations that operate like charities and for extracurricular public school fees. **Florida** allows individual and corporate taxpayers to claim a nonrefundable tax credit for contributions to nonprofit scholarship funding organizations. **Illinois** gives taxpayers a nonrefundable tax credit for qualified education expenses. **Iowa** gives taxpayers a tax credit for tuition, secular textbooks, and extracurricular activities for children attending accredited not-for-profit K-12 schools. **Pennsylvania** allows corporations to claim a nonrefundable tax credit for contributions to nonprofit scholarship funding organizations and innovative public school programs. Courts in Arizona, Illinois, and Iowa have upheld the permissibility of these education credits.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Lisa Larson at 651-296-8036. Also see the House Research publication *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, December 2003.

Joel Michael

Updated: January 2006

Cigarette and Tobacco Excise Taxes and Fees

Minnesota imposes several taxes and fees on cigarettes and tobacco products

Minnesota imposes a series of taxes and fees on the sale or possession of cigarettes and tobacco products. The table lists the taxes and fees and their rates. The cigarette taxes and fees are all imposed on a "per unit" basis—i.e., on the number of cigarettes sold, not as a percentage of the sale price. Because the tax is a per unit tax, it does not increase as the price of cigarettes increases. By contrast, the taxes and fees on tobacco products, such as cigars, pipe tobacco, snuff, and chewing tobacco, are imposed as a percentage of their wholesale prices.

Tax or fee	Per pack of 20 rate	Percent of price
Cigarette excise tax	48 cents	NA
Tobacco products excise tax	NA	35%
Health impact fee	75 cents	35%
Fee on cigarettes manufactured by nonsettling companies	35 cents	NA
Tax in lieu of general sales tax (rate for FY2006)	25.5 cents	NA

The 2005 Legislature converted the sales tax to a per pack tax and imposed the health impact fee

The 2005 Legislature made two changes in cigarette and tobacco products taxation:

- It converted the 6.5 percent state general sales tax on cigarettes to a flat amount per pack tax collected from wholesalers (rather than as a percentage of the retail sale prices, as other products are taxed under the sales tax). The commissioner of revenue annually sets the amount based on a survey of the average retail price of cigarettes. The 2005 legislation set the amount initially at 25.5 cents per pack.
- The 2005 Legislature also imposed a health impact fee of 75 cents per pack of cigarettes and 35 percent of the wholesale price of tobacco products. Combining the Minnesota's excise tax and fee, the burden equals $1.23 per pack and 70 percent of the wholesale price of tobacco products. This fee is imposed and collected in the same manner as the cigarette excise tax.

Payments made to settle state lawsuits against the tobacco industry have similar effects to excise taxes

Settlements of the states' lawsuits against the tobacco companies have about the same economic effect as a cigarette tax, since these settlement payments are passed along to consumers (nationally) through higher cigarette prices. However, they do not affect companies that were not part of the lawsuit. To compensate partially for the lower prices of cigarettes produced by nonsettling companies, the 2003 Legislature imposed a 35-cent per pack fee on those cigarettes. These cigarettes make up a growing share of the national and Minnesota markets. (Other states have imposed similar fees: Michigan and Utah impose a 35-cent surcharge; and Alaska a 25-cent surcharge.)

Both of the fees are being challenged in court

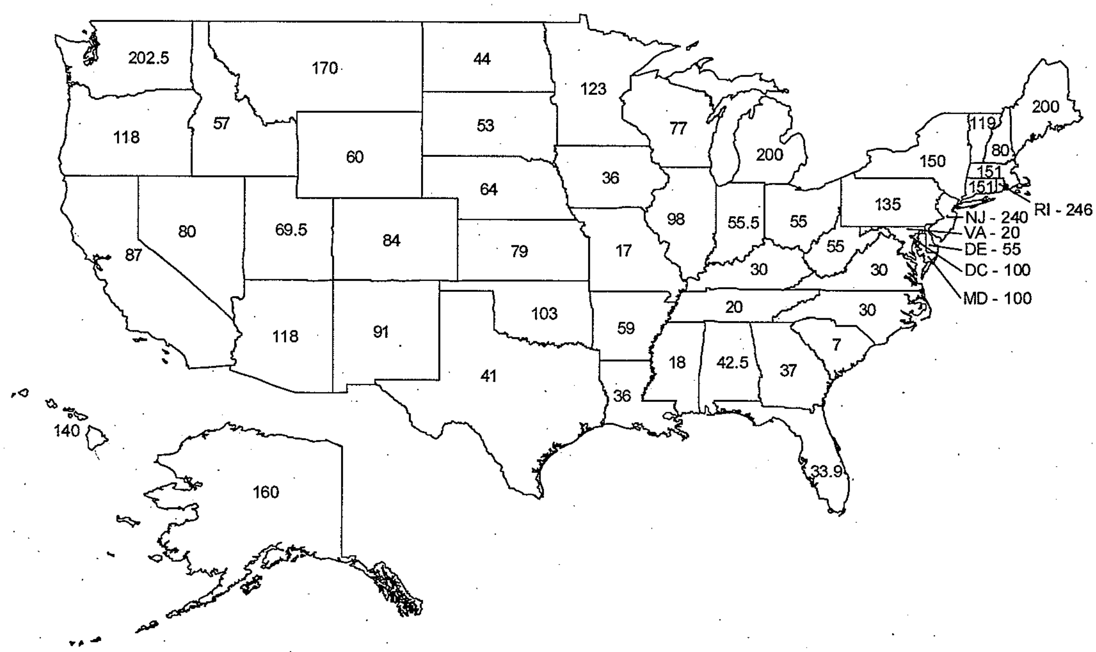
Nonsettling companies have challenged the 35-cent fee. The Minnesota Court of Appeals has upheld the law, but it is on appeal to the Minnesota Supreme Court.

In December 2005, the Ramsey County District Court held that the health impact fee was barred by the agreement settling the state's lawsuit against the tobacco industry. The fee is being collected while the case is on appeal.

The taxes and fees are estimated to yield revenues of about $450 million	For fiscal year 2007, the Finance Department estimates collections from the two excise taxes and the sales tax on cigarettes will be $221.6 million and from the health impact fee, $223.4 million. Revenues from the tobacco products tax are deposited in the general fund. For fiscal year 2007, cigarette tax revenues of $22.25 million go to fund the Academic Health Center, $8.55 million to the medical education and research account, and the rest to the state general fund. The health impact fee revenues are deposited in a health impact fund and are transferred to the general fund after the commissioner of human services certifies that state health programs have incurred tobacco-related costs equal to the fee.
Neighboring states have significantly lower tax rates	Because cigarettes can easily be transported, the tax rates in other states (especially border states) are important. Taking into account the combined effects of the tax and fee ($1.23/pack), Minnesota's bordering states have significantly lower rates, ranging from 77 cents (Wisconsin) to 36 cents (Iowa). All states' rates are shown on the map. The map does not reflect local cigarette taxes; some of these local taxes are substantial (e.g., $1.50 per pack in New York City). Some states have no sales tax or exempt cigarettes from sales taxation, lowering the overall tax burden.

State Cigarette Tax Rates*

as of 1/1/2006
cents per pack



* These exclude some significant local taxes.
Source: Federation of Tax Administrators and other sources

For more information: Contact legislative analyst Joel Michael at 651-296-5057.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

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Nina Manzi and Jim Cleary **February 2006**

Military Pay under Minnesota's Individual Income Tax

What factors affect Minnesota individual income taxation of active service military pay?

Minnesota income tax treatment of active service military pay depends on several factors:

- where the service was provided (in Minnesota, or outside Minnesota)
- whether the individual had other Minnesota source income during the tax year
- whether the individual is a Minnesota resident
- whether the individual is in the full-time military or in the National Guard or reserves

Service outside Minnesota, no other Minnesota source income

Individuals who serve outside Minnesota and have no other Minnesota source income are not subject to state income tax withholding and do not have to file a Minnesota income tax return. This treatment typically applies to members of the full-time military who are in active service outside Minnesota throughout the entire tax year, as members of either the full-time military or the National Guard or reserves.

Service outside Minnesota, with other Minnesota source income

Individuals who serve outside Minnesota and have other Minnesota source income must file a Minnesota return, but may subtract most types of military pay earned outside Minnesota. The exception is that pay for National Guard training under Title 32 that occurs outside Minnesota may not be subtracted. Some common situations include the following:

- members of the full-time military in active service who have employed spouses who live in Minnesota
- members of the National Guard and reserves deployed outside Minnesota for the entire tax year who have employed spouses who live in Minnesota, or whose employer provides a salary differential
- members of the National Guard and reserves deployed outside of Minnesota for part or all of the year who own businesses in Minnesota that are organized as S corporations or partnerships that continue to generate income for the solider
- members of the National Guard and reserves called to active service outside Minnesota for a portion of the tax year, who have civilian income in Minnesota during the remainder of the tax year

Service in Minnesota by a resident of another state

Individuals who serve in Minnesota and are residents of another state must file a Minnesota income tax return but may claim a subtraction for active service military pay. Federal law prohibits states from taxing active service military pay earned by nonresidents. This treatment typically applies to residents of other states who are stationed in Minnesota.

Service in Minnesota by a Minnesota resident who is a member of the full-time military

Individuals who serve in Minnesota and are Minnesota residents are subject to state income tax, and generally may not claim a subtraction for regular active service military pay. This treatment typically applies to Minnesota residents who are full-time military and are stationed in Minnesota, such as active guard and reserve (AGR) personnel, recruitment officers, liaisons to defense contractors, or public health officers.

Service in Minnesota by a Minnesota resident who is a member of the National Guard or reserves

Minnesota residents who are members of the National Guard and reserves are allowed a subtraction for pay received when they are ordered by the president or the governor to certain types of qualifying active service within Minnesota.

"Qualifying active service" includes

- certain *state active service*, such as assistance in natural disasters and searches for lost persons (Minn. Stat. § 190.05, subd. 5a, clause (1)),
- *federally funded state active service*, under U.S.C. Title 32, such as airport security or active duty for special work (ADSW), (Minn. Stat. § 190.05, subd. 5b); and
- *federal active service*, under U.S.C. Title 10, such as while on medical hold under Title 10 active duty orders for community-based health care operations, for which one's assignment typically is to perform light duty at a nearby armory or training and community center while recuperating from an injury (Minn. Stat. § 190.05, subd. 5c).

"Qualifying active service" excludes

- weekend drills and annual training (summer camp),
- special school attendance, and
- service by Active Guard Reserve (AGR) personnel (includes some members of the staff of the Department of Military Affairs).

Does Minnesota follow federal tax treatment of other kinds of military income and benefits, such as combat pay?

Yes, Minnesota conforms to federal income tax treatment of various types of military income, whether received in kind or as a reimbursement or allowance. Examples of excluded income include the following:

- housing allowances
- moving allowances
- travel allowances and per diem
- combat zone pay
- death gratuity benefits

While Minnesota excludes combat pay from taxable income, it counts combat pay in determining an individual's eligibility for the working family tax credit. This credit for low-income taxpayers is calculated as a percentage of earned income. Counting combat pay as earned income results in some service members remaining eligible for the credit.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Jim Cleary at 651-296-5053.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Joel Michael

February 2006

Penalties for Underreporting Minnesota Individual Income Tax

What is the civil penalty for failure to pay Minnesota income tax by the due date?

For calendar year taxpayers, final payments are due on April 15 following the close of the tax year. (Most taxpayers pay on a calendar year basis; a small number use fiscal years instead.) Income tax not paid by April 15 is subject to a late payment penalty equal to 4 percent of the amount not paid.

An additional 4 percent penalty applies to amounts owed as a result of an assessment order from the commissioner of revenue if the taxpayer either does not pay the amount assessed within 60 days of the order or does not appeal the assessment.

An additional extended delinquency penalty of 5 percent of the tax due applies to income tax not paid within 180 days of an order from the commissioner or the date a return is filed.

Is there a reasonable cause exception?

Yes. A taxpayer is presumed to have reasonable cause for underpayment if the taxpayer paid 90 percent of the amount due by the April 15 due date, filed the return by October 15, and paid the balance of the tax due when the return was filed. In this situation the 4 percent late payment penalty does not apply.

What is the "additional tax charge"?

Individuals who expect to owe $500 or more after withholding and credits must make estimated payments, which are due in four installments: April 15, June 15, and September 15 during the tax year, and January 15 following the close of the tax year. If estimated payments and withholding do not equal at least 90 percent of the tax due, or 100 percent of liability for the preceding tax year, the taxpayer is subject to an additional tax charge. The additional tax charge equals 4 percent of the amount underpaid, prorated by the number of days elapsed between the due dates of the four installments and the date of the final payment.

The additional tax charge does *not* apply if the individual was a Minnesota resident in the preceding tax year but did not have tax liability.

What is the civil penalty for failure to file a return?

While individual income tax payments are due by April 15 following the close of the tax year, returns are not due until October 15. Taxpayers who fail to file an individual income tax return by October 15 must pay a penalty equal to 5 percent of the tax not paid by October 15.

If an individual is required to file a return and does not file it by October 15 and receives a written demand to file from the Department of Revenue, the individual must file within 60 days or face an additional "extended late file" penalty. The extended late file penalty equals the greater of 5 percent of the tax not paid or $100.

What other civil penalties are there?

- **Failure to report changes to the federal return: 10 percent.** When a federal return is amended by the taxpayer or corrected by the Internal Revenue Service, a copy of that return or a letter of explanation must be reported to Minnesota within 180 days. An amended Minnesota return is also required within 180 days. If federal changes are not reported, a penalty of 10 percent of the underpayment of Minnesota tax attributable to the federal change applies.
- **Intentional disregard of laws: 10 percent.** A 10 percent penalty applies if the taxpayer has been negligent or shown intentional disregard of the law or rules for determining liability, but didn't intend to defraud.
- **Failure to provide Social Security number as required on return: $50.**
- **Substantial understatement of liability: 20 percent.** "Substantial understatement" means underreporting of the correct tax that exceeds the greater of $5,000 or 10 percent of the tax actually owed. A penalty of 20 percent applies to a substantial understatement of liability.
- **Filing a frivolous return: greater of 25 percent or $1,000.** A return is considered frivolous if it is substantially incorrect on its face or lacks information needed to judge the accuracy of the return, and consists of inappropriate conduct or reflects a desire to impede the tax process.
- **Filing a false or fraudulent return: 50 percent.** A penalty of 50 percent applies to the underreported liability and overstated refund claimed if the commissioner can prove the return was fraudulent in order to evade the tax, or if failure to file a return was intended to evade the tax. The 50 percent penalty also applies to fraudulently claimed refundable credits (the dependent care credit, the working family credit, the K-12 education credit, and the property tax refund).

Does interest apply to underreported tax liability and penalties?

In addition to the penalties listed, taxpayers who underreport individual income tax liability must pay interest on the amount underpaid and on the associated penalty from the date the tax was due. Penalties and underreported liability bear interest at an annual rate tied to the prime rate. This rate is adjusted annually and is set at 4 percent for 2005 and 6 percent for 2006.

How are the penalties applied?

The penalties for underreporting of individual income tax liability are imposed and collected in the same manner as the original taxes.

Are failing to file and underreporting liability criminal offenses in Minnesota?

Yes, in certain circumstances. It is a gross misdemeanor to knowingly fail to file a return or pay tax. It is a felony to willfully fail to file a return or pay tax, with intent to evade the tax, and a felony to file a false return concerning a material matter. Penalties for these criminal offenses are in addition to civil penalties.

For more information: Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. (**Note:** Research assistant Matt Burress provided help with this publication.)

Karen Baker and Nina Manzi

Updated: February 2006

Homeowner's Property Tax Refund Program

What is the property tax refund program?

The homeowner's property tax refund program (sometimes called the "circuit breaker" or the PTR) is a state-paid refund that provides tax relief to homeowners whose property taxes are high relative to their incomes. If property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

Has the program changed?

The 2001 tax law expanded the homeowner's property tax refund program, effective for refunds based on property taxes payable in 2002. The changes lowered the threshold for determining eligibility and increased the maximum refund allowed. The tax law also limited the amount of tax qualifying for the refund for farmers to the tax attributable to the house, garage, and first acre of property. (Previously the tax amount for farmers also included the tax on the first $600,000 of land and farm buildings.)

What are the maximums?

For refund claims filed in 2006, based on property taxes payable in 2006 and 2005 household income, the maximum refund is $1,640. Homeowners whose income exceeds $87,780 are not eligible for a refund.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue Schedule M1PR. Claims filed before August 15, 2006, will be paid beginning in late September 2006. The deadline for filing claims based on taxes payable in 2006 is August 15, 2007; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf. Claimants can check the status of their refund by calling (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml

What is the average refund and total amount paid?

2004 Statewide Homeowner Property Tax Refunds
Filed in 2004 (based on 2003 incomes and payable 2004 taxes)

	Number of returns	Total refund amount	Average per return
Under 65 years old	142,438	$78.3 million	$550
Senior/disabled	104,321	$57.3 million	$550
Total: all homeowners	246,759	$135.6 million	$550

How do refunds vary depending upon the filer's income and property tax?

The following table shows the refund amount for two example families with different incomes—one family in the metro area and one in greater Minnesota. Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average residential homestead property tax in the metro area is higher than in greater Minnesota. The metro area family has payable 2006 property taxes of $2,773, the estimated average for the metro. The greater Minnesota family has payable 2006 property taxes of $1,419, the estimated average for greater Minnesota. Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple both under age 65, two dependents					
		Metro area		**Greater Minnesota**	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #3**	**Taxpayer #4**
1	Taxable Market Value of Home	$249,400	$249,400	$139,900	$139,900
2	Gross Income	$25,000	$50,000	$25,000	$50,000
3	Deduction for dependents	$8,640	$8,640	$8,640	$8,640
4	Household income (2 – 3 = 4)	$16,360	$41,360	$16,360	$41,360
5	Property tax	$2,773	$2,773	$1,419	$1,419
6	Statutory threshold percentage	2.1%	2.8%	2.1%	2.8%
7	Threshold % x income (4 x 6 = 7)	$344	$1,158	$344	$1,158
8	Property tax over threshold (5 – 7 = 8)	$2,429	$1,615	$1,075	$261
9	Statutory copay percentage	30%	45%	30%	45%
10	Taxpayer copay amount (8 x 9 = 10)	$729	$727	$323	$117
11	Remaining tax over threshold (8 – 10 = 11)	$1,700	$888	$752	$144
12	Maximum refund allowed	$1,370	$1,100	$1,370	$1,100
13	Net property tax refund	$1,370	$888	$753	$144

For more information: Contact legislative analyst Karen Baker at 651-296-8959 or Nina Manzi at 651-296-5204.

Nina Manzi and Karen Baker

Updated: February 2006

Renter's Property Tax Refund Program

What is the renter's property tax refund program?

The renter's property tax refund program (sometimes called the "renters' credit") is a state-paid refund that provides tax relief to renters whose rent and "implicit property taxes" are high relative to their incomes. "Rent constituting property taxes" is assumed to equal 19 percent of rent paid. If that rent constituting property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

What are the maximums?

For refund claims filed in 2006, based on rent paid in 2005 and 2005 household income, the maximum refund is $1,350. Renters whose income exceeds $47,350 are not eligible for refunds.

What is the average refund and total amount paid?

2004 Statewide Renter Property Tax Refunds
Filed in 2004 (based on 2003 incomes and payable 2003 taxes)

	Number of returns	Total amount	Average per return
Under 65 years old	193,039	$97.2 million	$504
Senior/disabled	77,577	$43.1 million	$555
Total: all renters	270,616	$140.3 million	$518

How are claims filed?

Refund claims are filed using Minnesota Department of Revenue Schedule M1PR. Claims filed before August 15, 2006, will be paid beginning in August 2006. The deadline for filing claims based on taxes payable in 2006 is August 15, 2007; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf. Claimants can check the status of their refund by calling (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml.

How do refunds vary depending upon the filer's income and rent constituting property taxes?

The following table shows the refund amount for two example families with different incomes—a married couple without dependents in the metro area, and a married couple without dependents in greater Minnesota (a single person living alone would qualify for the same refund amounts). Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average rent is higher in the metro area than in greater Minnesota. The metro area family paid monthly rent in 2005 of $763, the fair market rent for a one-bedroom apartment in the metro area. (19% of $763 x 12 = $1,740, which is their rent constituting property tax.) The greater Minnesota family paid monthly rent in 2005 of $404, the fair market rent for a one-bedroom apartment in many greater Minnesota counties. (19% of $404 x 12 = $921, which is their rent constituting property tax.) Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple both under age 65, no dependents

		Metro area		Greater Minnesota	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #3**	**Taxpayer #4**
1	Gross income	$15,000	$30,000	$15,000	$30,000
2	Deduction for dependents	0	0	0	0
3	Household income (1 – 2 = 3)	$15,000	$30,000	$15,000	$30,000
4	Rent constituting property tax	$1,740	$1,740	$921	$921
5	Statutory threshold percentage	1.5%	2.7%	1.5%	2.7%
6	Threshold % x income (3 x 5 = 6)	$225	$810	$225	$810
7	Property tax over threshold (4 – 6 = 7)	$1,515	$930	$696	$111
8	Copay percentage	20%	35%	20%	35%
9	Taxpayer copay amount (7 x 8 = 9)	$303	$325	$139	$39
10	Remaining tax over threshold (7 – 9 = 10)	$1,212	$605	$557	$72
11	Maximum refund allowed	$1,350	$1,350	$1,350	$1,350
12	Net property tax refund	$1,212	$604	$557	$72

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Karen Baker at 651-296-8959.

Nina Manzi **Updated: February 2006**

The Minnesota and Federal Dependent Care Tax Credits

What are the credits?

The Minnesota and federal dependent care credits partially offset the cost of child care for certain workers. The maximum Minnesota credit is $720 for one child and $1,440 for two or more children. The maximum federal credit is $1,050 for one child and $2,100 for two or more children.

Are the credits refundable?

The Minnesota credit is fully refundable. If an individual qualifies for a credit that is greater than his or her tax liability, the excess is paid as a refund. The federal credit is not refundable and may only be used to offset federal income tax liability.

Who is eligible for the credits?

Anyone who incurs expenses related to the care of a dependent and related household expenses may be eligible to claim the credits. The claimant must:

- maintain a household that includes the dependent;
- pay for care for a dependent under age 13, or a disabled spouse or adult dependent; and
- pay for care in order to work or look for work.

What are qualifying expenses?

Qualifying expenses are amounts paid for the care of a dependent under age 13, or a disabled spouse or adult dependent, but do not include:

- amounts paid to the claimant's spouse or another dependent, or
- amounts paid through a dependent care pre-tax account.

Qualifying expenses may not exceed the claimant's earned income (for married couples filing joint returns, expenses may not exceed the earned income of the lesser earning spouse).

How are the credits calculated?

The *federal credit* equals 35 percent of up to $3,000 of qualifying expenses for one child ($6,000 of qualifying expenses for two or more children). The maximum federal credit is $1,050 for one child and $2,100 for two or more children. The federal credit begins to phase down when income exceeds $15,000, with the credit percentage decreasing as income increases. Claimants with incomes over $43,000 qualify for the minimum federal credit equal to 20 percent of qualifying expenses, or up to $600 for one child and $1,200 for two or more children, depending on actual child care costs. For example, a claimant with $50,000 of income and $1,000 of expenses will qualify for a credit of $200 (20 percent of $1,000).

The *state credit* equals the lesser of the federal credit, or $720 for one child ($1,440 for two or more children). The state credit is calculated by reference to the federal credit for which the claimant is eligible, not the amount actually used to offset federal liability. For example, an individual with expenses of $2,000 and income below $15,000 is eligible for a federal credit of $700 (35 percent of $2,000). While this individual will probably not have any federal tax liability and thus will not benefit from the nonrefundable federal credit, he or she will still be eligible for a refundable state credit of $700.

The state credit is subject to a separate phaseout than the federal credit. In tax year 2006, the state phaseout begins when income exceeds $21,060, and the state credit is fully phased out when income exceeds $34,710. The income threshold for the phaseout is adjusted each year for inflation.

How do filers claim the credits?

Filers claim the credits when they file their federal and state income tax returns, by completing a separate schedule—Form 2441 for the federal credit and schedule M1CD for the state credit.

How many Minnesotans claim the credits?

In tax year 2003, 143,548 Minnesotans claimed the federal dependent care credit and 36,190 claimed the state credit. These claims represent 6.0 percent of all federal returns filed by Minnesotans, and 1.5 percent of all state returns filed.

Because the federal credit is nonrefundable and can only be used to offset tax liability, most of the federal credits are claimed by middle- and upper-income filers who have income over $43,000 and qualify for the minimum credit amount.

Because the state credit is refundable and only available to filers with incomes below $34,570, most of the state credits are claimed by low-income filers.

How much is paid out in credits?

In tax year 2003, Minnesotans claimed $61.7 million of federal dependent care credits. The average federal dependent care credit was $430.

In tax year 2003, Minnesotans claimed $13.0 million of state dependent care credits. The average state dependent care credit was $359.

How are the credits distributed geographically?

While about 44 percent of the returns claiming state credits came from the Twin Cities metropolitan area, these seven counties generated about 55 percent of all returns filed. Put another way, in 2003 nonmetro filers were more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 5.1 percent of all income tax returns claimed the federal dependent care credit, compared to 6.0 percent in Minnesota. Maryland had the highest percentage of returns claiming the federal credit, at 7.0 percent, and West Virginia had the lowest, at 2.3 percent. Minnesota's percentage of returns claiming the credit may be higher than national figures because Minnesota has a high proportion of two-worker households.

The average federal dependent care credit nationwide in 2003 was $516; it was $430 in Minnesota. The District of Columbia had the highest average credit, at $631, and Montana had the lowest, at $384. Minnesota's average credit amount may be lower than the national averages because state residents have above average incomes.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Minnesota and Federal Dependent Care Tax Credits*, February 2005.

HOUSE RESEARCH | **Short Subjects**

Karen Baker and Nina Manzi

Updated: February 2006

Targeting Property Tax Refund

What is targeting?

The "additional" or "special" property tax refund, generally referred to as "targeting," directs property tax relief to homeowners who have large property tax increases from one year to the next.

Who qualifies?

A homeowner qualifies if the property tax on the home has increased by more than 12 percent over the previous year's tax, and if the increase is over $100.

The homeowner must have owned and lived in the same home for both years. If any improvements were made to the home, that portion of the tax increase resulting from the improvements must be subtracted when determining the refund.

How does targeting work?

The refund equals 60 percent of the increase over the greater of (1) 12 percent or (2) $100. The maximum refund is $1,000. The following example shows how the refund is calculated.

Payable 2005 Property Tax	$1,400
Payable 2006 Property Tax	2,000
Tax increase – 2006 compared to 2005	$600
Taxpayer pays 1st 12% or $100 of increase (12% x 1,400)	168
Remaining increase eligible for relief ($600 - $168 = $432)	$432
State pays 60% of excess over 12% increase up to a $1,000 maximum (60% x $432 = $259)	$259
Amount of 2006 increase paid by taxpayer ($600 - $259)	$341

The taxpayer's $600 increase (i.e., 42.9 percent) is reduced to an out-of-pocket property tax increase of $341 (i.e., 24.4 percent) as a result of the $259 refund.

The taxpayer pays the full $2,000 amount of the 2006 property tax to the county, the first half in May and the second half in October. The taxpayer applies to the state for a targeting refund, which is paid at the same time the regular homeowner property tax refund ("circuit breaker") is paid.

Does targeting have any other restrictions?

No, unlike the regular property tax refund, the targeting refund is not tied to the taxpayer's household income. Under the regular homeowner property tax refund, the taxpayer's household income may not exceed a specified maximum and the amount of household income affects the amount of the refund.

However, the targeting refund does not use income as a factor, nor is there any limitation on the taxpayer's household income. Therefore, many higher income taxpayers who do not qualify for the regular property tax refund due to income restrictions are eligible for the targeting refund.

Is targeting a new program?

No, the first targeting program was enacted in 1980. With the exception of a few years in the 1980s, the program has been in effect for about 20 years, although miscellaneous changes have been made to the program during that time.

What are statewide amounts?

The amounts paid out for the targeting program have been low in recent years, but increased significantly from 2002 to 2003, then decreased in 2004. Total refunds increased from $1.0 million in 2002 to $7.6 million in 2003, then fell to $3.7 million in 2004.

The table below shows the statewide amount, with a breakdown for the metro and the 80 nonmetro counties, for the past three years.

Targeting Refunds, 2002 – 2004 (dollars in thousands)			
	Filed 2002	**Filed 2003**	**Filed 2004**
Total Metro	$359	$6,335	$2,463
Total Nonmetro	$674	$1,244	$1,241
State	$1,033	$7,579	$3,704

Some taxpayers (e.g., those who typically don't qualify for the regular property tax refund) may not be aware of the targeting program, resulting in lower total refunds statewide than would be the case if the program were more widely known.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue Schedule M1PR, the property tax refund form. There is a separate schedule on the back of the M1PR ("Schedule 1 – Special Refund") for the targeting program. The taxpayer files for this refund after receiving his or her property tax statement in February or March. Claims filed before August 15, 2006, will be paid beginning in late September 2006. The deadline for filing claims based on taxes payable in 2006 is August 15, 2007; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf. Claimants can check the status of their refund by calling (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml.

For more information: Contact legislative analyst Karen Baker at 651-296-8959 or Nina Manzi at 651-296-5204. Also see the House Research Short Subject *Homeowner's Property Tax Refund Program*, February 2006.

Nina Manzi

Updated: February 2006

The Federal Earned Income Tax Credit and Minnesota Working Family Credit

What are the credits?

The federal earned income tax credit (EITC) and Minnesota working family credit (WFC) equal a percentage of the earnings of low-income individuals. The credits are refundable; if the credit exceeds a filer's tax liability, the rest is paid as a refund. Since these credits increase their recipients' earnings, they act as wage supplements and are thought to provide a work incentive.

Who is eligible for the credits?

Anyone with wages or self-employment income may be eligible to claim the EITC and the WFC. In tax year 2006, individuals with more than $2,800 in interest income, dividends, rental and royalty income, and capital gain income do not qualify.

How are the credits calculated?

The credits equal a percentage of earned income, up to a maximum credit amount, and are phased out when the claimant's total income exceeds a threshold. The maximum credit amounts and income levels at which the credits are phased out vary depending on the number of children in the household and whether the claimants are married. Both the maximum credit and the phaseout threshold are adjusted annually for inflation. In tax year 2006, the maximum credits, phaseout threshold, and income level at which the credits are no longer allowed are as follows:

	Maximum credit		**Phaseout threshold**		**Income at which credit fully phased out**	
	EITC	WFC	EITC	WFC	EITC	WFC
Unmarried claimants						
No children	$412	$103	$6,740	$6,740	$12,120	$12,130
1 child	$2,747	$823	$14,810	$17,600	$32,001	$31,960
2 or more children	$4,536	$1,587	$14,810	$20,880	$36,348	$36,288
Married claimants						
No children	$412	$103	$8,740	$8,740	$14,120	$14,130
1 child	$2,747	$823	$16,810	$19,600	$34,001	$33,960
2 or more children	$4,536	$1,587	$16,810	$22,880	$38,348	$38,288

How do filers claim the credits?

Filers claim the credits when they file their federal and state income tax returns, by completing a schedule or worksheet.

How many Minnesotans claim the credits?

In tax year 2003, 258,529 Minnesota returns claimed the EITC and 247,068 claimed the WFC. These claims represent 10.8 percent of all federal returns filed by Minnesotans, and 10.4 percent of all state returns filed.

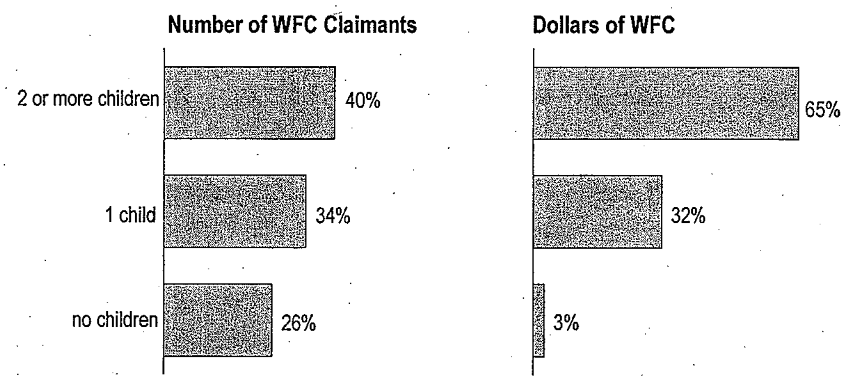
How much is paid out in credits?

In tax year 2003, Minnesotans claimed $397 million in EITC, of which $56 million offset tax liability and the remaining $341 million was paid as a refund. The average EITC was $1,535.

Minnesotans claimed an additional $127 million in WFC, of which $24 million offset tax liability and the remaining $103 million was paid as a refund. The average WFC was $516.

How are the credits distributed among different types of families?

Seventy-four percent of all earned income credits and working family credits went to families with one or more children. These families received about 97 percent of the total amount of credits paid in 2003. Individuals without children filed 26 percent of returns claiming credits, but received only 3 percent of the total amount of credits. Claimants with children received most of the total amount of credits because these families qualify for a higher maximum credit than do claimants without children.



How are the credits distributed geographically?

While over 47 percent of the returns claiming credits came from the Twin Cities metropolitan area, these seven counties generated about 55 percent of all returns filed. Put another way, in 2003 nonmetro filers were more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 16.8 percent of all income tax returns claimed the EITC, compared to 10.8 percent in Minnesota. The average EITC nationwide in 2003 was $1,772; it was $1,535 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above average incomes.

Seventeen other states and the District of Columbia provide a state version of the EITC. In most cases the state credit equals a percentage of the federal EITC.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*, February 2006.

Joel Michael

Updated: March 2006

Corporate Franchise Tax: Foreign Operating Corporations

What is an FOC?

Foreign operating corporations (FOCs) qualify for special tax treatment under the corporate franchise tax. To be an FOC, a corporation must:

- Be a domestic corporation that is part of a unitary group, one member of which is taxable in Minnesota;
- Have at least 80 percent of its average property and payroll outside of the United States (Puerto Rico and other possessions qualify as outside of the United States) or be a "936 corporation" (936 corporations qualify under special federal tax rules that provide an incentive for operating in Puerto Rico and other U.S. possessions.);
- Have at least $1 million of foreign payroll and at least $2 million of foreign property (The 2005 Legislature added this requirement, effective for tax year 2005.); or
- Not be a foreign sales corporation (FSC). FSCs were formed under a now obsolete federal tax provision that provided export incentives.

What are the tax benefits of FOCs?

In broad terms, 80 percent of an FOC's income is sheltered from tax as "deemed dividends." The FOC's income is allocated to its shareholders and "deemed" to be a dividend that qualifies for the dividend-received deduction.

When an FOC (or a foreign corporation) pays royalties and fees, the receiving corporation may subtract 80 percent of these amounts if the FOC is part of its unitary business. This is referred to as the foreign royalty subtraction.

Thus, a unitary business's income that flows through an FOC is taxed at one-fifth of the regular rate (i.e., 80 percent of the income is not taxed).

How much do FOCs reduce corporate tax receipts?

The Minnesota Department of Revenue's *Tax Expenditure Budget* (2005) estimates that FOC and related provisions reduce corporate franchise tax collections by between $117 million (fiscal year 2006) and $114 million (fiscal year 2009). Total corporate tax revenues are about $840 million per year, based on the November 2005 forecast. According to Departments of Finance and Revenue staff, the cost of the foreign income provisions has grown rapidly.

When were the FOC provisions adopted?

The FOC provisions were adopted by the 1988 Legislature. Later legislatures have made minor modifications, but the basic structure has remained largely unchanged.

What is the policy rationale for FOCs?

The FOC provisions were a response to the adoption of combined reporting apportionment in the early 1980s. Supporters argued that they were necessary to appropriately tax foreign operations under Minnesota's "water's edge" combined reporting system. This method excludes foreign corporations from the unitary group, while including foreign operations of domestic corporations.

As a result, tax is deferred on the income of foreign subsidiaries or affiliates until it is "repatriated" or paid to a domestic corporation. If the income is paid as a dividend, only 20 percent of it is taxed. By contrast, income from foreign operations of domestic corporations (other than FOCs) is fully taxed immediately.

The FOC and foreign royalty provisions have two primary policy purposes:

- They allow foreign operations of domestic corporations to qualify for about the same state tax treatment as foreign corporations, if they satisfy the FOC rules. FOC income is deemed to be a dividend qualifying for the 80 percent deduction (i.e., the same treatment as a dividend paid by a foreign subsidiary).
- They provide "factor relief" for nondividend income paid by foreign corporations and FOCs. When a foreign subsidiary or FOC makes royalty or similar payments to a U.S. corporation, this income is fully taxable; the apportionment formula does not taken into account the foreign sales, payroll, and property that helped generate the income because these corporations are not included in the combined report. The royalty subtraction excludes 80 percent of this income to adjust for the absence of the foreign and FOC factors in the apportionment formula.

How do taxpayers "abuse" the FOC provisions?

Recent legislative attention has focused on alleged abuses of the FOC provisions. The abuses (or flaws in the qualifying criteria) take two basic forms:

- **Sheltering domestic source income.** Although the provisions were intended to apply to foreign operations and income, corporations can funnel domestic source income through an FOC, qualifying for an 80 percent discount in tax. The law requires the FOC to have specified amounts and proportions of foreign property and payroll, but the income need not be from foreign sources. As a result, a unitary business can assign its "intangibles" (e.g., patents, copyrights, trademarks, and trade names) to an FOC, which satisfies the payroll and property tests, but derives most of its income from charging domestic members of its unitary group for use of the intangibles. This mechanism reduces the tax on this income by 80 percent.
- **Transfer pricing.** The FOC mechanism also relies upon prices set by the unitary business internally (not by market forces) in determining how much income is assigned to the FOC. These prices don't matter to the unitary business, since the business is doing little more than shifting money from one of its pockets to another. However, by maximizing the amount of income in the FOC, overall Minnesota tax is minimized.

Hutchinson Technology, Inc. v. Commissioner of Revenue, 698 N.W.2d 1 (Minn. 2005), makes clear that the Minnesota Supreme Court reads the FOC statutes very literally. If the court holds to this view, it will likely validate many arrangements that seek to shift domestic income into FOCs.

For more information: Contact legislative analyst Joel Michael at 651-296-5057.

HOUSE RESEARCH | Short Subjects

Joel Michael

Updated: March 2006

Alcoholic Beverage Taxes

Two special state taxes apply to alcoholic beverages: excise taxes and a special (2.5%) gross receipts tax

Minnesota imposes two types of special taxes on alcoholic beverages:

- **Special excise taxes** are imposed on manufacturers or wholesalers of these products. These taxes are a fixed dollar amount per unit (per barrel or liter). The tax rates vary by beverage type. See the table below for tax rates.
- A **special gross receipts tax** of 2.5 percent applies to retailers making both on-sale (to be consumed in bars or restaurants) and off-sale (in liquor stores or by other sellers) sales. This tax replaced the special retail sales tax rate that applied to alcoholic beverage sales on January 1, 2006. The sales tax was repealed to comply with the Streamlined Sales Tax Agreement. The burdens of the two taxes are identical.

Excise tax rates are set as a dollar amount per volume of the beverage

Manufacturers of beer and wholesalers of distilled spirits and wines pay the special excise taxes. If the beer manufacturer doesn't pay, the wholesaler or importer is liable for the tax. The table shows the rates for the most common beverage categories. Higher rates apply to wines with alcoholic contents that exceed 21 percent and 24 percent, but little or none of these products are sold. A special "bottle tax" of 1 cent per bottle also applies to each wine and liquor bottle that is 200 milliliters or larger.

Beverage Type	Excise Tax per	
	Gallon	Liter
Beer < 3.2% alcohol	$.08	NA
Beer > 3.2% alcohol	.15	NA
Cider < 7% alcohol	.15	NA
Low-alcohol dairy cocktails	.08	$.02
Wine < 14% alcohol	.30	.08
Wine > 14% alcohol	.95	.25
Sparkling wine	1.82	.48
Distilled spirits	5.03	1.33

Because the excise taxes are fixed dollar amounts, they don't vary by the price of the product. Higher priced products pay the same tax as lower priced products. Moreover, revenues grow only as more liters or barrels of the products are sold; revenues don't increase with inflation (price increases). For revenues to keep pace with inflation, the legislature must adjust the tax rates periodically. It has done this only sporadically (most recently in 1987).

Few exemptions apply

The law exempts the following from the excise tax:

- Sacramental wine
- Products sold to food processors and pharmaceutical companies
- The first 25,000 barrels of beer produced by a brewery with annual production of less than 100,000 barrels. (A barrel is 31 gallons.)

Revenues go to the general fund

Revenues from both the excise taxes and the gross receipts tax go to the general fund. Fiscal year 2004 revenues from the excise taxes were about $67 million and from the then special sales tax, $54 million. Thus, the gross receipts tax raises over 40 percent of alcohol tax revenues. The table to the right shows the collections by beverage type for the excise tax and for the additional sales tax. The excise tax revenue from liquor reflects the higher rates imposed on these products, rather than their share of the market (measured by dollars spent). The sales tax imposes a much higher tax burden on wine and beer than the excise tax does.

Beverage Type	**FY2004 Revenues (000)**	**% of Total**
Beer < 3.2%	$345	0.3%
Beer > 3.2%	15,635	12.9%
Cider	34	0.0%
Wine < 14%	3,099	2.6%
Wine > 14%	290	0.2%
Sparkling Wine	747	0.6%
Distilled Spirits	46,729	38.6%
Excise tax total	66,880	55.2%
2.5% sales tax	54,208	44.8%
Total	**$121,088**	
Source: MN Department of Revenue		

Minnesota tax compared with other states

Minnesota's wine and beer excise taxes are average or below average compared with most other states. Minnesota's tax on distilled spirits (liquor) is among the higher taxes for states with excise taxes. A number of states (including Iowa) have liquor monopolies and a portion of the price markup is a *de facto* tax; it is difficult to compare the tax burden with these states. The table compares Minnesota's tax rates with its bordering states. However, only North Dakota imposes a gross receipts tax (at a 2 percent rate) similar to Minnesota's. Thus, the total Minnesota alcohol tax burden is higher than suggested by simply comparing excise tax burdens.

Excise Tax Rates (per gallon) Bordering States			
	Strong Beer	Table Wine	Liquor
IA	$.19	$1.75	NA
MN	**.15**	**.30**	**$5.03**
ND	.16	.50	2.50
SD	.27	.93	3.93
WI	.06	.25	3.25
Source: Federation of Tax Administrators			

Tax relative to alcohol content varies

The excise taxes are imposed on the volume of the beverage, not its alcoholic content. (The federal tax on distilled spirits, by contrast, is imposed explicitly on alcoholic content.) Since alcoholic content varies significantly within beverage type, it is difficult to generalize about the tax on alcohol content. But using averages for beverage types, it is apparent that alcohol in beer and wine is lightly taxed compared with liquor. The excise tax per an ounce of alcohol in liquor is about 9 cents, while it is between 2 and 3 cents for wine and beer.

Tax is regressive

The alcohol taxes are regressive; they constitute a higher share of income for lower income families and individuals, on average. The Department of Revenue's Tax Incidence Study indicates they are less regressive than the tobacco taxes but more regressive than the general sales tax.

For more information: Contact legislative analyst Joel Michael at 651-296-5057.

Joel Michael

Updated: March 2006

Apportionment of Corporate Franchise Tax

Apportionment is constitutionally required

A state can constitutionally tax only the income of a multistate corporation that is "fairly apportioned" to the state. The reason for this requirement seems obvious: if a business operates in several states and each state could tax all of its income, the business could easily be subject to double taxation. Aside from being unfair, this would discourage a business from operating in multiple states; it would interfere with interstate commerce.

All states use formula apportionment

A state can apportion income using separate accounting or formula apportionment. Separate accounting traces income to the state where it was earned using standard accounting methods. Formula apportionment uses a proxy or rough measure to determine the in-state share of income (e.g., the percentage of the business's in-state sales to its total sales). All states use some type of formula apportionment. Using separate accounting would be expensive, difficult to do, and subject to manipulation.

Minnesota uses a weighted three-factor formula

Minnesota uses a weighted three-factor formula of sales, property, and payroll, but is phasing in apportionment based only on sales (fully effective in tax year 2014). The formula for tax year 2006 weights sales at 75 percent, property at 12.5 percent, and payroll at 12.5 percent. The Minnesota percentage for each factor is multiplied by the weight, and the three factors are added to determine the Minnesota percentage of the corporation's total income. Expressing this as a formula:

$$MN\ percent = \left(0.75 * \frac{MnSales}{TotalSales}\right) + \left(0.125 * \frac{MnProperty}{TotalProperty}\right) + \left(0.125 * \frac{MnPayroll}{TotalPayroll}\right)$$

Sales are defined on a destination basis; that is, the location of the buyer generally determines whether the sale is a Minnesota sale. The property factor is the value of real and tangible personal property in Minnesota. Leased property is included; its value equals the lease payments multiplied by eight. Payroll is the amount paid to employees. The apportionment factors are also used to calculate the add-on minimum fee.

Special formulas apply to some industries

Special apportionment rules apply to some industries. Mail-order companies that have substantially all of their operations in Minnesota use a sales-only formula. A separate formula for financial institutions includes deposits and intangible property (e.g., receivables and loans), since these are important contributors to their profits.

No throwback rule applies

The Uniform Division of Income for Tax Purposes Act (adopted by a group of states) provides that sales to buyers in a state in which the corporation cannot be taxed and sales to the federal government are "thrown back." Under a throwback rule, these sales are assigned to the seller's location. Minnesota has not adopted a throwback rule. This favors businesses making sales from Minnesota to the federal government or to states where they can't be taxed, since it reduces their Minnesota tax. Minnesota's apportionment formula does not affect the tax owed to another state, in any case.

Minnesota uses combined reporting for "complex" corporations

Special rules apply to complex corporations (i.e., those with multiple corporations, such parent-subsidiary or brother-sister corporations). If these corporations are part of a "unitary business," Minnesota requires them to file a combined report. Under combined reporting, each corporation in the unitary group calculates its tax using the total income of the unitary group and using its own factors as the numerator and the total group's factors as the denominator. This method prevents most transactions among related corporations in the unitary group from affecting the tax liability of the group. In effect, the apportionment formula divides the unitary business's income among the states without regard to how the business allocates the income among its various corporate entities. State corporate taxes that do not use this method allow corporations to artificially shift income (e.g., through "transfer pricing" among the related corporations) to states in which income is lightly taxed or is not taxed at all.

Formula apportionment has important economic effects

Public finance economists generally agree that apportionment formulas are a very important feature of state corporate taxes. They essentially make the tax the same as a tax directly on the factors. For example, the tax on the portion of income assigned using the sales factor is the same, in economic effect, as a sales tax. This affects both:

- the incidence of the tax (i.e., who bears the real burden of the tax); and
- the incentive effects of the tax (i.e., the impact of the tax on behavior).

Incidence effects vary by factor weights

Following conventional economic theory, the portion of the tax that is apportioned by sales will be a tax on consumption or consumers, similar to a sales tax. The portion on payroll is a tax on labor income and the portion on property falls on capital. (Caveat: capital is mobile; it can move between states. In the long run, a state cannot increase the portion of the tax on capital much beyond the average imposed by other states. If it does, capital will flow to other states where higher rates of return are available.)

Minnesota is phasing in single sales apportionment to encourage in-state investment

Weighting sales more heavily generally encourages export businesses. Since sales are assigned to the buyer's location and there is no throwback rule, export or non-Minnesota sales will reduce the amount of income taxable by Minnesota. Thus, increasing the weight for sales creates an incentive for companies to invest in Minnesota property or to hire more employees to sell products outside of Minnesota. The property and payroll factors, by contrast, would assign more income to Minnesota, increasing the tax, because the investment increases Minnesota property and payroll. It was following this logic that the legislature provided for a gradual shift of apportionment to relying only on sales. This change will be accomplished in eight annual steps between 2007 and 2014.

Other states are also adopting single sales apportionment

After the U.S. Supreme Court ruled sales-only apportionment was valid in 1978, many states increased their reliance on the sales factor because of these incentive effects.

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publications *Single Sales Apportionment of Corporate Franchise Tax* (March 2006) and *Corporate Franchise Taxation* (October 2002).

Joel Michael and Nina Manzi Updated: March 2006

Revenue Recapture Program

Revenue recapture allows state to collect debt

Revenue recapture authorizes the Department of Revenue (DOR) to intercept or offset part or all of a state tax refund or other payment to collect a debt that the taxpayer owes to a government agency or other authorized creditor.

Several state agencies are permitted to use revenue recapture

The following agencies may use the Revenue Recapture Program:

- State agencies
- University of Minnesota
- Minnesota district courts
- Counties
- Cities for public ambulance service and public library debts
- Governmentally owned hospitals and Regions Hospital
- Agencies responsible for child support enforcement
- Agencies that administer low-income housing programs

A variety of debts are subject to recapture

The debt (minimum amount of $25) must be owed to or collectable by one of the qualifying governmental agencies. The debtor must be an individual; the law does not apply to corporations. The creditor does not need to obtain a court judgment or order to enforce the debt. Qualifying debts include the following:

- Unpaid taxes, interest, and penalties
- Contractual or statutory obligations
- Criminal fines and fines for petty misdemeanors
- Court-ordered restitution for a crime
- Child support obligations
- Overpayment of public assistance
- Unpaid MinnesotaCare insurance premiums

Obligations of low-income individuals (incomes between $9,960 and $18,830 in 2005, depending upon family size) to repay Medical Assistance cannot be recaptured. Debts barred by the statute of limitations also cannot be recaptured.

Some types of refunds are subject to recapture

Revenue recapture applies to the following:

- Individual income tax refunds
- Property tax refunds
- Sales tax rebates
- Sustainable forest tax payments
- Lottery prizes

DOR must notify debtor about revenue recapture

Under revenue recapture, a claimant (creditor) agency submits the claim (debt) to DOR for offset. Within five days after doing so, it must notify the debtor-taxpayer in writing of the debt(s) that will be subject to revenue recapture. The taxpayer then has 45 days to request a contested case hearing under the Administrative Procedures Act. The claimant agency conducts the hearing.

Debts are recaptured by priority

When more than one debt is submitted, the debts are applied in the following order of priority:

- DOR accounts receivable (e.g., unpaid taxes, interest, and penalties)
- Child support obligations
- Restitution obligations
- Other debts based on the order in which DOR received the claims

Creditors pay an administrative fee

In order to use revenue recapture, the creditor (government agency) must pay a fee of $15 per claim that is deducted from the amount recaptured. Of this $15, $4 is set aside in a dedicated, revolving fund to pay DOR's cost of operating the program; the rest goes to the state's general fund.

More than $59 million was recaptured in 2005

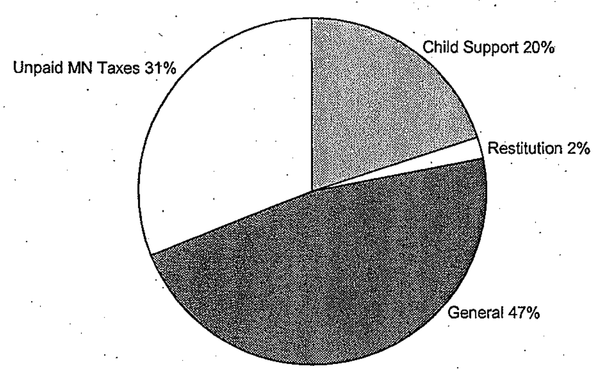
The table to the right shows the number of revenue recapture offsets and amount of refunds offset by category for calendar years 2001 to 2005. The number of offsets was high in 2001 because of payment of a sales tax rebates. This and earlier rebates generated tax refunds for many individuals who normally do not receive refunds. The number of offsets per year has declined significantly since 2001, the year of the most recent rebate.

Revenue Recapture Amounts CY2001-2005

	Number of Offsets	Amount of Recapture
2001	300,093	$70,471,518
2002	153,200	$43,060,194
2003	184,641	$51,206,131
2004	204,077	$54,804,757
2005	210,655	$59,247,902

Excludes amounts offset on behalf of the IRS to satisfy debts for taxes owed to the federal government.
Source: DOR

The graph shows the percentage of revenue recapture amounts for calendar years 2001 to 2005 by the four major types of debts for which the law sets priorities.



For more information: Contact legislative analyst Joel Michael at 651-296-5057 or Nina Manzi at 651-296-5204.

Joel Michael

Updated: March 2006

Single Sales Apportionment of Corporate Franchise Tax

Apportionment is a key feature of corporate taxes

Apportionment formulas are important features of state corporate income taxes. They determine how much of a business's income is taxable and affect the incidence and competitiveness of the tax. Minnesota apportions income from sales, payroll, and property to determine corporate franchise tax.

Minnesota is phasing in single sales apportionment

In the 2005 legislative session, Minnesota began phasing in single sales apportionment under its corporation franchise tax; the phase-in will occur over eight years, starting in tax year 2007. Since tax year 2001, Minnesota has used a three-factor, weighted formula (75 percent sales, 12.5 percent payroll, and 12.5 percent property). The table to the right shows the phase-in schedule for the transition to single sales apportionment.

Tax year	Sales	Property	Payroll
2007	78%	11.0%	11.0%
2008	81%	9.5%	9.5%
2009	84%	8.0%	8.0%
2010	87%	6.5%	6.5%
2011	90%	5.0%	5.0%
2012	93%	3.5%	3.5%
2013	96%	2.0%	2.0%
2014	100%	0.0%	0.0%

Effects vary by type of business

The effects of adopting single sales apportionment vary by business. The crucial variables are the business's Minnesota apportionment factors:

- The taxes of businesses with all of their property, payroll, and sales in Minnesota will be unaffected.
- Minnesota businesses whose Minnesota sales factor is lower than the average of their Minnesota property and payroll factors will receive a tax cut. The larger the disparity, the bigger the benefit. A classic example would be a business that has most of its operations (headquarters, plants, and so forth) in Minnesota, but makes most of its sales nationwide.
- Businesses with higher Minnesota sales factors than their average Minnesota property and payroll factors will have tax increases. The classic example is a national consumer products company with few facilities in Minnesota.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is an economic development argument: it makes Minnesota more competitive in attracting investment in plant and equipment. Sales are determined by the buyer's location. All other things being equal, increasing non-Minnesota sales will reduce the amount of Minnesota taxable income, since more income will be attributed to or apportioned outside of Minnesota. Thus, increasing the weight for sales creates an incentive for companies to invest in Minnesota property or to hire more employees (or reduces the tax's disincentive to do so) to sell products outside of Minnesota. Empirical studies have found some support for the idea that single sales apportionment encourages in-state investment.

Policy concerns with single sales apportionment: equity and tax theory

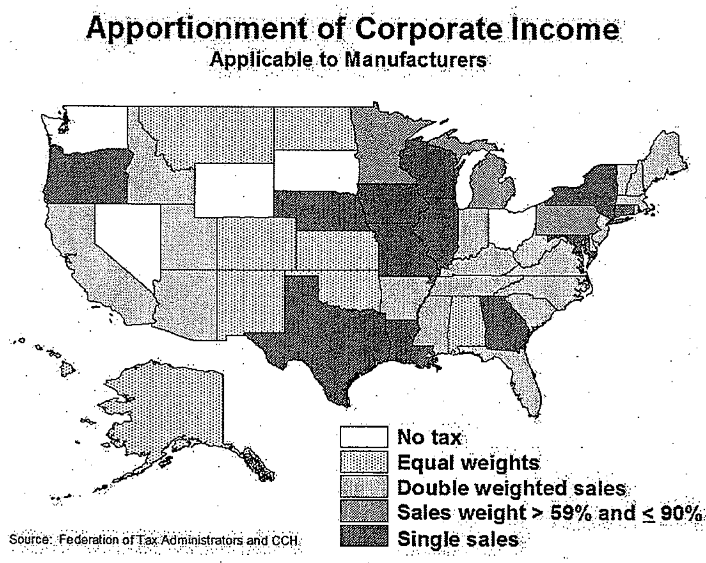
Opponents of single sales apportionment argue that it shifts the burden of the tax from capital (the property factor) to consumption, reducing the progressivity of the tax. Some also question as an empirical matter whether it has much of the desired effects on competitiveness. Tax theorists also argue that if the corporate tax is to be a benefits tax (i.e., based on the business's use of government services) or if it is to be based on production of income, apportionment should take into account where the business's property and employees are located. These factors are important contributors both to the production of income and the consumption of government services.

Cost is about $50 million per year

Adopting single sales apportionment will reduce overall state revenues. A March 2005 estimate by the Department of Revenue showed an annual tax reduction of about $50 million per year (based on the February 2005 forecast).

Trend in other states to heavier sales weighting

The U.S. Supreme Court upheld single sales apportionment in 1978. Since that decision, states have increasingly shifted their apportionment formulas to more heavily weighted sales. Effective for tax year 2008, 12 states are scheduled to use single sales as their apportionment formula for manufacturers. This is up from seven states for tax year 2005. Many of Minnesota's neighboring states use single sales: Illinois, Iowa, Missouri, Nebraska, and Wisconsin (effective tax year 2008). Michigan weights sales at 90 percent. The map below shows the apportionment formulas for manufacturers as of tax year 2008.



For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *Apportionment of Corporate Franchise Tax* (March 2006).

HOUSE RESEARCH | **Short Subjects**

Patrick J. McCormack **June 2006**

The Ban on Breathable Alcohol Devices

A new law passed in the 2006 legislative session bans the possession or use of a device designed to allow alcohol to be consumed by inhaling fumes. This law takes effect August 1.

What is an "alcohol without liquid device"?

The law defines an alcohol without liquid device as a device that:

- Mixes an alcoholic beverage with pure or diluted oxygen;
- To produce an alcohol vapor;
- That is intended to be inhaled by an individual.

What is and isn't included?

For purposes of this law, devices, machines, apparatuses, or appliances that meet the above definition are banned. Some devices are not included. An alcohol without liquid device does not include:

- An inhaler, nebulizer, atomizer, or other device that is designed and intended for medical purposes, to dispense medicines.

There are exemptions for research. Hospitals, state institutions, private colleges or universities, or pharmaceutical and biotechnology firms may have these devices for bona fide research purposes.

Is it against the law to own an alcohol without liquid device?

Owning these devices is a crime.

- It is unlawful for any person or business establishment to possess, purchase, sell, offer to sell, or use an alcohol without liquid device.
- Except for legitimate research, it is unlawful for a person or business establishment to use a nebulizer, inhaler, or atomizer for the purpose of inhaling alcoholic beverages.

For more information: Contact Patrick McCormack at 651-296-5048.

Jeffrey Diebel

June 2006

Minnesota's Criminal DNA Collection and Preservation Laws

Who must submit a DNA sample?

Minnesota law requires those convicted of a felony, those released from prison after serving a felony sentence, those felons whom the state accepts through an interstate compact, and those charged with certain predatory felonies to submit a DNA sample. All people (both juvenile and adult) charged with committing or attempting to commit a felony, who are subsequently convicted of the felony *or any offense arising out of the same set of circumstances*, provide a sample upon sentencing, if they have not already done so. Minn. Stat. § 609.117, subd. 1(1), (2). People meeting these criteria, but who were convicted prior to enactment of this requirement or who otherwise avoided submitting a sample, must furnish a sample prior to their release from incarceration. Minn. Stat. § 609.117, subd. 2.

Offenders serving a prison term in Minnesota under a reciprocal agreement, who were convicted in another state of committing or attempting to commit a felony offense or of any offense arising out of the same set of circumstances, also must submit a biological sample before being released. Minn. Stat. § 609.117, subd. 2(2). Offenders received from another state through an interstate compact who were charged with a felony and were subsequently convicted of the felony or any offense arising out of the same set of circumstances are accepted only if they submit a biological sample.

As of July 1, 2005, both adults and juveniles charged with committing certain violent predatory felonies must submit DNA samples if a judge has concluded that the charge is based on probable cause. Minn. Stat. § 299C.105, subd. 1(a)(1), (3).

Who collects the DNA sample?

Sheriffs, peace officers, and community corrections agencies operating secure juvenile detention facilities are required to collect samples from people who have been charged with certain predatory felonies if a judge has concluded the charges are supported by probable cause. Minn. Stat. § 299C.105, subd. 1(a).

Those ordered to provide a sample upon sentencing must submit a sample to the Bureau of Criminal Apprehension (BCA), where it will be collected and maintained. Minn. Stat. § 609.117, subd. 1. Specimens obtained before release, including offenders' samples from other states, are collected by the commissioner of corrections or local corrections authorities. Minn. Stat. § 609.117, subd. 2. Similarly, any offenders accepted from other states are collected by the Department of Corrections or a county probation agency.

When is the sample collected?

Those charged with a predatory felony must submit the sample within 72 hours of a probable cause hearing, unless the superintendent of the BCA requires a shorter period. Minn. Stat. § 299C.105, subd. 1(c). All other persons must furnish a sample either upon sentencing or prior to release, depending upon the situation. If the person charged is a juvenile, the law enforcement officer who seeks to obtain a sample from the individual must notify the juvenile's parent or guardian prior to collecting the biological specimen. Minn. Stat. § 299C.105, subd. 2(b).

Where does the sample go?

After submission, each sample collected under these provisions is forwarded to the BCA, where it is processed and maintained in the BCA's DNA database.

What are the rights and protections of the person whose sample is collected?

There are more protections provided to those who submit DNA based on a criminal charge than to those who submit DNA based on a felony conviction. The additional protections apply to those who have been charged, but not convicted of a crime that requires submission of a biological specimen.

The BCA is required by statute to destroy any biological specimen and return all records to people who submitted a specimen if, although they were charged with perpetrating an enumerated offense and received a probable cause determination, they are subsequently found not guilty. Similarly, if a person submits a sample and the charges against the person are later dismissed, upon the individual's request, the BCA must destroy the sample, remove the information from the BCA's DNA index system, and return all records. Minn. Stat. § 299C.105, subd. 3(a), (b).

People convicted of crimes do not have similar protection. Even upon expungement of the offense for which the specimen was collected, those convicted of a crime requiring a biological specimen may not move to seal their DNA records or to have the sample returned or destroyed. Minn. Stat. § 609A.03, subd.7(a).

What other duties must government agencies and law enforcement officials perform?

All government agencies must retain and preserve any biological evidence relating to identification of a defendant that is used to secure a conviction in a criminal case *until expiration of the individual's sentence*, unless earlier disposition is authorized by court order. However, the agencies need only retain the portion of the specimen that was used to obtain an accurate biological sample used to obtain a conviction. Failure to retain the evidence may result in sanctions to the appropriate party. Minn. Stat. § 590.10.

Law enforcement officials charged with collecting the specimens must be trained to BCA-established standards in the proper method of collecting and transmitting the sample. Minn. Stat. § 299C.105, subd. 2(a).

For more information: Contact legislative analyst Jeffrey Diebel at 651-296-5041.

Danyell LeMire

Revised: June 2006

Child Care Assistance

What is child care assistance?

Child care assistance programs subsidize the child care expenses of eligible low-income families. Minnesota administers two child care assistance programs, Minnesota Family Investment Program (MFIP) child care assistance and Basic Sliding Fee (BSF) child care assistance. MFIP child care subsidizes the child care costs of families receiving cash assistance through MFIP and provides child care assistance for eligible families for the first 12 months after the family leaves MFIP cash assistance (transition year child care). BSF child care provides a child care subsidy to low-income working families who are not receiving cash assistance from MFIP. BSF child care assistance also includes a set-aside, which allows a parent to stay home with an infant and receive a subsidy in lieu of assistance (at-home infant child care).

What are the eligibility requirements for child care assistance?

To be eligible for child care assistance, both parents (or one parent in single-parent households) must participate in an authorized work, education, or training activity, cooperate with child support enforcement, and meet income eligibility guidelines. The maximum income limit to be eligible for child care assistance is 175 percent of the federal poverty guidelines at program entry and 250 percent or less of the federal poverty guidelines at program exit.

Children up to age 13 are eligible for child care assistance (up to age 15 for disabled children).

County agencies or their contractors must determine eligibility within 30 days of receiving a request for child care assistance. Direct reimbursement is the only method of receiving child care assistance.

What is the average annual subsidy a family receives?

In fiscal year 2006, the estimated average annual subsidy for a family receiving MFIP child care assistance was $11,078, and the estimated average annual subsidy for a family receiving BSF child care assistance was $8,621.

Beginning July 1, 2006, the maximum reimbursement rate for child care assistance is increased by 6 percent over the rate established on January 1, 2006, in each county or multicounty region. At least once every two years, the Commissioner of Human Services conducts a survey of rates charged by child care providers to determine the 75th percentile maximum rates for similar care in a county, multicounty region, or category that the commissioner deems to be similar.

Are families required to pay for some child care expenses?

There is a family co-payment requirement based on family size and income. The maximum family co-payment is about 18 percent of gross monthly income. Families with incomes below 75 percent of the federal poverty level are exempt from making co-payments.

How is child care assistance funded?

The child care assistance programs receive funding from a variety of sources, including: the federal Child Care Development Fund (CCDF), federal Temporary Assistance for Needy Families (TANF) funds, the state general fund, the state special revenue fund, and county funds.

How many families receive child care assistance?

During fiscal year 2006, an estimated average of 8,568 families received MFIP child care assistance and 8,394 families received BSF child care assistance per month.

Not all families who apply for child care assistance receive it. MFIP child care is a forecasted, fully funded program, while BSF child care receives a capped allocation. As of March 31, 2006, there were 4,752 families on the waiting list for BSF child care assistance.

What are some potential legislative issues?

During the 2001 legislative session, there were several proposals to consolidate the child care assistance programs into one program to reduce administrative and program complexity. However, none of these proposals were passed by the legislature. There may be future attempts to consolidate the child care assistance programs.

For more information: See the House Research publication *Funding to Support Child Care Assistance*, October 2005.

HOUSE RESEARCH | Short Subjects

Nina Manzi & Janelle Taylor

Updated: June 2006

Long-term Care Insurance Income Tax Credit

What is the credit?

The Minnesota long-term care insurance credit offsets the cost of long-term care insurance premiums by providing a credit against state income tax liability. The maximum Minnesota credit is equal to the lesser of $100 or 25 percent of the amount paid for each beneficiary. The maximum total credit is $200 annually on a joint return or $100 for individual filers.

This credit was enacted in 1997 and took effect in tax year 1999.

What is the rationale for this tax credit?

The Minnesota long-term care tax credit provides an incentive for Minnesotans to purchase long-term care insurance coverage. If more Minnesota residents purchase long-term care insurance, there may be a decrease in the cost to the state in providing for the long-term care of residents who are unable to afford long-term care services.

Is the credit refundable?

The Minnesota credit is a nonrefundable credit and may be used only to offset tax liability. If an individual qualifies for a credit that is greater than her or his tax liability, the excess will *not* be paid as a refund.

Who is eligible for the credit?

A Minnesota taxpayer who purchases insurance to provide long-term care coverage, such as nursing home or home care coverage, for the taxpayer or spouse is eligible for the credit. To qualify for the credit, the long-term care policy must:

- qualify for the federal itemized deduction for medical expenses, disregarding the 7.5 percent income test; and
- have a lifetime long-term care benefit limit of $100,000 or more.

How is the credit calculated?

The Minnesota credit equals 25 percent of qualifying long-term care insurance premiums for one beneficiary, up to a maximum of $100 for individuals and up to $200 for married couples filing jointly who both have coverage. A taxpayer may claim only one policy for each qualified beneficiary. It is *not* necessary that the taxpayers filing jointly have separate policies or premiums. The amount of premiums used to calculate the credit must be reduced by any premiums claimed as a medical expense deduction on the taxpayer's federal return.

Filers claim the credit on their Minnesota income tax return using Schedule M1LTI.

How many Minnesotans claim the credit?

For tax year 2004, 52,532 Minnesota returns claimed the credit. These claims represent about 2 percent of all state returns filed by Minnesotans.

How much is paid out in credits?

In tax year 2004, Minnesotans claimed $7.2 million of long-term care insurance credits. The average long-term care tax credit was $138 in tax year 2004.

How does Minnesota compare with other states?

This table includes all states that offered a long-term care insurance tax credit in 2004, but not those states that offer a long-term care insurance tax deduction. Data on number of claimants and cost by state is for 2004 unless otherwise noted.

	Maximum Credit	**Credit Rate***	**How many returns claimed the credit?**	**What is the cost to the state for the tax credit?**
Colorado	$150	25%	32,900 (estimate, FY 2001)	$4.6 million (estimate, FY 2001)
Minnesota	$100	25%	52,532	$7.2 million
Maryland	Varies by age: $220-$500	100%	10,238	$4.5 million
Montana	No maximum	Varies by income: 20% to 30%	114,000	$80.3 million
New York	No maximum	10%	114,000	$80.3 million
North Carolina	$350	15%	34,376	$7.9 million
North Dakota	$100	25%	559	$79,396
Oregon	$500	15%	200 (estimate, 2002)	$100,000 (estimate, 2002)

*Percentage of premiums, usually the amount not deducted under the itemized deduction, but not always.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204, Joel Michael at 651-296-5057, or Janelle Taylor at 651-296-5808. (**Note:** Research assistant Ruthie Eklund provided help with this publication.)

HOUSE RESEARCH | Short Subjects

Nina Manzi and Joel Michael

Updated: June 2006

Minnesota Individual Alternative Minimum Tax

What is the alternative minimum tax?

The theory underlying the federal and state alternative minimum taxes (AMT) is to require taxpayers who benefit heavily from some tax preferences to pay a minimum amount of tax relative to their incomes. The first version of the federal tax was enacted in 1969 in response to the revelation that a number of "millionaires" were paying no federal income tax.

What is the history of the AMT?

The federal AMT was first enacted in 1969, the state AMT in 1977. For some time during the 1970s and 1980s, both the federal and state taxes were levied as "add-on minimum" taxes, rather than alternative minimum taxes, and required certain taxpayers to pay a fraction of some preferences as an add-on minimum tax. The basic structure of the two taxes has been in place since the 1986 federal reform and 1987 state reform. Both Congress and the legislature have made many changes, both in defining the base of the taxes and their rates.

How is Minnesota's AMT structured?

The Minnesota AMT roughly follows the federal AMT. Both taxes follow the model of requiring taxpayers to compute a tentative tax liability under a second tax structure. This second tax structure, the AMT, has a broader tax base (due to fewer deductions, exemptions, and credits) and lower rates than the regular tax. If this tentative tax is higher than the taxpayer's regular tax liability, the taxpayer pays the difference. In effect, the AMT takes away part of the benefit of tax preferences that lowered the regular tax. The Minnesota AMT has one flat rate; the federal tax, by contrast, has two rates.

Who pays the AMT?

AMT filers fall into two main groups:

- Those who have significant amounts of deductions that are allowed under the regular tax but not under the AMT
- Taxpayers with large families whose personal exemptions and standard deduction (or typical itemized deductions) under the regular tax exceed the flat exemption amount allowed under the AMT

How are the federal and state AMTs different?

The federal and state AMTs have one major difference. The federal AMT allows the deduction of home mortgage interest; the Minnesota AMT does not.

What are the recent changes to the Minnesota AMT?

In tax year 2006, the Minnesota AMT will allow full deduction of charitable contributions and an increased exemption amount. Before 2006, the exemption was $40,000 for married joint filers and $30,000 for single filers. In 2006 the exemption increases to $60,000 for married joint filers and $45,000 for single filers, and will be adjusted annually for inflation in following years.

How are the Minnesota regular tax and AMT different?

The Minnesota AMT uses a broader tax base than does the regular tax and applies a single 6.4 percent rate against that base. The following table outlines the parameters of the Minnesota regular and alternative minimum tax.

Comparison of the Regular Income Tax and Minnesota AMT
($ amounts are for the 2006 tax year)

Feature	Regular Tax	AMT
Tax base	Federal adjusted gross income	Federal adjusted gross income
Rules carried over from federal AMT		Less generous depreciation rules Incentive stock options Depletion Intangible drilling costs Tax exempt interest from private activity bonds
Standard deduction	$9,350 (married joint)	$60,000 for married joint
Personal exemptions	$3,250 per taxpayer, spouse, and dependents	None
Itemized deductions	Home mortgage interest	Not allowed (federal allows, with limits)
	Charitable contributions	Allowed
	Property taxes	Not allowed (same as federal)
	Medical expenses	Allowed
	Miscellaneous deductions (e.g., employee business expenses)	Not allowed
	Casualty losses	Allowed
Tax rates	5.35%; 7.05%; 7.85%	6.4% (federal is 26%; 28%)
Tax credits	Transit passes	Not allowed
	Long-term care insurance	Allowed
	Marriage credit	Allowed
	Credit for taxes paid to other states	Allowed
	Refundable credits (working family, dependent care, and K-12 education)	Allowed, but the K-12 credit is reduced by AMT liability

How much revenue does the AMT raise?

The Minnesota AMT is estimated to raise about $13 million in tax year 2006. The amount of revenue and the number of taxpayers paying the AMT are not expected to increase in future years, since the exemption is indexed annually for inflation.

For more information: Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: June 2006

Minnesota Taxable Income

What is Minnesota taxable income?

Minnesota taxable income (MTI) is the tax base used to calculate Minnesota income tax liability. Minnesota taxable income equals federal taxable income after Minnesota subtractions and additions.

Federal taxable income (FTI)	+	Minnesota additions	–	Minnesota subtractions	=	Minnesota taxable income (MTI)

What are Minnesota additions to taxable income?

Minnesota requires the following *additions* to federal taxable income:

- State income or sales tax deduction. Filers who claimed a federal itemized deduction for state income or sales taxes paid must add that amount back into Minnesota taxable income. Taxpayers making this addition are always allowed to claim at least the full standard deduction for the tax year.
- Bond interest and mutual fund interest dividends paid by non-Minnesota state and local governments. The federal government does not tax state and local bond interest. Minnesota does not tax Minnesota state and local bond interest, but does tax interest on bonds of other states and their local governments.
- Expenses relating to income not taxed by Minnesota. These are mainly expenses deducted at the federal level and attributable to U.S. bond interest income, which is excluded from Minnesota taxable income.
- Capital gain portion of a lump-sum distribution from a qualified retirement plan

What subtractions does Minnesota allow from taxable income?

Minnesota allows the following *subtractions* from federal taxable income. The estimated cost of most subtractions is taken from the Department of Revenue's *Tax Expenditure Budget for 2006-2009*. Revenue estimates made during the 2007 legislative session differ from the *Tax Expenditure Budget* because they will be based on a more recent economic forecast.

- **State income tax refund** (filers who claimed federal itemized deductions only). The federal income tax allows a deduction for state income taxes. Minnesota requires filers to add back the amount deducted, and allows a subtraction for amounts refunded in order to avoid twice taxing the same income.
- **Subtractions required by federal law.** Federal law prohibits state taxation of these three types of income:
  - U.S. bond interest

- Railroad retirement benefits
- On-reservation earnings of enrolled tribal members

- **K-12 dependent education expenses** ($15.8 million in fiscal year 2007). The deduction applies to school-related expenses, including tuition, textbooks, academic tutoring and camps, and instructional materials and supplies. The maximum deduction is $1,625 for each child in grades K-6 and $2,500 for each child in grades 7-12.
- **Compensation for military active service outside of Minnesota** ($6.2 million in fiscal year 2007).
- **50 percent of charitable contributions in excess of $500** ($5.5 million in fiscal year 2007). Allowed only for filers who do not claim federal itemized deductions—those who itemize have already deducted their charitable contributions in computing federal taxable income.
- **Minnesota elderly/disabled exclusion** ($1.4 million in fiscal year 2007). Equals up to $12,000 for low-income elderly and disabled filers with low amounts of Social Security and nontaxable pensions.
- **Job Opportunity Building Zone (JOBZ) income** ($1.4 million in fiscal year 2007). Allowed for net income from a qualified business in a JOBZ, for net income from renting property for use by a qualified business, and for gain from the sale of property used by a qualified business.
- **Organ donation expenses** ($100,000 in fiscal year 2007). Allowed for up to $10,000 of expenses related to organ donation by the taxpayer or a dependent, including lost wages.
- **Federal small ethanol producer credit** ($100,000 in fiscal year 2007). Producers with ethanol production capacity under 30 million gallons may claim a federal credit equal to 10 cents per gallon, but must include the credit in gross income. This subtraction prevents the credit from being included in Minnesota taxable income.
- **Compensation for National Guard and reserve active service in Minnesota** (less than $50,000 in fiscal year 2007). Allowed for state active service and federally funded state active service (generally floods, other disasters, and airport security) but not for drill pay.
- **Gain on sale of farm property for insolvent taxpayers** (less than $50,000 in fiscal year 2007). This subtraction is allowed for taxpayers who use the proceeds of the sale of a farm to pay off a mortgage, contract for deed, or lien on the property.
- **Foreign subnational income taxes.** Taxpayers subject to a foreign subnational income tax may subtract the amount of tax paid to the foreign governmental unit, to the extent the taxpayer did not use the subnational taxes to claim the federal foreign tax credit.

For more information: Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publications *Income Tax Terms: Deductions and Credits*, July 2005; and *Minnesota's Elderly Exclusion* (web only) at www.house.mn/hrd/issinfo/tx_inc.htm.

Karen Baker & Nina Manzi

May 2006

Major State Aids and Taxes: An Overview of the 2004 Update

This provides a brief overview of the report *Major State Aids and Taxes: A Comparative Analysis, 2004 Update*, highlighting major aids provided to the local governments and people in Minnesota and lists the major taxes collected. The per capita amounts were calculated using 2004 population. Some aids are presented on a different basis in other settings (e.g., per pupil for education aid); however, in the report they are presented on a per capita basis to allow comparison of different aids.

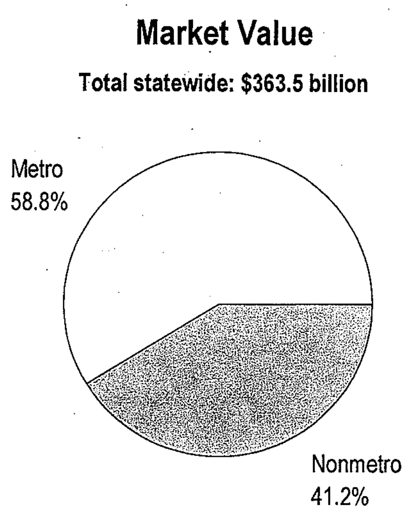
STATE AIDS

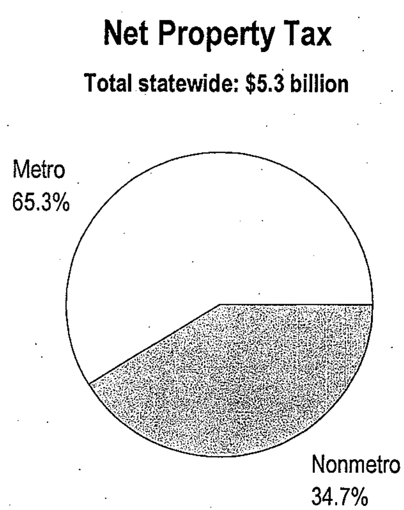
Program	Year	Amount (millions)	Per Capita
Education aid *Aid paid to school districts for all K-12 educational expenses*	2003/2004 (school year)	**$6,102.4 State** $3,310.1 Metro $2,792.3 Nonmetro	**$1,186 State** $1,195 Metro $1,176 Nonmetro
Human services aid *State's share of human services aid for various income and medical assistance programs*	2004	**$3,439.8 State** $1,825.7 Metro $1,614.1 Nonmetro	**$669 State** $659 Metro $680 Nonmetro
Highway aid *Distributed to counties, cities with more than 5,000 people, and towns*	2004	**$510.4 State** $146.6 Metro $363.8 Nonmetro	**$99 State** $53 Metro $153 Nonmetro
Local government aid *Provides property tax relief by providing general purpose financial support to cities*	2004	**$437.5 State** $160.9 Metro $276.6 Nonmetro	**$85 State** $58 Metro $117 Nonmetro
Disparity reduction aid *Provides aid to jurisdictions (counties, towns, and school districts) that had inordinately high tax rates in 1998*	2004	**$18.9 State** $1.4 Metro $17.6 Nonmetro	**$4 State** – Metro $7 Nonmetro
County program aid *Includes former county general purpose aids: homestead and agricultural credit, county criminal justice aid, family preservation aid, and attached machinery aid*	2004	**$111.6 State** $39.3 Metro $72.4 Nonmetro	**$22 State** $14 Metro $30 Nonmetro
Community corrections funding *Aid that provides a portion of counties' costs for community correctional services*	2004	**$72.8 State** $38.3 Metro $34.5 Nonmetro	**$14 State** $14 Metro $15 Nonmetro
Property tax refund (excludes targeting) *Partly reimburses homeowners and renters for a portion of property taxes if their taxes exceed a level of income*	2003 (filed in 2004)	**$275.9 State** $189.6 Metro $86.3 Nonmetro	**$53 State** $68 Metro $36 Nonmetro
Targeting *Additional property tax refund for homeowners whose property taxes increased over a certain percentage threshold from the previous year*	2004	**$3.7 State** $2.5 Metro $1.2 Nonmetro	**$1 State** $1 Metro $1 Nonmetro

Major Taxes

	Year	Amount	Per capita
Individual income tax *Imposed on income of state residents and income derived from state sources of nonresidents*	2003 (filed in 2004)	**$5,312.7 Total** **$5,122.3 Residents** $3,480.7 Metro $1,641.6 Nonmetro	**$996 State** $1,256 Metro $691 Nonmetro
Sales and use tax *Imposed on gross receipts of people who sell, lease, or rent tangible personal property at retail at a rate of 6.5 percent (does not include local sales taxes)*	2004	**$4,122.6 (After refunds)** **$3,542.8 Residents** $2,288.3 Metro $1,254.5 Nonmetro	**$689 State** $826 Metro $528 Nonmetro
Motor vehicle sales tax *Imposed on new and used motor vehicles at the time of sale at the same rate of state sales tax*	2004	**$538.8 State** $282.1 Metro $256.7 Nonmetro	**$105 State** $102 Metro $108 Nonmetro
Motor vehicle license tax *Imposed annually on vehicles licensed in the state*	2004	**$504.9 State** $273.4 Metro $231.5 Nonmetro	**$98 State** $99 Metro $98 Nonmetro
Motor vehicle fuels tax *Imposed on gasoline, diesel fuel, and other motor fuels used by vehicles and on aviation fuels*	2004	**$643.8 State** $301.4 Metro $342.5 Nonmetro	**$125 State** $109 Metro $144 Nonmetro
Corporate franchise (income) tax *Imposed at a rate of 9.8 percent on the net income of corporations*	2003	**$545.7 State** $395.4 Metro $150.4 Nonmetro	**$106 State** $143 Metro $63 Nonmetro
State property tax *Imposed on commercial/industrial/public utility property and seasonal recreational property*	2004	**$621.1 State** $416.0 Metro $205.2 Nonmetro	**$121 State** $150 Metro $86 Nonmetro

Property Tax Data





For more information: Contact legislative analysts Karen Baker at 651-296-8959 or Nina Manzi at 651-296-5204. See *Major State Aids and Taxes: Comparative Analysis, 2004 Update* (March 2006) for further details about each aid program and tax and data by county and economic development region.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

HOUSE RESEARCH | Short Subjects

Colbey Sullivan

June 2006

State Methane Digester Programs

There are two state programs designed to encourage farmers to install methane digesters, which capture methane gas that can be converted into electricity. In spite of these efforts, Minnesota farmers have been slow to adopt this technology. This hesitancy may be due in large part to the significant upfront costs and low electricity purchase rates offered by utilities. Technical limitations of biogas production may also be a factor—studies have indicated that profitable biogas production in Minnesota using current digester technology may be limited to large dairy operations (at least 300 cows) that collect manure by scraping rather than flushing. Profitable methane production requires a significant amount of manure, and cows have been shown to have greater gas production potential than swine or poultry (measured in $ft.^3$/animal unit/day).

What are methane digesters?

Methane digesters (also referred to as biogas recovery systems or anaerobic digesters) can be incorporated into a farm's manure management system to capture the biogas that is emitted when bacteria break down the organic material in manure solids. This biogas is volatile and composed primarily of the greenhouse gases methane and carbon dioxide. The gas is captured in an enclosure, or digester, then flared to control odor and curb greenhouse gas emissions or combusted in a generator to produce electricity and heat. Electricity produced from biomass can be used to power farm operations and/or plugged into the grid and sold to the local electric utility, creating an additional revenue stream.

How many digesters are there in Minnesota?

Two Minnesota dairy farms use methane digesters—Haubenschild Farms near Princeton and Northern Plains Dairy near St. Peter. For comparison, there are 21 digesters in Wisconsin, 18 in California, five in Iowa, and none reported in North or South Dakota.

What state programs provide incentives for on-farm methane digesters?

Two state programs provide incentives for methane digesters: the Renewable Energy Production Incentive and the Methane Digester Loan Program.

Renewable Energy Production Incentive

Qualifying owners of on-farm methane digesters who sell electricity to a utility or other party are eligible to receive incentive payments from the Department of Commerce. Eligible digesters must be located on the site of an agricultural operation and owned by an entity that is not prohibited from owning agricultural land in Minnesota. Payments are 1.5¢/kilowatt-hour for up to ten years or until 2017, whichever comes first. Northern Plains Dairy is the only operation enrolled in the program.

For more information, contact Jeremy DeFiebre at the Minnesota Department of Commerce (jeremy.defiebre@state.mn.us or 651-296-5175)

Methane Digester Loan Program

Administered by the Rural Finance Authority, the program provides loans to help eligible farmers purchase and construct digesters that convert manure to electricity. Eligible borrowers must be a resident of Minnesota or an entity eligible to own agricultural land in the state. The loan may not exceed $250,000 and is limited to 45 percent of the total principal when the state participates with another eligible lender. Loans are interest free. Haubenschild Dairy received the only program loan issued to date.

For more information, contact Matt Drewitz at the Minnesota Department of Agriculture (MDA) (matt.drewitz@state.mn.us or 651-201-6520) or visit the MDA web site at www.mda.state.mn.us/feedlots/digester.htm.

More information

In addition to the MDA web site, there are many other sources of information on methane digesters, including tools that can help farmers determine the financial feasibility of digesters, information on federal and private assistance programs, and case studies of successful operations. Here are two resources:

- AgSTAR: The federal government's multi-agency effort to promote on-farm methane recovery technologies.
  www.epa.gov/agstar or 1-800-95-AgSTAR (1-800-952-4782)

- Agricultural Utilization Research Institute (AURI): AURI has compiled a checklist to help farmers decide if a digester makes sense for them.
  www.auri.org/research/digester/diglead.htm

For more information: To learn more about these programs and how to apply, contact the resources listed above. For other questions, contact legislative analyst Colbey Sullivan at 651-296-5047.

Elisabeth Long Updated: July 2006

Charitable Gambling: An Overview

Nonprofit organizations can conduct gambling to raise money for "lawful purposes" with a license from the Lawful Gambling Control Board.

Who may conduct gambling?

A charitable, religious, veterans, or other nonprofit organization may be licensed to conduct charitable gambling if it has at least 15 active members and has been in existence for at least three years. About 1,400 Minnesota organizations are licensed to conduct gambling at about 3,300 different locations.

What kinds of games are allowed?

Licensed organizations may conduct bingo, raffles, and tipboards, sell pull-tabs, and operate paddlewheels.

Who regulates charitable gambling?

Charitable gambling is regulated by the seven-member Lawful Gambling Control Board. It licenses organizations and gambling managers and makes rules for the conduct of gambling. It also regulates bingo halls and the distributors and manufacturers of gambling equipment.

What can gambling proceeds be spent for?

Gross gambling profits (gross receipts less prizes) can only be spent for *gambling expenses* and *lawful purposes*.

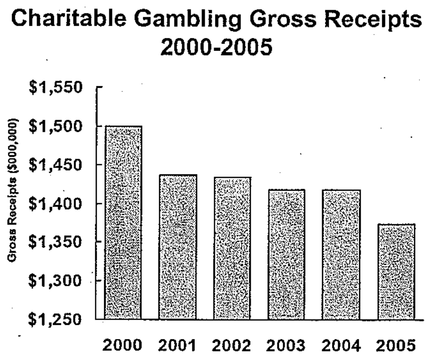
Gambling expenses are all expenses directly related to the conduct of gambling. Examples are gambling supplies, rent, license fees, and wages of gambling workers. Expenses are limited to 70 percent of gross profits for bingo and beginning July 1, 2006, 60 percent for other gambling.

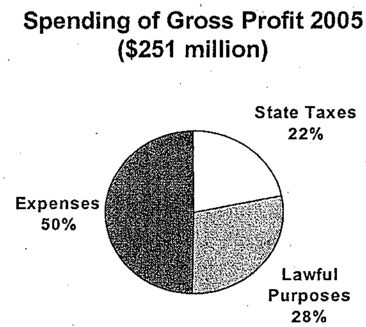
Gross profit not spent for expenses (net profit) can only be spent for *lawful purposes*, which include the following:

▸ Expenditure by or contribution to a 501(c)(3) organization or a 501(c)(4) festival organization	▸ Contributions to government
▸ Contributions to relieve poverty, disability, or homelessness	▸ Contributions to or expenditures by a religious institution
▸ Compulsive gambling treatment	▸ Snowmobiles and ATV trails and wildlife management projects
▸ Scholarships and contributions to educational institutions	▸ Food shelves and dining programs primarily for older persons
▸ Recognition of humanitarian or military service	▸ Community arts organizations and programs
▸ Recreational and athletic facilities primarily for young people	▸ Utilities for veterans' organization buildings
▸ Property taxes on gambling premises	▸ Recognition dinners for veterans, up to $5,000 per organization annually

Net profits can also be spent to pay state, federal, and local taxes on gambling.

Charitable Gambling Statistics





What are the rules for charitable gambling?

The major rules that apply to all gambling are as follows:

- Gambling must be supervised by a gambling manager appointed by the organization
- Players must be at least 18 years old
- Players can't use checks or play on credit (except checks for raffle tickets)
- Odds and house rules must be posted on the premises
- Compensated gambling workers must be registered with the board and may not gamble at sites where they are working, with some limited exceptions

Are there prize limits for charitable gambling?

Prize limits are as follows:

- Bingo, $200 per game and $2,800 for most bingo occasions
- Single pull-tab, $599
- Single paddlewheel prize, $70
- Largest tipboard prize, $599

What taxes apply to charitable gambling?

The state imposes taxes on charitable gambling in lieu of sales taxes:

- Bingo, paddlewheels, and raffles, 8.5 percent of gross profit
- Pull-tabs and tipboards, 1.7 percent of "ideal gross" (potential gross receipts from all tickets in a package, with a refund for unsold tickets)
- Pull-tabs and tipboards, additional "combined receipts tax" of 1.7 percent to 5.1 percent of gross receipts, depending on the organization's annual receipts

What gambling is exempt from licensing?

Organizations do not have to obtain a license for the following:

- Gambling conducted for five or fewer days a year with total prizes not exceeding $50,000
- Bingo conducted at fairs for up to 12 days a year and bingo conducted elsewhere for up to four days a year
- Raffles with a prize of not more than $1,500

Exempt organizations must register with the board, except for excluded raffles, and follow state law on spending net profits.

For more information: Contact legislative analyst Elisabeth Long at 651-296-5052. Also see the House Research publication *Charitable Gambling*, July 2006.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

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Joel Michael

Updated: August 2006

Cigarette and Tobacco Excise Taxes and Fees

Minnesota imposes several taxes and fees on cigarettes and tobacco products

Minnesota imposes a series of taxes and fees on the sale or possession of cigarettes and tobacco products. The table lists the taxes and fees and their rates. The cigarette taxes and fees are all imposed on a "per unit" basis—i.e., on the number of cigarettes sold, not as a percentage of the sale price. Because the tax is a per unit tax, it does not increase as the price of cigarettes increases. By contrast, the taxes and fees on tobacco products, such as cigars, pipe tobacco, snuff, and chewing tobacco, are imposed as a percentage of their wholesale prices.

Tax or fee	Per pack of 20 rate	Percent of price
Cigarette excise tax	48 cents	NA
Tobacco products excise tax	NA	35%
Health impact fee	75 cents	35%
Fee on cigarettes manufactured by nonsettling companies	35 cents	NA
Tax in lieu of general sales tax (rate for FY2006)	25.5 cents	NA

The 2005 Legislature converted the sales tax to a per pack tax and imposed the health impact fee

The 2005 Legislature made two changes in cigarette and tobacco products taxation:

- It converted the 6.5 percent state general sales tax on cigarettes to a flat amount per pack tax collected from wholesalers (rather than as a percentage of the retail sale prices, as other products are taxed under the sales tax). The commissioner of revenue annually sets the amount based on a survey of the average retail price of cigarettes. The 2005 legislation set the amount initially at 25.5 cents per pack.
- The 2005 Legislature also imposed a health impact fee of 75 cents per pack of cigarettes and 35 percent of the wholesale price of tobacco products. Combining the Minnesota's excise tax and fee, the burden equals $1.23 per pack and 70 percent of the wholesale price of tobacco products. This fee is imposed and collected in the same manner as the cigarette excise tax.

Payments made to settle state lawsuits against the tobacco industry have similar effects as excise taxes

Settlements of the states' lawsuits against the tobacco companies have about the same economic effect as a cigarette tax, since these settlement payments are passed along to consumers (nationally) through higher cigarette prices. However, they do not affect companies that were not part of the lawsuit. To compensate partially for the lower prices of cigarettes produced by nonsettling companies, the 2003 Legislature imposed a 35-cent per pack fee on those cigarettes. These cigarettes make up a growing share of the national and Minnesota markets. (Other states have imposed similar fees: Michigan and Utah impose a 35-cent surcharge, and Alaska a 25-cent surcharge.)

The Minnesota Supreme Court upheld both of the fees

Industry interests challenged both cigarette fees on various grounds. The Minnesota Supreme Court rejected these challenges, upholding the state's power to impose the fees. *Council of Independent Tobacco Mfr. v. State,* 713 N.W.2d 300 (Minn. 2006) (fee on nonsettling companies); *State v. Philip Morris,* 713 N.W.2d 350 (Minn. 2006) (health impact fee).

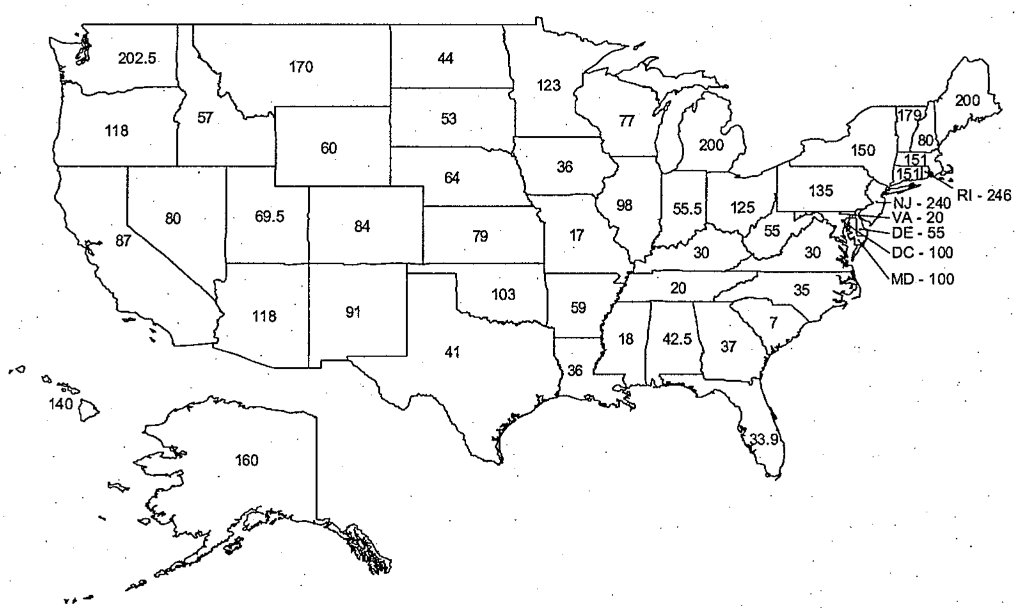
The taxes and fees are estimated to yield revenues of about $450 million

For fiscal year 2007, the Finance Department estimates collections from the two excise taxes and the sales tax on cigarettes will be $221.6 million and from the health impact fee, $223.4 million. Revenues from the tobacco products tax are deposited in the general fund. For fiscal year 2007, cigarette tax revenues of $22.25 million go to fund the Academic Health Center, $8.55 million to the medical education and research account, and the rest to the state general fund. The health impact fee revenues are deposited in a health impact fund and are transferred to the general fund after the commissioner of human services certifies that state health programs have incurred tobacco-related costs equal to the fee.

Neighboring states have significantly lower tax rates

Because cigarettes can easily be transported, the tax rates in other states (especially border states) are important. Taking into account the combined effects of the tax and fee ($1.23/pack), Minnesota's bordering states have significantly lower rates, ranging from 77 cents (Wisconsin) to 36 cents (Iowa). All states' rates are shown on the map. The map does not reflect local cigarette taxes; some of these local taxes are substantial (e.g., $2.00 per pack in Chicago). The map does not reflect the effect of general sales taxes (including Minnesota's per pack tax in lieu of the sales tax). Some states have no sales tax or exempt cigarettes from sales taxation, lowering the overall tax burden. Texas's rate will increase by $1 on January 1, 2007, and Alaska's by 20 cents on July 1, 2007.

State Cigarette Tax Rates*
as of 7/1/2006
cents per pack



* These exclude some significant local taxes.
Source: Federation of Tax Administrators and other sources

For more information: Contact legislative analyst Joel Michael at 651-296-5057.

HOUSE RESEARCH | **Short Subjects**
The Constitution and the Legislature

Deborah A. Dyson

August 2006

Eminent Domain: Regulatory Takings

The Takings Clause of the Fifth Amendment of the U.S. Constitution provides that private property must not be taken for public use without payment of just compensation. (The clause is made applicable to the states through the Fourteenth Amendment.) Under the Minnesota Constitution, article 1, section 13, private property must not be taken, destroyed, or damaged for public use without payment of just compensation.

Definition of a "taking." The classic taking is a direct appropriation or physical invasion of private property. Since 1922, however, the courts have recognized that a state statute or local ordinance may impose restrictions or demands on the use of private property that are so onerous that it amounts to a taking and the government must compensate the owner. *Lingle v. Chevron, U.S.A., Inc.*, 125 S. Ct. 2074, 2081 (2005) (citing *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922)). In these instances, called regulatory takings, the property owner brings an inverse condemnation action to compel the government to begin eminent domain proceedings and compensate the owner. A compensable regulatory taking may be temporary or permanent. *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987).

Categorical or per se regulatory takings. There are two situations in which a court could find that a regulation is clearly a taking—a categorical or "per se" taking. First, if the regulation requires an owner to allow a physical invasion of the property, however minor, the owner must be compensated. *Lingle*, 125 S. Ct. at 2081 (citing *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (state law requiring landlords to permit cable TV companies to install cable facilities in apartment buildings held to be a taking)).

The second situation is when the regulation denies the owner of all economically viable use of the property and the regulation is not merely an explicit statement of common law limitations already present in the title. *Lingle*, 125 S. Ct. at 2081 (citing *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992)).

Penn Central test. Apart from the two situations in which the Court would find a categorical taking or taking *per se*, there is little guidance on what constitutes a regulatory taking, and courts have relied on ad hoc factual inquiries. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978) (historical preservation designation limited development options for railroad station not a taking). In these cases, a court will analyze a regulatory takings claim under a three-part test in which the court, considering the parcel as a whole, looks at:

(1) the economic impact of the regulation on the owner;
(2) the extent to which the regulation interferes with distinct legitimate, investment-backed expectations; and
(3) the character of the government action—does it result in the equivalent of a physical invasion of the property or is it more a "public program adjusting the benefits and burdens of economic life to promote the common good."

Id.; Johnson v. City of Minneapolis, 667 N.W.2d 109, 114-115 (Minn. 2003) (following *Penn Central* analysis, court held that the "cloud of condemnation" over Nicollet Mall property in Minneapolis due to drawn out conflict over proposed LSGI development was a taking).

The Court does not look at whether the regulation is an effective way to achieve the stated purpose; the focus is not on the government's purpose (once public use or purpose is established), but on the impact on the property owner's rights. *Lingle,* 125 S. Ct. 2074. Each of the tests for regulatory takings looks for the functional equivalent to an appropriation or physical invasion of private property. *Id.* at 2084.

Minnesota's government enterprise or arbitration test. In general, a regulation that diminishes property value alone does not constitute a taking. In Minnesota, however, a regulation that is designed to benefit a government enterprise, such as an airport, and results in a substantial diminution in value, may be a taking. *McShane v. City of Faribault*, 292 N.W.2d 253 (Minn. 1980) (airport safety zoning ordinance that limited development and caused a substantial and measurable decline in market value was a taking). When a regulation arbitrates between competing uses, the court looks at whether the regulation deprives the property of all reasonable uses before determining that it is a taking. *Concept Properties, LLP v. City of Minnetrista,* 694 N.W.2d 804, 823 (Minn. App. 2005) ("comprehensive planning objective [is] to balance many public interests and to promote the City's particular land-use goals and rural values"), *rev. denied* (Minn. July 19, 2005).

Development moratorium. Local governments have authority to impose a moratorium on development in order to protect the planning process. Minn. Stat. §§ 394.34, 462.355, subd. 4. During the moratorium, a property owner may have limited or no economically viable use of the property. The U.S. Supreme Court has held that under the federal constitution, a temporary regulation that denies all economically viable use of property is not a per se taking. The Court applies the *Penn Central* factors to determine if the regulation amounts to a compensable taking. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Reg. Planning Agency*, 535 U.S. 302 (2002); *Woodbury Place Partners v. City of Woodbury*, 492 N.W.2d 258 (Minn. App. 1992) (remanded for determination of whether moratorium constituted a taking under case-specific analysis of *Penn Central*).

Exactions. An exaction is a government requirement that a landowner dedicate land or a property interest, such as an easement, as a condition for granting a development permit. An exaction may be found to be a taking unless the government shows that there is an essential nexus between a legitimate government interest and the condition exacted. Assuming the nexus exists, there must also be a "rough proportionality" between the planned development and the required dedication. "No precise mathematical calculation is required, but the city must make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Dolan v. City of Tigard*, 512 U.S. 374, 391 (1994) (permit to expand a store and parking lot conditioned on the dedication of a portion of the property for a greenway pedestrian/ bicycle path held a taking); *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 831-832 (1987) (permit to build a larger residence on beachfront property conditioned on dedication of an easement for public to cross a strip of property between owner's seawall and the mean hide tide mark held a taking); *see also Collis v. City of Bloomington*, 310 Minn. 5, 246 N.W.2d 19 (1976) (cited in *Dolan*); *Kottshade v. City of Rochester*, 357 N.W.2d 301, 307-308 (Minn. App. 1995) (citing *Dolan* analysis); Minn. Stat. § 462.358, subds. 2b and 2c (amended in 2004 to incorporate terms used in *Dolan*).

Removal of nonconforming uses. The 2006 Legislature enacted a number of significant changes to the statutes governing eminent domain in Minnesota. *See* Minn. Laws 2006, ch. 214, effective May 20, 2006, with certain exceptions. One of the changes requires a local government to compensate the owner of a nonconforming use if the local government requires its removal as a condition of granting a permit, license, or other approval for a use, structure, development, or activity. This provision does not apply if the permit, license, or approval is for construction that cannot be done unless the nonconforming use is removed. Minn. Stat. § 117.184.

For more information: Contact legislative analyst Deborah Dyson at 651-296-8291.

Kathy Novak

Updated: August 2006

Financial Aid for Higher Education: Minnesota State Grant Program

What is the state grant program?

Minnesota's state grant program provides financial aid to Minnesota undergraduates to attend a public or private postsecondary institution located in Minnesota. The Office of Higher Education (Office) administers the state grant program.

Who is eligible for a state grant?

Each term, students must apply for a state grant by the deadline of 30 days after the start of the term. Eligible students are Minnesota residents who are high school graduates or age 17 or older and able to meet the admission requirements of a participating postsecondary institution. Students must demonstrate financial need and must not be in default on student loans or in arrears for child support.

Minnesota residents must meet one of the residency criteria: have lived in the state for one year; are dependents of a resident; have graduated from a Minnesota high school, lived in the state while attending high school and are physically attending an eligible institution; are members of the military on active service in Minnesota or their spouses or dependents; have relocated to Minnesota due to a declared disaster that interrupted their education, or are legal refugees residing in Minnesota.

Financial need is based on the student's ability to meet the cost of attending the selected postsecondary institution according to the standard for federal financial aid through the Pell grant program.

How much aid is available through the state grant?

State law requires grant awards to be based on a shared responsibility for paying for the recognized cost of attendance:

- Students are responsible for 46 percent of the cost
- The amount of the Pell Grant is deducted from the cost
- The family's financial responsibility is determined through a federal needs analysis (FAFSA)

The cost of attendance is equal to the amount of tuition and fees up to a cap set in law plus an allowance, also set in law, for living and miscellaneous expenses (LME). For academic year 2005-2006, the tuition maximums were $9,208 for four-year programs and $6,567 for two-year programs. For 2006-2007, the maximums increase for four-year programs to $9,438 and decrease for two-year programs to $6,436. The LME allowance for two- and four-year programs is set at $5,350 per year. Surplus appropriations for the 2006-2007 biennium triggered an increase in LME of $400 to $5,570 for the 2006-2007 academic year, as required by law.

Except for private and institutional scholarships, the state grant is the last contribution to the cost of attendance. The average state grant for the 2004-2005 year was $1,695, a decrease of 8.1 percent from the $1,845 average grant for 2003-2004.

Are part-time students and independent students eligible?

Part-time students are eligible for a state grant based on the cost of attendance, prorated for the number of credits the student is taking. Independent students (generally students who are not dependents for tax purposes) are also eligible, but are responsible for a larger share of the cost of attendance.

How is the state grant program funded?

The legislature appropriates money from the general fund for the state grant program based on an estimate by the Office of the cost to fully fund grant awards. State law allows the Office to carry a balance from the first year of the biennium to the second year and, if certain criteria are met, authorizes the transfer of money to and from other financial aid programs. For the current biennium, the Office must use surplus appropriations in the state grant program to increase the LME for 2006-2007.

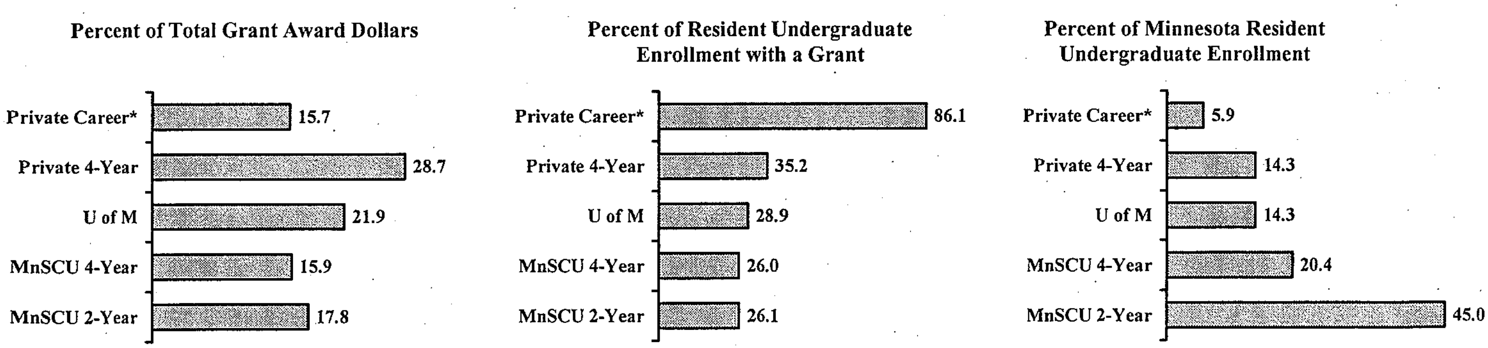
Are eligible students entitled to a state grant?

Under state law, the state grant program is not an entitlement. The Office must award grants based on available funding. If funding is insufficient to make full awards, the Office is required, by law, to reduce all grants by adding a surcharge to the family responsibility and increasing the student's responsibility by a percentage.

How do grants compare to enrollment at state postsecondary institutions?

The graph below summarizes participation in the state grant program and compares it to resident enrollment in fiscal year 2005 when state grant awards totaled $124 million in grants to 73,410 recipients. Of the 233,533 Minnesota undergraduate students who attended participating public and private postsecondary institutions in Minnesota, 31 percent received a state grant. More of the grant awards went to students at private colleges and universities (29 percent) than other institutional types. A large majority of students at private career schools receive grants (86 percent) compared to other types of institutions. MnSCU two-year institutions account for about 45 percent of total resident enrollment, but only 26 percent of the students receive a state grant, accounting for 18 percent of the grant awards.

Distribution of State Grants and Minnesota Resident Enrollment by Institution Type
Fiscal Year 2005



* Enrollment statistics include private career schools that participate in the state grant program.

For more information: Contact legislative analyst Kathy Novak at 651-296-9253.

Joel Michael

Updated: August 2006

The Minnesota Estate Tax

The estate tax equals a percentage of the taxable estate

Minnesota imposes a tax on the estates of individuals who are residents of the state when they die or who own real property in Minnesota when they die. The tax is imposed under a graduated rate schedule on the taxable estate. The taxable estate is generally the fair market value of the estate on the day the decedent died, less deductions (e.g., transfers to a surviving spouse and charitable bequests) and an exemption amount. *See the box to the right for the exemption and rate amounts.*

Exemption Amount and Tax Rates

Exemption. The exemption amount is $1,000,000 for individuals dying in 2006 and later.

Because transfers to surviving spouses are exempt, a $1 million exemption allows a married couple with a joint net worth of less than $2 million to avoid the tax.

Tax rates. The tax rates range from 5.6 percent to 16 percent. The top rate applies to the amount of the taxable estate over $10,040,000.

The Minnesota tax evolved as a creature of the federal estate tax

The rules under the estate tax are determined largely by reference to the rules under the similar federal estate tax. For the 16 years ending December 31, 2001, the Minnesota estate tax was directly linked to the federal tax as a "pickup" or "soak-up" tax equal to the credit allowed under federal estate tax for state death taxes. As a pickup tax, the Minnesota tax imposed no additional tax burden on estates. For each dollar of state tax paid, federal tax was reduced by an equal amount. However, Congress repealed this credit in 2001, so that it is completely eliminated for decedents dying after December 31, 2004. In 2001, the legislature chose to continue imposing the estate tax under the rules in effect before Congress repealed the credit. As a result, the tax now is a stand-alone estate tax and imposes a real tax burden on estates and their heirs.

Few estates pay the tax; it is a progressive source of revenue

Fewer than 2 percent of estates pay the estate tax. The small number of estates paying tax results from the exemption amount and the fact that amounts left to surviving spouses are deductible. Decedents with taxable estates are, almost by definition, some of the most affluent individuals in the state. Most evidence also suggests that recipients of bequests from taxable estates also have above average income and assets. Based on Minnesota Department of Revenue's *Tax Incidence Study*, the tax is the most "progressive" source of state tax revenue.

The estate tax provides a modest, but volatile, source of general fund revenue

All revenues from the tax are deposited in the general fund. The Department of Finance (February 2006 forecast) estimates that the tax raises about $90 million to $100 million per fiscal year. *See the box to the right for the last five years of actual collections.* Revenues from the tax are very volatile, since they depend on the deaths of a few individuals. If one very wealthy individual dies, collections can soar. For example in August 2005, the Department of Revenue received a check from one estate for tax of $112 million (compared with estimated revenues for the whole year of $86 million and total collections of $72.7 million in fiscal year 2005). In other years, revenues may fall below estimates.

Estate Tax Revenues FY 1998-2002 (millions)

2002	$68.2
2003	$127.7
2004	$90.1
2005	$72.7
2006	$215.9

Source: Department of Finance

Repeal of the federal credit creates an incentive for high net worth Minnesota residents to move to another state

The repeal of the federal credit creates an incentive for affluent, elderly Minnesotans to consider changing their domiciles to a state without an estate tax. When Minnesota imposed only a pickup tax, the federal treasury paid the effective burden of the tax. As a result, Minnesota residents had no reason to change their domiciles to another state to avoid the Minnesota tax. However, in 2001 Congress eliminated the credit. Repeal of the credit makes the state tax a "real" tax that reduces the amount of money and other property that can be left to heirs.

Affluent individuals may be willing to change their domiciles to avoid paying potentially multimillion dollar state estate tax liabilities. The fact that many of these individuals have second homes in states that will not have stand-alone estate taxes increases their ease of moving. (Alabama, Florida, and Nevada, for example, are prohibited by their state constitutions from imposing a state tax that exceeds the federal credit; Texas has taken no action to impose an estate tax and seems unlikely to do so.) If these individuals change their domiciles, they would also avoid the state income tax, since most of these states (Florida, Nevada, and Texas, again) do not have individual income taxes.

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research short subject *State Responses to 2001 Federal Estate Tax Changes*, January 2005.

HOUSE RESEARCH | Short Subjects

Lisa Larson

Updated: August 2006

Minnesota's K-12 Academic Standards and Assessments

The 2006 Legislature added math and science courses to the state's required academic standards

The 2003 Minnesota Legislature repealed the profile of learning portion of the high school graduation rule for the 2003-04 school year and replaced it with required academic standards in five subject areas: language arts; mathematics; science, including biology; social studies, including U. S. and world history, geography, economics, government, and citizenship; and the arts. The 2004 Legislature adopted science and social studies standards for the 2005-2006 school year and added locally developed health and physical education standard as a sixth required subject area. The 2006 Legislature imposed additional math and science course requirements on the class of 2015 and later. Public high school students must complete these standards to graduate. The federal No Child Left Behind Act makes state academic standards in language arts, mathematics, and science applicable to all public school students.

Students entering ninth grade must complete four language arts credits; three mathematics credits that encompass algebra, geometry, statistics, and probability; three science credits that include at least one biology credit and may include an agriculture science credit; three and one-half social studies credits; one arts credit; and at least seven elective course credits. In addition, students in the class of 2015 or later must complete an algebra I credit by the end of eighth grade, and an algebra II credit and a chemistry or physics credit before graduating. Districts may apply state or locally developed academic standards for the arts. Districts decide whether students meet course credit requirements by successfully completing an academic year of study or by demonstrating mastery of the applicable subject matter.

In addition to meeting course requirements, public school students also must satisfy existing state basic skills requirements in reading, math, and writing in order to graduate. A district must adopt the new graduation requirements no later than the 2007-08 school year; a district that adopts the new graduation requirements earlier must allow students who enter ninth grade by the 2003-2004 school year to graduate based on local requirements in effect when the students became ninth graders.

Benchmarks specify the academic knowledge and skills used to implement state academic standards

The Commissioner of Education must supplement the required academic standards with published grade-level benchmarks that specify the academic knowledge and skills that schools must offer and students must achieve to satisfy the standards. Benchmarks provide information about the content of standards and are used to develop tests. The commissioner must embed technology and information literacy standards and implement a cycle in the 2006-07 through 2013-2014 school years to review required academic standards, related benchmarks, and elective standards.

State assessments are aligned with state academic standards

As they become available, districts must use state assessments aligned with state-required academic standards in language arts, mathematics, and science to measure student progress in achieving those standards and to determine whether students have satisfied state basic skills requirements in reading, math, and writing. The commissioner must not develop statewide assessments for social studies and arts standards. An 11-member assessment advisory committee reviews statewide assessments before they are finalized.

Beginning in the 2005-06 school year, students in grades 3 through 8 and in high school take annual language arts and mathematics assessments. Beginning in the 2007-08 school year, students take science assessments one time in the 3-5 and 6-9 grade spans, and a life sciences assessment in the 10-12 grade span. Districts administer alternative assessments to students with disabilities or limited English proficiency only when appropriate. The state and local districts must publicly report student, school, district, and state assessment results. By the 2006-07 school year, the commissioner must include in the assessment results a value-added component that measures students' growth in achievement over time. Public schools and districts may use students' assessment performance to promote or retain students or as a percentage of students' final course grade, or may record the performance on student transcripts.

Districts set local elective standards

Districts must establish local elective standards for and offer courses in vocational and technical education, health and physical education, and world languages. Districts use locally selected assessments to determine whether students achieve these standards. Districts must periodically review the local standards.

Legislature must approve changes in rules

The Education Commissioner adopted rules for standards in language arts, mathematics, science, social studies, and arts. The commissioner cannot amend or repeal these rules nor adopt new rules without specific legislative authorization.

Commissioner annually identifies high and low performing schools

The commissioner must use objective criteria, including student performance, school safety, staff characteristics, and by the 2006-07 school year, a value-added component, to identify four to six designations of high and low performing public schools. Annually, by September 1, the commissioner must post performance report cards that show each school's designation on the Education Department's web site. A school or district may appeal its designation to the commissioner; the commissioner's decision to uphold or deny an appeal is final. For 2006 only, the department must release all school performance report cards and AYP data to the public by September 1, unless a school or district submits an appeal to the department by August 31.

Timeline for Implementing New Standards

School Year	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008
Requirements	Profile of learning repealed and replaced with standards in six subjects; schools' report cards and high or low performing designations are posted on web	Students entering ninth grade must complete credit requirements in six subjects in order to graduate	Students in grades 3-8 and high school must take annual language arts and math assessments; science and social studies standards must be implemented for all students	Commissioner must include a value-added component when designating high and low performing schools; commissioner must review required standards, related benchmarks, and elective standards through 2013-2014	All high school students are subject to new graduation requirements; students must take science assessments in grade spans 3-5 and 6-9, life sciences assessment in grade span 10-12

For more information: Contact legislative analyst Lisa Larson at 651-296-8036.

Joel Michael

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MinnesotaCare Provider Taxes

What are the taxes?

Minnesota imposes a series of gross revenue taxes on various types of providers of health care goods and services. Revenues collected under these taxes are used to pay for the MinnesotaCare program, which provides state-subsidized health care coverage for low-income individuals.

Who is subject to the tax?

Provider taxes apply to the following:

- "Health care providers," which include licensed health care professionals such as physicians, dentists, nurses, psychologists, physical therapists, chiropractors, and so forth; nonlicensed individuals who provide services that qualify for reimbursement under Minnesota's Medicaid program; staff model health plan companies (a type of HMO where services are provided by employees); ambulance services; and opticians
- Hospitals
- Surgical centers
- Wholesale drug distributors

What entities are exempt from the tax?

MinnesotaCare provider taxes do not apply to the following:

- Nursing homes and various other residential care facilities, such as board and care homes, adult foster homes, boarding care homes, and adult day care centers
- Home health agencies
- Providers of personal care services
- Providers of private duty nursing services
- An entity that employs health care providers to service only their employees
- An educational institution that provides services to its students, if it does not charge students a fee for extended coverage

What is the tax base?

The taxes apply to the gross revenues derived from "patient services," which are defined to include most services provided to patients, such as diagnostic and therapeutic services, bed and board, and so forth. Various types of services are explicitly excluded from patient services, including the following:

- Services provided to nursing homes and in connection with assisted living and congregate housing programs
- Exams for insurance, employment, litigation, and so forth
- Certain mental health services
- Hospice services
- Various types of residential services for the mentally retarded

What is the tax rate? The tax rate is 2 percent. A temporary 1.5 percent rate applied from 1998 through 2002.

What exemptions apply? Exemptions from the tax apply to the following payments:

- For services provided under Medicare
- For home health care services
- Those made from the state chemical dependency fund
- Those funded by charitable donations
- Those under programs funding research on human subjects in compliance with federal law
- Those made by the federal employee and military (Tricare) health insurance plans that cover federal workers and military personnel and retirees
- Those from providers that were already subject to the tax

Are credits allowed? Credits are allowed for taxes paid to other states and for qualifying research expenditures. The research credit is subject to an annual cap of $2.5 million; the commissioner of revenue sets the credit rate to equal the cap amount.

How is the tax paid? Providers make quarterly estimated payments; an annual return is filed to reconcile the estimated payments with the final liability for the tax year. All payments and returns are required to be filed and made electronically. The Department of Revenue administers the tax. Providers may itemize the tax on patient bills.

How are drugs taxed? Legend drugs (i.e., those requiring prescriptions under FDA regulation) are taxed under a wholesale drug tax. This tax is levied on wholesale drug distributors. It applies at a 2 percent rate to the wholesale price. A use tax applies when drugs are purchased for resale in Minnesota from an out-of-state seller who does not have nexus and, thus, cannot be required to pay the tax.

How much revenue is collected from the taxes? In February 2006, the Department of Finance estimated that the MinnesotaCare provider taxes will yield $424 million in revenues for the Health Care Access fund in fiscal year 2007. Because health costs are rising at a rapid rate and because consumption of health services is also increasing steadily, these revenues are likely to rise at a faster rate than most, if not all, of the other state tax sources.

Are these the only sources of revenue for the health care access fund? No, the revenues from applying the insurance premiums tax to health maintenance organizations (HMOs) and nonprofit health services corporations (such as Blue Cross) are deposited in the health care access fund and used to pay for MinnesotaCare. In addition, other revenues from the program, such as premium payments by participants, go to the fund.

For more information: Contact legislative analyst Joel Michael at 651-296-5057.

Deborah A. Dyson **August 2006**

Eminent Domain: Just Compensation

The state and federal constitutions require payment of just compensation when private property is taken for public use. U.S. Const. 5th Amend.; Minn. Const. art. 1, § 13. The just compensation requirement "was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49, 80 S. Ct. 1563, 1569 (1960).

Just compensation is determined by looking at the fair market value of the property taken as of the time the commissioners make the award. *City of St. Louis Park v. Almor Co.*, 313 N.W.2d 606, 610 (Minn. 1981) (en banc). Fair market value is what a person who is willing, but not required, to buy the property would pay a seller, who is willing, but not required, to sell it, taking into consideration the highest and best use to which the property can be put. *County of Ramsey v. Miller*, 316 N.W.2d 917, 919 (Minn. 1982). If only part of a property is taken, the owner must be compensated for the diminution in value to the remainder as well as the value of the part taken. The compensation is the difference between the fair market value of the entire property immediately before the taking and the fair market value of the remainder afterwards. *State v. Strom*, 493 N.W.2d 554, 558-559 (Minn. 1992).

Minnesota courts recognize four methods to determine fair market value. Minnesota courts have recognized four ways to calculate the fair market value (FMV) of property in takings cases: comparable sales, income capitalization, reproduction cost, and development cost. *County of Ramsey v. Miller*, 316 N.W.2d 917, 919, 922 (Minn. 1982). These methods are described in various cases and in *The Dictionary of Real Estate Appraisal*, 4th edition (Appraisal Institute 2002) as follows:

Comparable sales is the preferred method of determining FMV and is used to value improved properties, vacant land, or land considered vacant. It is determined by comparing the property to similar properties that have been sold recently and then applying appropriate units of comparison to adjust the sale prices.

Income capitalization is used for determining the FMV of an income-producing property. This method calculates the present value of the future revenues for the useful life of the business, based on past performance.

Reproduction costs less depreciation estimates the current cost to construct a reproduction of (or replacement for) the existing structure, deducting depreciation from the total cost, and adding the estimated land value.

Development cost is the price a developer-purchaser would be warranted in paying for the land, given the cost of development and the probable proceeds of selling it. In order to use this method, the land must be ripe for development, the owner must reasonably expect to be able to secure zoning and required permits to develop the land, and the development cannot take place at too remote a time.

These techniques are neither conclusive nor exclusive but are factors to consider in arriving at FMV. *State v. Harbor City Oil Co.*, 486 N.W.2d 455, 456 (Minn. App. 1992). "Any competent evidence may be considered if it legitimately bears upon the market value." *State v. Strom*, 493 N.W.2d 554, 559 (Minn. 1992) (quoting *County of Ramsey*, 316 N.W.2d at 919).

There are four aspects to determining the highest and best use. Highest and best use is defined as the most profitable use for which the property is adaptable. A real estate appraiser will consider four criteria: legal permissibility, physical possibility, financial feasibility, and maximum productivity. *The Dictionary of Real Estate Appraisal*, 4th edition (Appraisal Institute 2002), page 135. The owner's actual use, or intentions for use, is not relevant to determining the highest and best use. *State v. Gannons*, 275 Minn. 14, 18-19, 145 N.W.2d 321, 326 (1966).

The 2006 Legislature established a new minimum compensation. Under the 2006 provision, compensation must allow the owner to purchase a comparable property in the community. A condemning authority cannot require an owner to accept as compensation a substitute property or return of property taken. This does not apply to takings by public service corporations, which include utilities, airports, and pipelines. Minn. Stat. §§ 117.187, 117.188, 117.189.

Attorney fees are required, permitted, or prohibited in specified takings cases. The court *must* award an owner attorney fees and other costs of litigation if the final compensation award is 40 percent or more than the condemning authority's last written offer made before the condemnation petition was filed or if the court determines that the taking is not for a public use or is unlawful. The court *may* award attorney fees and other fees and costs if the final award is at least 20 percent, but not more than 40 percent, greater than the last written offer. The court *may not* award attorney fees if the judgment or award is not more than $25,000. The above do not apply to takings by public service corporations. Minn. Stat. §§ 117.031, 117.189. The *condemning authority* may be granted attorney fees if the owner fails to deliver possession of the real estate. Minn. Stat. § 117.043, subd. 2. The court *may* award reasonable attorney fees to a property owner (1) that brings an inverse condemnation case, and (2) if an eminent domain case is dismissed. Minn. Stat. §§ 117.045, 117.195, subd. 2. The court *must* award reasonable attorney fees to the property owner who has to bring an action against a commissioner who fails to file a report in eminent domain proceedings if proceedings are set aside as to that owner. Minn. Stat. § 117.105, subd. 2.

Appraisal costs are provided to property owners. An acquiring authority must reimburse an owner up to $1,500 for an appraisal of a single-family or two-family residential property, or any taking under $10,000. The cap is $5,000 for other types of property. This does not apply to takings by public service corporations. Minn. Stat. §§ 117.036, 117.189. In an appeal, the court may award the property owner reasonable expert witness and appraisal fees. The condemning authority cannot be awarded expert witness fees, costs, or disbursements. Minn. Stat. § 117.175, subd. 2.

A business may be compensated for loss of a going concern. A business owner must be compensated for loss of a going concern related to the taking of real property unless the condemning authority shows that the loss is not due to the taking, reasonable measures could have avoided the loss, or that it will duplicate other compensation awarded. A business owner must be compensated for a permanent loss of a majority of the businesses' driveway access that results in revenue losses. Minn. Stat. § 117.186.

Relocation assistance is also provided. In addition to the property owner receiving compensation for the value of the property taken, the owner and tenants may receive relocation assistance. An acquiring authority must pay relocation benefits, as defined and regulated by federal law, except that an acquiring authority *must* reimburse a displaced business for actual relocation expenses up to $50,000. Minn. Stat. §§ 117.50 to 117.56 (referring to 42 U.S.C. § 4601, et seq., and related regulations, 49 C.F.R. § 24.1, et seq.).

For more information: Contact legislative analyst Deborah Dyson at 651-296-8291. See also the House Research publications *Eminent Domain: Public Use*, August 2006, and *Eminent Domain: Regulatory Takings*, August 2006.

Matt Burress **Updated: August 2006**

Minnesota Speed Limits

Minnesota law sets speed limits on state highways and local roads, establishes penalties, and provides authority for the Department of Transportation (MnDOT) and local governments to change the limit in certain situations (see Minnesota Statutes, section 169.14).

Basic requirements and speed limits

Regulation of speeding is part of Minnesota's traffic laws. The law requires that: "No person shall drive a vehicle on a highway at a speed greater than is reasonable and prudent under the conditions .... In every event speed shall be so restricted as may be necessary to avoid colliding with any person, vehicle, or other conveyance on or entering the highway." Minn. Stat. § 169.14, subd. 1.

Minnesota law also sets speed limits for different types of roadways, which can be adjusted under certain circumstances. The speed limit is 30 m.p.h. for most local streets and highways, 65 or 70 m.p.h. for interstate highways (depending on whether it is, respectively, within or outside an urbanized area of 50,000 or more), and 55 or 65 m.p.h. on other types of highways.

Speed zones adjust speed limits

MnDOT has the authority to establish speed zones in which the speed limit is higher or lower than the limits set in law. Speed zones are established after MnDOT conducts an engineering and traffic investigation that includes a segment's design, physical characteristics, traffic volume, accident history, and actual speeds. Generally, MnDOT believes that a speed limit at or near the 85th percentile—the speed at or below which 85 percent of vehicles are traveling—is most likely to be the safest maximum limit. Speed limits in speed zones are effective as soon as signs are erected.

Local authority is limited

Cities, counties, and towns have limited authority over speed limits, even on their own streets and highways. A local road authority may ask MnDOT to conduct an engineering and traffic investigation into whether a speed zone could be created for a portion of a local road, but MnDOT makes the final determination of the speed limit on that segment. There are a few exceptions to this general rule:

- On a segment of road up to a half-mile long that is classified as a local street (referred to in statute as a residential roadway), a local road authority may reduce the speed limit from 30 to 25 m.p.h.
- If MnDOT has established a speed zone for a city street or town road in an urban district, the local road authority can lower the limit to 30 m.p.h. An "urban district" is any segment of a street or highway that is built up with structures less than 100 feet apart, for a distance of at least a quarter-mile. Minn. Stat. § 169.01, subd. 59.
- In school zones, defined as a segment of street or highway that abuts school grounds where children have access to the roadway or where a school crossing is established, a local road authority may prescribe a

lower speed limit that is not less than 15 m.p.h., or more than 30 m.p.h. below the surrounding limit.

- Subject to certain state requirements, lower speed limits can also be set on park roads and in alleys.

Both MnDOT and local road authorities can set speed limits within their own highway work zones, which are effective while highway workers are on the job. A work zone speed limit cannot be less than 20 m.p.h. or reduce the speed limit by more than 15 m.p.h. The maximum work zone speed limit is 55 m.p.h. on divided highways and 40 m.p.h. on other highways.

Penalties for speeding violations

Speeding is generally a petty misdemeanor punishable by a fine of up to $300 with no prison sentence, but other penalties can apply. An additional surcharge that doubles the amount of the fine is applied if the violation occurs in a work zone or school zone, or if it involves speeds of 20 m.p.h. or more above the posted limit. If a speeding violation is committed in a manner that endangers persons or property, it can be charged as a misdemeanor with maximum penalties of a $1,000 fine and 90 days imprisonment. A driver's license will be suspended for six months for driving over 100 m.p.h.

Minnesota does not use a point system, which assigns point values to different traffic violations and then requires driver's license suspension or revocation once a driver accumulates a minimum number of points within a time period, such as a year or 18 months. However, a third petty misdemeanor in a year can be charged as a misdemeanor, and a third misdemeanor in a year can result in a driver's license revocation.

Speed limits within cities are absolute, meaning that any speed in excess of them is automatically illegal. Elsewhere, any speed in excess of the limit is "prima facie evidence" that the speed was illegal. This means that there is a presumption that the excess speed is illegal but the presumption may be rebutted by other evidence.

Speeding violations on a driver's record

A law first enacted in 1986 known as the "Dimler amendment" (after its author, former Rep. Chuck Dimler) governs which speeding violations are recorded on a motorist's driving record. The Department of Public Safety maintains the record. Speeding violations are not placed on the driving record if:

- The driver was going no more than 10 m.p.h. above the speed limit in a 55 m.p.h. zone; or
- The driver was going no more than 5 m.p.h. above the speed limit in a 60 m.p.h. zone.

There is no prohibition on recording speeding violations when the speed limit is 65 or 70 m.p.h. The Dimler amendment provisions do not apply if the speeding violation occurred in a commercial motor vehicle, or if the driver holds a commercial driver's license (class A, B, or C). Minn. Stat. § 171.12.

For more information: Contact legislative analyst Matt Burress at 651-296-5045.

The Research Department of the Minnesota House of Representatives is a nonpartisan office providing legislative, legal, and information services to the entire House.

Deborah A. Dyson

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Eminent Domain: Public Use

The state and federal constitutions require a taking to be for a public use. Under both the state and federal constitutions, the power of eminent domain may only be used to acquire property for "public use." The Takings Clause of the Fifth Amendment of the U.S. Constitution provides that private property must not be taken for public use without just compensation. The Minnesota Constitution provides in article 1, section 13, "Private property shall not be taken, destroyed or damaged for public use without just compensation therefore, first paid or secured."

The U.S. Supreme Court has allowed a broad definition of public use for federal constitutional purposes and generally deferred to legislative decisions on what is a public use. What is included in the scope of "public use" has been controversial. In the summer of 2005, the U.S. Supreme Court, consistent with its prior decisions, held that the use of eminent domain to further redevelopment and increase tax revenues for an economically distressed area that was not blighted met the "public use" requirement of the federal constitution. *Kelo v. City of New London,* 545 U.S. 469, 125 S. Ct. 2655 (2005). The Minnesota Supreme Court had similarly upheld the use of eminent domain for economic development. *E.g., City of Duluth v. State,* 390 N.W.2d 757, 762-764 (Minn. 1986) (citing *City of Minneapolis v. Wurtele*, 291 N.W.2d 386 (Minn. 1980)).

The U.S. Supreme Court also stated, however, that legislatures could enact more stringent limits on the use of eminent domain. "We emphasize that nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power." *Kelo,* 125 S. Ct. at 2668.

Minnesota was among the states that enacted new laws governing "public use" and otherwise limited the exercise of eminent domain. Under the law passed by the 2006 Legislature, private property may not be taken for economic development alone. Minn. Stat. §§ 117.012, subd. 2, 117.025, subd. 11, para. (b) (enacted in Minn. Laws 2006, ch. 214, generally effective May 20, 2006).

The new law also limits takings related to redevelopment. [In addition, the law makes changes intended to protect property owners, including changes in procedures, providing for attorney fees in certain instances, and providing for or increasing other elements of compensation.]

The substantive limitations on public use in the new law are largely found in the definitions. Minn. Stat. (2006) § 117.025. " 'Public use' or 'public purpose' means, exclusively:

> (1) the possession, occupation, ownership, and enjoyment of the land by the general public, or by public agencies;
>
> (2) the creation or functioning of a public service corporation; or
>
> (3) mitigation of a blighted area, remediation of an environmentally contaminated area, reduction of abandoned property, or removal of a public nuisance."

A public service corporation is a public utility, gas, electric, telephone, or cable communications company, and other listed utilities, and also a municipality or public corporation when operating an airport, a common carrier, a watershed district, or a drainage authority, and an entity operating a regional distribution center within an international economic development zone.

Abandoned property is property that has not been legally occupied or used for any commercial or residential purpose for at least one year, that has not been maintained, and for which taxes have not been paid for at least two years.

Blighted area means an area that is in urban use and where more than 50 percent of the buildings are structurally substandard. A building is structurally substandard if it was inspected and cited for code violations that have not been fixed after two notices and for which it would cost more than 50 percent of the taxable market value of the building to fix.

An area is *environmentally contaminated* if more than 50 percent of the parcels are contaminated and for which the estimated costs of investigation, monitoring, testing, and clean-up are more than the estimated market value of the parcel, or a court has issued a clean-up order and the owner has not complied within a reasonable time.

A *public nuisance* for eminent domain purposes arises by an intentional act or failure to perform a legal duty that: (1) maintains or permits a condition that unreasonably annoys, injures, or endangers the safety, health, morals, comfort, or repose of any considerable number of members of the public; (2) interferes with, obstructs, or renders dangerous for passage, any public highway or right of way, or waters used by the public; or (3) is declared by law to be a public nuisance and for which no sentence is specifically provided.

The new law trumps other existing provisions in statute that conflict with it. The new law does not expressly repeal conflicting provisions in statute that authorize takings for economic development alone or that do not impose the same standards for determining blight or contamination. However, the new law expressly preempts any charter provision, ordinance, statute, or special law. Under the statutes governing statutory interpretation, a general provision enacted at a later session trumps previously enacted provisions. In addition, "when the provisions of two or more laws passed at different sessions of the legislature are irreconcilable, the law latest in date of final enactment shall prevail." Minn. Stat. § 645.26, subds. 1, 4.

There are exceptions for Tax Increment Financing (TIF) projects. The new definition of public use or public purpose does not apply to eminent domain actions for qualifying TIF projects and abatements. For information on what constitutes a qualifying TIF project or abatement, see Laws 2006, chapter 214, section 22.

***Other states have enacted eminent domain legislation in response to the* Kelo *decision*.** As of July 2006, at least 27 other states had enacted legislation to limit the use of eminent domain.

For more information: Contact legislative analyst Deborah Dyson at 651-296-8291. See also the House Research publications *Eminent Domain: Just Compensation*, August 2006, and *Eminent Domain: Regulatory Takings*, August 2006.

HOUSE RESEARCH | **Short Subjects**

Lynn Aves

Updated: August 2006

Child Support: Basic Questions

When is child support ordered?

If a married couple with minor children are divorced or obtain a legal separation, a court must order one or both parents to pay child support. If a child's parents are not married, generally paternity must be established before a court will order child support. Paternity can be established by court order or by the parents voluntarily executing a document called the Recognition of Parentage.

What does child support include?

Child support includes, at a minimum, basic support, which is an amount intended to feed, clothe, and shelter the child; medical support; and work- or education-related child care costs. Child support also may include support arrears or reimbursement of public assistance payments made on behalf of the child.

Who pays child support, and who receives it?

"Obligor" is the legal term for the parent who pays money to the other parent or anyone else for the child's support. "Obligee" is the parent or other individual or entity who receives money on behalf of a child. Usually the obligee is the parent with whom the child lives, and the obligor is the other parent. But sometimes parents have joint custody, each parent has custody of one or more of the couple's children, or the child is not in either parent's custody.

How is the child support amount calculated?

For actions or motions filed after January 1, 2007, the basic support obligation will be calculated based on the gross income of both parents. Gross income includes any form of periodic payment. Excluded from gross income are child support payments received by a party, public assistance, and in specific circumstances, overtime pay. Gross income does not include the income of an obligee's or obligor's spouse.

A deduction from gross income is allowed when a nonjoint child resides in a parent's household, and the parent is not obligated to pay child support. The resulting amount is the parental income for child support.

After each party's parental income for child support is determined, the amounts are combined. The court must compare the total to the child support guidelines in statute. Each parent is responsible for the percentage of the basic support obligation represented by his or her percentage share of the combined parental income for child support. The obligor is allowed a parenting expense adjustment, based on the percentage of parenting time granted by the court.

After determining the support amount under the statutory guidelines, the court must consider several statutory criteria that allow it to depart from the guidelines amount. These criteria include the parents' earnings, income, resources, and debts, the child's needs, the child's living standard before the dissolution, and which parent receives the dependent income tax exemption. The court may reduce support payments for a low-income obligor.

Support orders entered prior to January 1, 2007, cannot be modified using the new guidelines until January 1, 2008, except under specific circumstances.

What are the roles of federal, state, and local governments and the judiciary in setting child support?

Federal Government. Minnesota Statutes have long provided for child support in cases where parents divorce or have never married. In 1975 the federal government also became involved in this issue. Congress enacted laws aimed at establishing uniformity across states and setting minimum standards in state child support enforcement systems. The goal was to reduce the demand for public assistance by more effectively enforcing child support orders. The federal government provides funding to states with child support systems that meet certain federal requirements.

State Government. The legislature sets child support policy in Minnesota. State policy is greatly influenced by the federal requirements that are prerequisites to receiving federal welfare and child support funds. However, the federal requirements are often general in nature, leaving the details up to the legislature.

The Department of Human Services (DHS) is the primary executive branch agency responsible for overseeing Minnesota's child support system. The agency:

- provides training and assistance to the counties;
- operates Minnesota's centralized child support payment center;
- runs the statewide computer systems and maintains statewide data on child support;
- manages and disburses federal and state child support funding; and
- provides overall guidance for Minnesota's child support system.

Counties. Counties do a lot of the hands-on work in Minnesota's child support system. Counties deal directly with the families involved. Child support services are typically located within the county human services or social services department. The caseworkers that work on child support cases are called child support officers (CSOs). They work closely with the county attorney, who provides legal advice and represents the county (not the child or parents) in child support actions.

Judicial Branch. The judicial branch interprets and applies the child support laws in individual cases.

How is support enforced if payments are not made?

The state has several mechanisms in place to enforce child support, including parent locator services; the work reporting system; income withholding; occupational license sanction; driver's license suspension and motor vehicle title liens; recreational license suspension; civil judgments, real property liens, and liens against financial accounts; creditor's remedies; contempt of court; reports to credit agencies; intercepting tax refunds; denying passports; seek employment orders; and criminal charges.

For more information: Anyone affected by a child support order can call his or her county child support office or the automated DHS Child Support Help Line at 651-296-2542 or 1-800-657-3954. See also the DHS child support web site at www.dhs.state.mn.us/ECS/ChildSupport/Default.htm. See the House Research Department publication *Minnesota's Child Support Laws: An Overview* for more information about the law.

Lynn Aves

Updated: August 2006

State-Operated Services

What are State-Operated Services (SOS)?

State-Operated Services (SOS) are a variety of health care services administered by the Department of Human Services (DHS) serving people with mental illness (MI), developmental disabilities (DD), chemical dependency (CD), acquired brain injury, and people committed to the Commissioner of Human Services by the courts as mentally ill and dangerous (MI&D), sexual psychopathic personalities (SPP), and sexually dangerous persons (SDP). SOS provides services for clients at a variety of campus and community-based sites throughout the state. Services are organized under two categories of funding: "appropriated services" and "enterprise services."

What are SOS appropriated services?

SOS appropriated services are those the legislature finances through a state appropriation. Services include inpatient and community-based services for adults with mental illness and specialized treatment services for individuals committed to the Commissioner of Human Services.

SOS appropriated services provide:

- **Services for adult mental health.** SOS provides inpatient psychiatric services to adults at community-based behavioral hospitals located in Alexandria, Annandale, Baxter, Bemidji, Cold Spring, Fergus Falls, Rochester, St. Peter, and Wadena. In addition, services continue to be provided at regional treatment center (RTC) campuses in Anoka, Brainerd, Fergus Falls, and Willmar. These services are delivered in partnership with counties and community service providers.

- **Services for persons committed as Mentally Ill and Dangerous (MI&D).** SOS operates the Minnesota Security Hospital (MSH) in St. Peter, a 245-bed secure treatment facility, that provides multidisciplinary treatment for adults and adolescents admitted under judicial and other lawful orders for assessment and treatment of major mental disorders. MSH also operates a 58-bed transition program providing treatment to increase skills necessary for a safe return to the community. In addition, MSH operates a 50-bed forensic nursing facility for persons in need of nursing home care, and who are committed as mentally ill and dangerous, sexual psychopathic personalities, sexually dangerous persons, or who are on medical release from the Department of Corrections.

- **Services for persons committed as a Sexual Psychopathic Personality or Sexually Dangerous Person.** SOS operates the Minnesota Sex Offender Program (MSOP) with 218 beds in St. Peter and 150 beds in Moose Lake. The majority of persons are civilly committed to the program after completing a criminal sentence in the Department of Corrections. Services are in the process of being transitioned from the St. Peter campus to a new facility on the Moose Lake campus.

- **Services for adults committed as developmentally disabled who pose a risk to public safety.** SOS operates the Minnesota Extended Treatment Options (METO) in Cambridge, a 48-bed facility specializing in treatment to change client behavior and to identify support services that will permit clients to safely return to the community.

How are SOS appropriated services funded?

To assure the availability of services for clients in need, SOS appropriated services are funded prospectively through a general fund appropriation. DHS also seeks reimbursement for these services from Medicare, Medical Assistance, private insurance, clients' personal funds, and other revenue sources as available.

What are SOS enterprise services?

SOS enterprise services provide services to people with disabilities while operating in the marketplace with other providers. These services are funded solely through revenues collected from a variety of third-party payment sources.

Enterprise services provide the following:

- **Chemical Addiction Recovery Enterprise (CARE).** CARE provides inpatient and outpatient treatment to persons who are chemically dependent and abuse substances. CARE operates these programs in Anoka, Brainerd, Carlton, Fergus Falls, St. Peter, and Willmar.
- **Minnesota State-Operated Community Services (MSOCS).**
  - **Residential services for individuals with developmental disabilities or acquired brain injury.** MSOCS provides residential support services to people with disabilities in state-owned or state-leased homes, licensed foster care settings, or in the person's own home.
  - **Day training and habilitation (DT&H) services for individuals with developmental disabilities or acquired brain injury.** DT&H programs provide vocational support services to persons through a licensed work site or supported work site with job coaches.
- **Rehabilitation services for individuals with acquired brain injury.** Minnesota Neurorehabilitation Services (MNS) in Brainerd provides outreach and intensive rehabilitative services to individuals with acquired brain injuries who have challenging behaviors. MNS serves the entire state.
- **Child and Adolescent Behavioral Health Services (CABHS).** CABHS provides an array of services ranging from in-home crisis intervention to hospital-level care in Willmar and Brainerd.

How are SOS enterprise services funded?

SOS enterprise activities are funded solely through revenues collected from a variety of third-party payment sources, including private health insurance, Medical Assistance, counties, and other revenue sources available to clients.

For more information: Contact legislative analyst Lynn Aves at 651-296-8079.

Joel Michael

Updated: August 2006

Single Sales Apportionment of Corporate Franchise Tax

Apportionment is a key feature of corporate taxes

Apportionment formulas are important features of state corporate income taxes. They determine how much of a business's income is taxable and affect the incidence and competitiveness of the tax. Minnesota apportions income from sales, payroll, and property to determine corporate franchise tax.

Minnesota is phasing in single sales apportionment

In the 2005 legislative session, Minnesota began phasing in single sales apportionment under its corporate franchise tax; the phase-in will occur over eight years, starting in tax year 2007. Since tax year 2001, Minnesota has used a three-factor, weighted formula (75 percent sales, 12.5 percent payroll, and 12.5 percent property). The table to the right shows the phase-in schedule for the transition to single sales apportionment.

Tax year	Sales	Property	Payroll
2007	78%	11.0%	11.0%
2008	81%	9.5%	9.5%
2009	84%	8.0%	8.0%
2010	87%	6.5%	6.5%
2011	90%	5.0%	5.0%
2012	93%	3.5%	3.5%
2013	96%	2.0%	2.0%
2014	100%	0.0%	0.0%

Effects vary by type of business

The effects of adopting single sales apportionment vary by business. The crucial variables are the business's Minnesota apportionment factors:

- The taxes of businesses with all of their property, payroll, and sales in Minnesota will be unaffected.
- Minnesota businesses whose Minnesota sales factor is lower than the average of their Minnesota property and payroll factors will receive a tax cut. The larger the disparity, the bigger the benefit. A classic example would be a business that has most of its operations (headquarters, plants, and so forth) in Minnesota, but makes most of its sales outside of Minnesota.
- Businesses with higher Minnesota sales factors than their average Minnesota property and payroll factors will have tax increases. The classic example is a national consumer products company with few facilities in Minnesota.

Rationale for single sales apportionment: improve competitiveness

The principal rationale for single sales apportionment is an economic development argument: it makes Minnesota more competitive in attracting investment in plant and equipment. Sales are determined by the buyer's location. All other things being equal, increasing non-Minnesota sales will reduce the amount of Minnesota taxable income, since more income will be attributed to or apportioned outside of Minnesota. Thus, increasing the weight for the sales factor creates an incentive for companies to invest in Minnesota property or to hire more employees (or reduces the tax's disincentive to do so) to sell products outside of Minnesota. Empirical studies have found some support for the idea that single sales apportionment encourages in-state investment.

Policy concerns with single sales apportionment: equity and tax theory

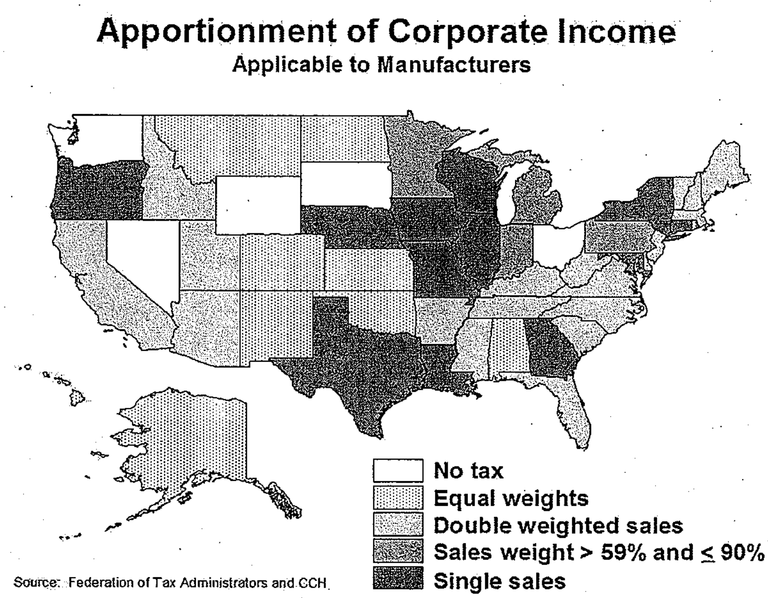
Opponents of single sales apportionment argue that it shifts the burden of the tax from capital (the property factor) to consumption, reducing the progressivity of the tax. Some also question as an empirical matter whether it has much of the desired effects on competitiveness. Tax theorists also argue that if the corporate tax is to be a benefits tax (i.e., based on the business's use of government services) or if it is to be based on production of income, apportionment should take into account where the business's property and employees are located. These factors are important contributors both to the production of income and the consumption of government services.

Cost is about $60 million per year

Adopting single sales apportionment will reduce overall state revenues. A March 2005 estimate by the Department of Revenue showed an annual tax reduction of about $50 million per year (based on the February 2005 forecast). Increases in the underlying corporate tax revenues since 2005 likely raise this cost by 20 percent or so, to about $60 million.

Trend in other states to heavier sales weighting

The U.S. Supreme Court upheld single sales apportionment in 1978. Since that decision, states have increasingly shifted their apportionment formulas to more heavily weighted sales. Effective for tax year 2008, 12 states are scheduled to use single sales as their apportionment formula for manufacturers. This is up from seven states for tax year 2005. Many of Minnesota's neighboring states use single sales apportionment: Illinois, Iowa, Missouri, Nebraska, and Wisconsin (effective tax year 2008). Michigan weights sales at 90 percent. The map below shows the apportionment formulas for manufacturers as of tax year 2008.



For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research publication *Apportionment of Corporate Franchise Tax* (March 2006).

HOUSE RESEARCH | Short Subjects

Lisa Larson and Kathy Novak September 2006

Comparing High School Graduation and College Admission Requirements

The quality and level of high school course work and instruction and their level of alignment with college admission requirements determine how well prepared high school graduates are to succeed in college. States are uniquely positioned to try to improve students' transition between high school and college by successfully aligning K-12 standards and post-secondary expectations, and thereby reducing college remediation rates and increasing college completion rates. Beginning in 2003, the Minnesota Legislature first adopted and then subsequently amended required and elective K-12 academic standards and coursework. The following table compares Minnesota's current and future high school graduation requirements and current admission requirements at the state's public colleges and universities.

Minnesota's Current and Future High School Graduation and Current College Admission Requirements

	K-12 Graduation Standards* for students beginning 9th grade in the 2004-2005 school year or later	K-12 Graduation Standards for students beginning 9th grade in the 2011-2012 school year or later	Four-year College Admission Requirements 2006-07
Language Arts	4 language arts credits	No additional requirements	4 years high school English, including ▸ writing ▸ literature
Mathematics	3 mathematics credits, including ▸ algebra ▸ geometry ▸ statistics and probability	Algebra I or equivalent by the end of 8th grade, and 3 mathematics credits, including ▸ 1 geometry ▸ 1 statistics and probability, and ▸ 1 algebra II credit or equivalent	3 years high school math, including ▸ elementary algebra ▸ intermediate algebra ▸ geometry
Science	3 science credits, including ▸ 1 biology	3 science credits, including ▸ 1 biology and ▸ 1 chemistry or physics credit ▸ An agriculture science credit may fulfill the additional science requirement	3 years high school science, including: ▸ biological science ▸ physical science ▸ lab experience
Social Studies	3½ social studies credits, including ▸ U.S. history ▸ geography ▸ government and citizenship ▸ world history and economics, or 3 credits of social studies, including ▸ U.S. history ▸ geography ▸ government and citizenship ▸ world history ▸ ½ credit of economics taught by the social studies or business department	No additional requirements	3 years high school social studies, including ▸ geography ▸ U.S. history

	K-12 Graduation Standards* for students beginning 9th grade in the 2004-2005 school year or later	K-12 Graduation Standards for students beginning 9th grade in the 2011-2012 school year or later	Four-year College Admission Requirements 2006-07
Foreign Language	World languages is an elective standard	No additional requirements	2 years of a single second or world language
Arts	One arts credit	No additional requirements	1 year visual or performing arts, or 1 year world culture or fine arts
Elective standards	School districts must establish elective standards for: ▸ vocational and technical education ▸ health and physical education and ▸ world languages School districts must offer courses in all elective standards		No additional requirements

* School districts decide if students meet course credit requirements by (1) successfully completing an academic year of study or (2) demonstrating mastery of the applicable subject matter. Minn. Stat. § 120B.024. One high school credit is equivalent to a year of study for college admission requirements.

Revising academic standards and benchmarks

The Education Commissioner must revise required K-12 academic standards and related benchmarks in the 2006-2007 through 2010-2011 school years. The benchmarks (1) specify the knowledge and skills that students must have to satisfy the academic standards and (2) contain information used to develop graduation tests.

Postsecondary remedial and developmental education

Despite the apparent alignment of K-12 graduation and college admissions requirements, reports on recent high school graduates show that many entering students at Minnesota's public postsecondary institutions take remedial and developmental courses.

The percentage of students taking remedial courses varies by institution type, institution admission standards, and year of high school graduation. The percentage of students at the University of Minnesota taking remedial classes has declined from 15 percent for 1999 high school graduates to 8 percent for 2002 graduates. At four-year state universities in the Minnesota State Colleges and Universities system (MnSCU) the percentage of students taking remedial classes has increased from 21 percent for 1999 graduates to 29 percent for 2002 graduates. Two-year MnSCU colleges are open enrollment institutions with much higher rates of remedial and development course work (46 percent for 2002 high school graduates). (Source: *Getting Prepared: A 2005 Report on Recent High School Graduates Who Took Developmental/Remedial Courses*, Minnesota State Colleges and the University of Minnesota, August 2005, page 6.)

For more information: Contact legislative analysts Lisa Larson at 651-296-8036 or Kathy Novak at 651-296-9253. Also see the House Research publication *Minnesota's K-12 Academic Standards and Assessments*, August 2006.

Nina Manzi and Lisa Larson

Updated: September 2006

The K-12 Education Deduction and Credit: An Overview

What is the K-12 deduction?

A state income tax deduction is allowed for K-12 education-related expenses. The deduction is for up to $2,500 for each dependent in grades 7-12, and up to $1,625 for each dependent in grades K-6.

What expenses qualify for the deduction?

Qualifying expenses include the following:

- Tuition, including nonpublic school, after-school enrichment, academic summer camps, music lessons, and tutoring
- Textbooks, including instructional materials and supplies, musical instrument rental and purchase, and up to $200 of computer hardware and educational software
- Transportation (paid to others for transporting children to school)

What is the tax benefit of the deduction?

A deduction reduces an individual's taxable income. The tax benefit depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has three marginal tax rates: 5.35 percent, 7.05 percent, and 7.85 percent. A taxpayer in the 5.35 percent bracket who claims a $2,500 deduction will pay $133.75 less in state income taxes (5.35% x $2,500). A taxpayer in the 7.85 percent bracket with the same deduction will pay $196.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. In tax year 2007, a typical married couple with two dependents would need to have $24,200 of gross income before owing any state income tax.

How many people claim the deduction, and how much does it cost?

In tax year 2007 (fiscal year 2008), an estimated 225,000 returns will claim the deduction at a cost to the state of $16.0 million.

What is the K-12 education credit?

A state income tax credit is allowed for 75 percent of K-12 education-related expenses. The credit is for up to $1,000 for each child in grades K-12, with parents allowed to allocate expenses among children as they choose. The credit is subject to an income-based phaseout. It begins to phase out when income exceeds $33,500. For families claiming the credit for one or two children, it is fully phased out when income reaches $37,500. The phaseout extends for an additional $2,000 of income for each additional child claimed (i.e., to $39,500 for three children, $41,500 for four children, etc.).

What expenses qualify for the credit?

The same expenses qualify for the credit as for the deduction, except nonpublic school tuition does not qualify for the credit.

What is the tax effect of the credit?

The K-12 credit directly reduces tax liability and is fully refundable. If an individual's credit exceeds his or her liability, the excess is paid as a refund.

Can parents obtain loans to pay for educational services that qualify for the credit?

Parents may assign payment of the credit to participating financial institutions and tax-exempt foundations. In exchange, parents receive a loan that is paid directly to a third-party provider of educational services and programs. This allows very low-income families to purchase educational products and services in anticipation of receiving a credit when they file their tax return the following year, with the credit paid directly to the financial institution or foundation that accepted the assignment.

How many people claim the credit, and how much does it cost?

In tax year 2004, 58,593 Minnesotans claimed a total of $15.0 million in K-12 education credits. The average credit was $256.

How do taxpayers claim the deduction and credit?

Taxpayers claim the deduction on form M-1, the Minnesota income tax return. Taxpayers claiming the credit must complete form M1ED and attach it to their state tax return.

Have the deduction and credit been challenged in court?

The constitutionality of the dependent education expense deduction was challenged in *Mueller v. Allen* in 1983. The U.S. Supreme Court upheld the statute authorizing the deduction in a 5-4 decision. The Court found that the deduction did the following:

- Offset parents' educational expenses and helped ensure an educated populace
- Helped ensure the financial health of nonpublic schools and relieved the financial burden on public schools
- Promoted "wholesome competition" between public and nonpublic schools and provided a high-quality education for all children

Minnesota's current K-12 education credit has not been subject to legal challenge.

What do other states provide in terms of income tax credits for education-related expenses?

To date, five states in addition to Minnesota provide income tax credits for education-related expenses: Arizona, Florida, Illinois, Iowa, and Pennsylvania (Puerto Rico provides a credit similar to those allowed in Arizona, Florida, and Pennsylvania.). **Arizona and Florida** give individual and corporate taxpayers tax credits for contributions to nonprofit school tuition organizations that operate like charities; **Iowa** will allow a similar credit beginning in 2006 but only for individual filers; **Pennsylvania** allows a corporate credit for contributions to both nonprofit scholarship funding organizations and innovative public school programs. **Arizona** also allows credits for individuals who pay extracurricular public school fees, and who contribute to character education programs at public schools. **Illinois** gives taxpayers a nonrefundable tax credit for qualified education expenses. **Iowa** gives taxpayers a tax credit for tuition, secular textbooks, and extracurricular activities for children attending accredited not-for-profit K-12 schools. Courts in Arizona, Illinois, and Iowa have upheld the permissibility of these education credits.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Lisa Larson at 651-296-8036. Also see the House Research publication *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2006.

Joel Michael

Updated: September 2006

State Estate and Inheritance Taxes After the 2001 Federal Estate Tax Changes

The 2001 federal tax act or EGTRRA eliminated the ability of states to impose pure "pickup" estate taxes that are borne by the federal treasury

From 1924 through 2001, the federal estate tax allowed a dollar-for-dollar credit for state death taxes paid (up to maximum limits). All states imposed estate taxes up to the amount of the federal credit; some states also imposed additional inheritance or estate taxes. In 2001, 38 states, including Minnesota, imposed pickup estate taxes as their only form of a death tax.

The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA) repealed the federal credit for state death taxes in three steps. *See box at the right.* States now can no longer impose estate taxes that do not increase total taxes. EGTRRA also increased the exemption amounts and reduced tax rates.

Phaseout of State Death Tax Credit Under EGTRRA

Calendar Year	% allowed
2002	75%
2003	50%
2004	25%
2005 – 2010	No credit

Minnesota opted to continue imposing an estate tax equal to the credit under pre-EGTRRA federal law. This short subject summarizes the status of state inheritance and estate taxes in other states as of September 2006.

Twenty-six states no longer impose estate or inheritance taxes

For decedents dying in calendar year 2006, 26 states no long impose an estate or inheritance tax. Most of these states imposed only a pickup tax before EGTRRA and allowed their taxes to expire (AL, AK, CA, CO, DE, FL, GA, HA, ID, MI, MS, MO, MT, NV, ND, NM, TX, UT, WV, and WY) and/or acted to eliminate them (AR, AZ, SC, and SD). Two states with inheritance taxes (beyond a pickup tax) either repealed the tax (NH) or allowed it to expire as previous scheduled (LA), as well as allowing their pickup taxes to expire.

Taxes in six more states are set to expire after 2006

Four states have enacted legislation that repeals their taxes (VA as of July 1, 2007, WI as of Jan. 1, 2008; KS and OK as of Jan. 1, 2010). Taxes in two states (IL and VT) will expire if the federal estate tax is repealed, as scheduled in 2010, and the state does not change its law. Washington state voters will decide at the November 2006 general election whether to repeal the Washington estate tax.

Five states impose only inheritance taxes

Five states (IN, IA, KY, PA, and TN) now impose only inheritance taxes; these states allowed their pickup estate taxes to expire with EGTRRA's repeal of the federal credit. Two of these states (IA and KY) impose no tax on bequests to surviving spouses or lineal heirs (children, grandchildren, parents, and so forth).

Sixteen states and the District of Columbia impose only estate taxes in 2006

Sixteen states impose only an estate tax. Twelve of these taxes are calculated based on the repealed federal credit under some version of the federal law (DC, IL, MA, ME, MN, NY, NC, OR, RI, VT, VA, and WI). The exemption amounts range from $675,000 (based on the federal tax and credit in effect in 2001: RI and WI) to $2 million (pre-EGTRRA credit and current federal exemption: IL, NC, VT, and VA). The other states, like Minnesota, have a $1 million exemption. Five states have separate estate taxes with their own exemption amounts and tax rate schedules (CT, KS starting in 2007, OH, OK starting in 2007, and WA). Exemptions under these stand alone taxes range from $338,333 (OH) to $2 million (CT and WA). As noted above, the Kansas, Oklahoma, Virginia, and Wisconsin taxes have been prospectively repealed.

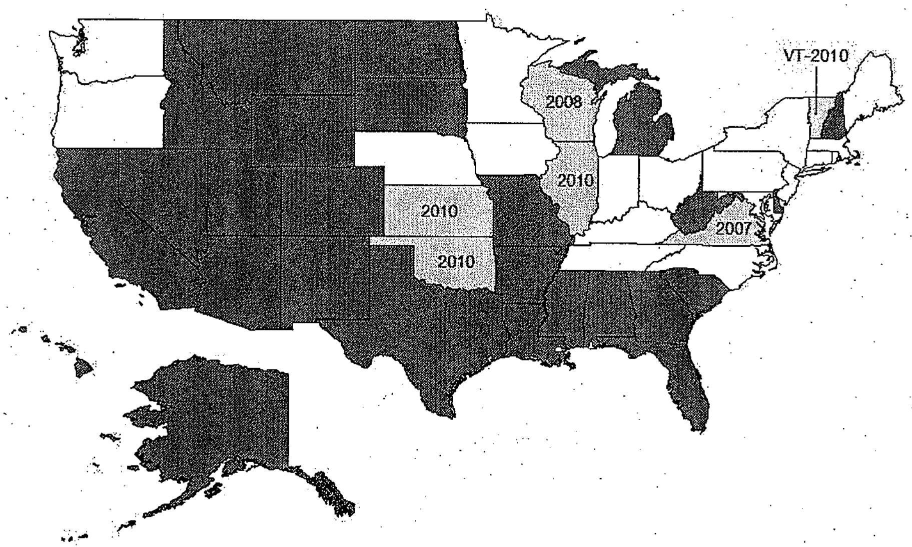
Three states impose both estate and inheritance taxes

Three states (MD, NE, and NJ) have both estate and inheritance taxes. The Maryland and New Jersey inheritance taxes have unlimited exemptions for lineal heirs (children, grandchildren, parents, and so forth). The Nebraska estate tax is a stand-alone tax with a $1 million exemption and its own rate schedule. New Jersey's estate tax exemption is $675,000, and Maryland's is $1 million. Inheritance tax paid is a credit against the estate taxes.

The map shows the states without an estate or inheritance tax.

States Without Estate or Inheritance Taxes

(2006 unless otherwise noted)



For more information: Contact legislative analyst Joel Michael at joel.michael@house.mn. Also see the House Research publications *The Minnesota Estate Tax after the 2001 Federal Tax Act*, January 2003, and *State Responses to 2001 Federal Estate Tax Changes*, February 2004.

Colbey Sullivan **Updated: September 2006**

The Ethanol Industry In Minnesota

Ethanol—an alcohol commonly produced by the fermentation of starches—can be blended with gasoline as a fuel extender and oxygenate. Examples of ethanol-gasoline blends include E10 (10 percent ethanol, 90 percent gasoline) and E85 (85 percent ethanol, 15 percent gasoline). For more than two decades, Minnesota lawmakers have actively encouraged the development of a sizeable state ethanol industry. Due in large part to policy and financial support at state and federal levels, Minnesota ethanol production has increased significantly—up from less than one million gallons in 1987 to a projected 550 million gallons by the end of 2006.

Federal fuel tax credit for ethanol

People who blend ethanol with gasoline are eligible for a refundable credit against their federal fuel tax liability. The credit is 51 cents per gallon of ethanol blended. In 2004, this Volumetric Ethanol Excise Tax Credit replaced a partial fuel tax exemption for ethanol blends. As ethanol usage grew, the exemption left a sizeable hole in the federal highway trust fund. To address this problem, Congress dropped the partial exemption and replaced it with a tax credit deducted from the general fund.

Duties on imported ethanol

Since 1980, the federal government has imposed two tariffs on ethanol imports. In general, there is a 2.5 percent ad valorem (i.e., percent of value) tax and a 54-cent per gallon secondary tariff.

Blender's tax credit

Enacted in 1980 and phased out completely by 1997, the tax credit for agricultural alcohol gasoline (more commonly referred to as the "blender's credit") reduced state fuel tax liability for blenders mixing ethanol and gasoline in Minnesota. Similar to its federal counterpart, the blender's credit reduced funding for transportation. In addition, it had little effect on the level of in-state ethanol production. A similar provision in 1983 that reduced the tax on ethanol-blended fuel used in government vehicles and school buses was repealed in 1998.

Producer payments

When the blender's credit failed to spawn a sizeable state ethanol industry, lawmakers reworked the subsidy. In 1986, the legislature created the ethanol development fund to directly pay owners of Minnesota ethanol plants per gallon of ethanol produced, subject to certain limitations. The payment amount has changed multiple times but has typically been 20 cents per gallon. For years 2004 through 2007, the payments were set at 13 cents per gallon, with a pledge to make up the remaining 7 cents per gallon as funds became available. The program is closed to new applicants.

Public education and ethanol promotion efforts

Each year from 1987 through 1998, the legislature appropriated funds (usually $100,000 per year) to the Department of Agriculture to educate the public about the benefits of ethanol and encourage the creation of farmer-owned plants.

Loans for start-up expenses and purchase of stock

A 1993 law created the Ethanol Production Facility Loan Program, providing up to $500,000 in direct loans to seven plants for assistance during the construction and early production phases. The program is closed to new applicants. A 1994 law authorized low-interest loans to farmers for up to 45 percent of the cost of shares of stock purchased in a value-added agricultural product processing facility. Investors in 13 of Minnesota's ethanol plants have utilized these loans.

Tax increment financing arrangements

A number of communities have used tax increment financing (TIF) to encourage construction of local ethanol plants. In the early 1990s, the legislature enacted laws that made it easier to use TIF for ethanol projects.

Economic development support

Three plants have received low-interest loans via the Minnesota Investment Fund, an economic development program designed to add and retain high-quality jobs. Another four received grants from its predecessor, the Economic Recovery Grants Program.

Job Opportunity Building Zones (JOBZ)

JOBZ provides local and state tax exemptions to new or expanding businesses that locate in designated areas of Greater Minnesota. Four ethanol plants have signed JOBZ agreements since the program began in January 2004. A 2006 law extended tax incentive eligibility from the standard 12 to 15 years for ethanol plants enrolled between April 30, 2006, and July 1, 2007.

Oxygenate mandate

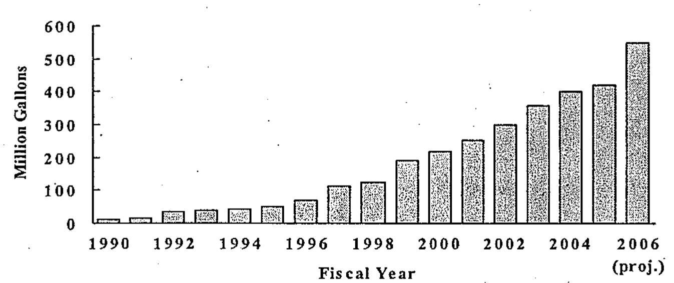
Today, almost all of the gasoline sold in the state is blended with 10 percent ethanol (E10). The law was passed in 1991 and became effective statewide in November 1997. This move followed a U.S. Environmental Protection Agency directive requiring the use of oxygenated gasoline in the Twin Cities during winter months to curb carbon monoxide emissions. A 1996 law exempted gasoline used for motor sports racing, airports, marinas, motorcycles, off-road vehicles, small engines, and collector vehicles.

In 2005 the legislature went a step further, passing a law that will enact an E20 mandate in 2013 unless at least 20 percent of the liquid fuel sold in the state is already derived from renewables by the end of 2010 or state officials have failed to obtain federal approval for the use of E20 as a motor fuel.

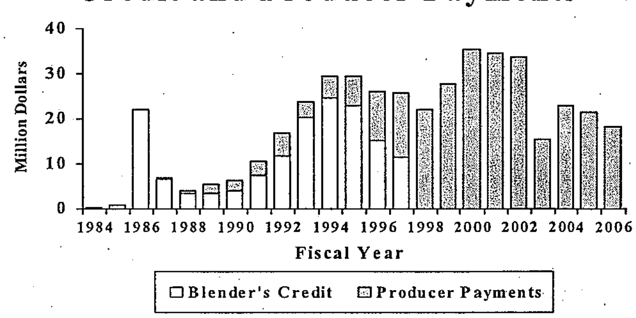
E85 promotion

As of 1995, the fuel tax on E85 is 14.2 cents per gallon; E10 and pure gasoline are taxed at 20 cents per gallon. Beginning in 2002, state agencies were directed to cut gasoline consumption, purchase vehicles capable of burning cleaner fuels like E85, and instruct employees to purchase cleaner fuels whenever reasonably available. A 2005 law approved $500,000 in grants to partially reimburse service station owners who install E85 dispensing pumps. Another 2005 law required auto dealers to provide written notice to consumers that new flexible fuel vehicles can run on E85.

Ethanol Production in Minnesota



Cost of Minnesota's Blender's Credit and Producer Payments



For more information: Contact legislative analyst Colbey Sullivan at 651-296-5047.

HOUSE RESEARCH | **Short Subjects**

Kathy Novak and Nina Manzi

September 2006

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of finance must prepare a forecast of state revenues and expenditures twice each year—in February and November.

What are the forecasts used for?

The November forecast in even-numbered years becomes the basis for the governor's budget recommendations to the legislature. The November 2006 forecast provides the revenue and expenditure projections that the governor will use in developing the budget for the fiscal year 2008-2009 biennium. The November 2006 forecast also tells if the state is on track to finish the fiscal year 2006-2007 biennium with a balanced budget.

The February forecast in odd-numbered years fine-tunes the preceding November's forecast with data that becomes available early in the calendar year. The February 2007 forecast provides the revenue and expenditure projections that the legislature will use in adopting a budget for the fiscal year 2008-2009 biennium. Following the February forecast the governor may submit modifications to the budget developed from the November forecast, which are called "supplemental budget recommendations." The February 2007 forecast also provides an update on the status of revenues and expenditures in the current biennium.

The November forecast in odd-numbered years and the February forecast in even-numbered years also provide updates on revenues and expenditures in the current biennium. Using the projections of the November 2007 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2008-2009 budget during the 2008 legislative session. The legislature will use the projections in the February 2008 forecast to ensure that the fiscal year 2008-2009 biennium closes with a balanced budget.

What if a forecast shows a budget shortfall?

If a forecast shows a shortfall for the *general fund in the current biennium*, the commissioner of finance may reduce the budget reserve account as needed to balance revenues with expenditures. If there isn't enough money in the budget reserve to balance the general fund in the current biennium, the commissioner may also reduce outstanding appropriations, commonly referred to as "unalloting." Before reducing the budget reserve or unalloting appropriations, the commissioner must obtain the approval of the governor and must consult with the Legislative Advisory Commission. When the legislature is in session, the governor typically makes recommendations to the legislature on how to resolve the shortfall before approving use of the budget reserve or unalloting.

If a forecast shows a shortfall for *any other fund in the current biennium*, the commissioner of finance must reduce the affected agency's allotment to avoid a deficit. As with general fund shortfalls, if the legislature is in session the governor would typically make recommendations on how to resolve the shortfall.

If a forecast shows a shortfall for *the coming biennium*, the governor's budget recommendations must propose revenues and expenditures changes in order for the budget at the close of the coming biennium to be in balance.

What if the forecast shows a budget surplus?

If a forecast shows a surplus for the *general fund in the current biennium*, the commissioner of finance must allocate the surplus in priority order as follows:

- to the cash flow account, until it reaches $350 million
- to the budget reserve account, until it reaches $653 million
- to increase the school aid payment schedule to 90 percent
- to restore previous school aid reductions and reduce the property tax recognition shift accordingly

If, as became the case following the February 2006 forecast, all these priorities have been met, the remaining surplus is called a "positive unrestricted budgetary general fund balance."

If the *November forecast in an even-numbered year*, or the *February forecast in an odd-numbered year*, projects a positive unrestricted budgetary general fund balance at the close of the *current biennium* greater than one-half of 1 percent of total general fund revenues for the biennium, the commissioner must designate the entire balance as available for rebate. The commissioner excludes general fund carryforward amounts in calculating the one-half of 1 percent threshold amount. The threshold amount and whether or not there is a balance available for rebate is calculated as part of both the November 2006 forecast and the February 2007 forecast; as of the February 2006 forecast, the balance that triggers a rebate designation is about $157 million.

If the projected surplus is less than one-half of 1 percent of total general fund revenues, the commissioner reports it in the forecast as an unrestricted budgetary general fund balance. If a biennium closes with a positive unrestricted general fund balance, the commissioner must transfer that amount to the tax relief account on the last day of the biennium.

If a forecast shows a surplus for *the coming biennium*, the governor's budget recommendations may propose revenue reductions and/or expenditure increases, as long as the proposed changes do not result in a projected budget shortfall.

What happens when a forecast shows an amount "available for rebate"?

If the commissioner designates an amount as "available for rebate," the governor must present a plan to the legislature for rebating the amount designated to the taxpayers. The plan must provide for payments to begin no later than August 15. The legislature must enact, modify, or reject the plan by April 15. For example, if the November 2006 forecast shows a positive unrestricted budgetary general fund balance greater than one-half of 1 percent of total general fund revenues, the governor must present a plan for rebate to the legislature during the 2007 session, providing for payments to begin by August 15, 2007. The legislature would have until April 15, 2007, to enact, modify, or reject the plan.

For more information: Contact legislative analyst Kathy Novak at 651-296-9253 or Nina Manzi at 651-296-5204. Also see the House Research publication *Unallotment*, March 2002.

HOUSE RESEARCH | Short Subjects

Deborah K. McKnight

Updated: October 2006

Gift Ban Law and Rules for House Members

What does the gift ban law prohibit?

Public officials must not request or accept a gift from a lobbyist or principal, and lobbyists and principals must not give a gift to a public official or ask someone else to do so. Legislators are public officials under this law. Family members are not subject to the ban.

Who are lobbyists and principals?

A "lobbyist" is an individual registered with the board to lobby Minnesota state government. A "principal" is an entity that hires lobbyists and is registered with the Campaign Finance and Public Disclosure Board. Registered lobbyists and principals are listed on the board's web site at www.cfboard.state.mn.us. If an individual or entity is not listed on the web site, a member may call the board at 651-296-5148 to see if the web site is current. Members may rely on the information provided by board staff on the issue of who is a lobbyist or principal. Examples of people who are not lobbyists include members of the media, local government officials, state employees, and representatives of foreign governments touring the Capitol.

What is the penalty for a violation?

There is no criminal penalty or civil fine. The board, which administers the law, takes the position that if possible, it will make a recipient return or pay for an improper gift. This has happened once. The practical effect of violating the law is that it would be embarrassing.

What is a gift?

A gift is something received without giving equal or greater value in return. If the House pays to send a member to a conference sponsored by a principal, the conference is not a gift from the principal. The event was paid for. By express terms or board advisory opinions "gift" includes the following:

- a job offer made as a bribe
- discounts, loans, privileges, or access made available to legislators but not to the general public
- paying off a debt for a legislator
- honoraria
- travel expenses or lodging for a meeting
- donations to a legal defense fund to benefit public officials generally
- donations to a retirement party held for a public official who is in office or has taken a new office
- a contribution to a charity made at the request of a public official

The following are excluded from the gift ban by the statute or by board opinions:

- campaign contributions
- services to assist in performing official duties
- services of insignificant monetary value
- plaques or mementos recognizing services in a field of specialty or charitable cause
- trinkets or mementos costing $5 or less
- informational material of unexceptional value
- food and drink when asked to speak or answer questions at a program (eating lunch free when speaking at a legislative update program sponsored by a principal; not eating lunch free when touring a business that hires lobbyists). An advisory opinion lets a covered individual attend a party paid for by a principal if the individual (1) reimburses the principal for his or her fair share of the cost of the party; or (2) contributes to the party an item or items that equal or exceed the individual's share of the cost of the party.
- a gift received because of membership in a group, a majority of whom are not public officials, and everyone in the group gets a similar gift (a member may accept a gift from his or her spouse's employer that is a principal if the employer gives all spouses an annual gift and a majority of those spouses are not public officials)
- a gift from a lobbyist or principal who is a relative, unless the gift is given on behalf of someone outside the family
- referral of legal matters between attorneys
- a job offer in the normal course of career changes

What House rules apply to gifts?

House Rule 9.20 prohibits a member from accepting an honorarium (other than expense reimbursement) for services performed for an individual or organization with a direct interest in the business of the House, including, but not limited to, lobbyists and principals. The rule specifies that violations must be referred to the Ethics Committee. House Rule 9.21 prohibits members from accepting travel or lodging from a business, union, lobbyist, association of lobbyists, or a foreign government. Both rules are stricter than the statute in restricting what members may accept.

For more information: Contact legislative analyst Deborah K. McKnight at 651-296-5056.

Joel Michael

Updated: October 2006

Tax Increment Financing

What is TIF?

Tax increment financing (TIF) uses the increased property taxes that a new real estate development generates to finance costs of the development. In Minnesota, TIF is used for two basic purposes:

- To induce or cause a development or redevelopment that otherwise would not occur—e.g., to convince a developer to build an office building, retail, industrial, or housing development that otherwise would not be constructed. To do so, the increased property taxes are used to pay for costs (e.g., land acquisition or site preparation) that the developer would normally pay.
- To finance public infrastructure (streets, sewer, water, or parking facilities) that are related to the development. In some cases, the developer would be required to pay for this infrastructure through special assessments or other charges. In other cases, all taxpayers would pay through general city taxes.

How does TIF work?

When a new TIF district is created, the county auditor certifies (1) the current net tax capacity (i.e., property tax base) of the TIF district and (2) the local property tax rates. As the net tax capacity of the district increases, the property taxes (i.e., the "tax increment") paid by this increase in value is dedicated and paid to the development authority. The tax increment is limited to the tax derived from the certified tax rate. Increases in value that generate increment may be caused by construction of the development or by general inflation in property values. The authority uses the increment to pay qualifying costs (e.g., land acquisition, site preparation, and public infrastructure) that it has incurred for the TIF project.

How is TIF used to pay "upfront" development costs?

There is a mismatch between when most TIF costs must be paid—at beginning of a development—and when increments are received—after the development is built and begins paying higher property taxes. Three basic financing techniques are used to finance these upfront costs:

- **Bonds.** The authority may issue its bonds to pay these upfront costs and use increment to pay the bonds back. Often, extra bonds are issued to pay interest on the bonds ("capitalizing" interest) until increments begin to be received.
- **Interfund loans.** In some cases, the authority may advance money from its own funds (e.g., a development fund or sewer and water fund) and use the increments to reimburse the fund.
- **Pay-as-you-go financing.** The developer may pay the costs with its own funds. The increments, then, are used to reimburse the developer for these costs. This type of developer financing is often called "pay-as-you-go" or "pay-go" financing.

What governmental units can use TIF?

Minnesota authorizes development authorities to use TIF. These authorities are primarily housing and redevelopment authorities (HRAs), economic development authorities (EDAs), port authorities, and cities. In addition, the "municipality" (usually the city) in which the district is located must approve the TIF plan and some key TIF decisions. TIF uses the property taxes imposed by all types of local governments. But the school district and county, the two other major entities imposing property taxes, are generally limited to providing comments to the development authority and city on proposed uses of TIF. The state-imposed tax on commercial-industrial and seasonal-recreational properties is not captured by TIF.

What is the but-for test?

Before an authority may create a TIF district, it and the city must make "but-for" findings that (1) the development would not occur without TIF assistance and (2) that the market value of the TIF development will be higher (after subtracting the value of the TIF assistance) than what would occur on the site, if TIF were not used.

What types of TIF districts may be created?

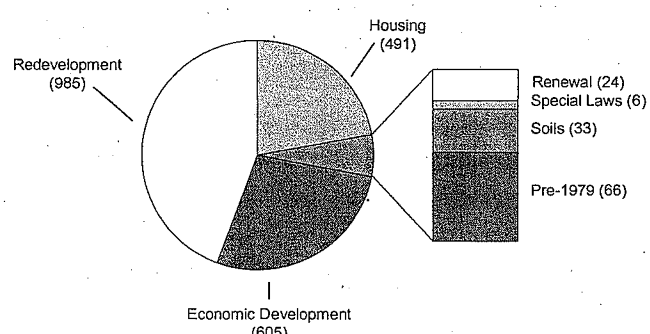
Minnesota allows several different types of TIF districts. The legal restrictions on how long increments may be collected, the sites that qualify, and the purposes for which increments may be used for vary with the type of district.

District type	Use of Increment	Maximum duration
Redevelopment	Redevelop blighted areas	25 years
Renewal and renovation	Redevelop areas with obsolete uses, not meeting blight test	15 years
Economic development	Encourage manufacturing and other footloose industries	8 years
Housing	Assist low and moderate income housing	25 years
Soils	Clean up contaminated sites	20 years

There were over 2,000 active TIF districts in 2004

According to the 2005 report of the Office of State Auditor, there were 2,210 active TIF districts in 2004. The graph shows the relative shares by type of district.

TIF Districts by Type in 2004
(2,210 districts)



Source: 2005 Report of the State Auditor

For more information: Contact legislative analyst Joel Michael at 651-296-5057. Also see the House Research web site for more information on TIF at www.house.mn/hrd/issinfo/tifmain.htm.

HOUSE RESEARCH | Short Subjects

Joel Michael and Karen Baker

Updated: October 2006

Property Tax Abatements for Economic Development

What is economic development property tax abatement?

Minnesota law authorizes political subdivisions to grant property tax abatements for economic development, e.g., to encourage a business to locate or expand at a location or to redevelop an area. Minn. Stat. §§ 469.1813-469.1815. Abatements may be either permanent forgiveness or temporary deferral of property tax. Abatements can serve similar purposes to tax increment financing (TIF), a widely used development tool. The legislature enacted the abatement law in 1997 to provide an alternative to TIF and to supplement it.

These economic development tax abatements should be distinguished from property tax abatements that are granted by the county board primarily to correct errors (e.g., to reduce the assessor's market value or to change the classification). Minn. Stat. § 375.192.

For what purposes may abatements be used?

The law allows abatements to be used for a broad range of projects and purposes, if the political subdivision finds that public benefits exceed the costs. Permitted uses of abatements include the following:

- General economic development, such as increasing the tax base or the number of jobs in the area
- Construction of public facilities or infrastructure (e.g., streets and roads), but not for many government buildings (e.g., city halls or schools) or social and recreational facilities
- Redevelopment of blighted areas
- Providing access to services for residents (e.g., housing or retail would be common examples)
- Deferring or phasing in a large (over 50 percent) property tax increase
- Stabilize tax base resulting from the updated utility valuation administrative rules

Which local governments can grant abatements?

Counties, cities, towns, and school districts may grant abatements of the taxes they impose. The governing body grants an abatement by resolution. For towns, action at the town meeting is not required. Taxes imposed by special taxing districts (e.g., watersheds or regional agencies) cannot be abated. Similarly, the state general property tax (on commercial/industrial and seasonal-recreational properties) cannot be abated. In the Twin Cities metropolitan area and on the Iron Range, the fiscal disparities tax cannot be explicitly abated. However, a political subdivision may increase its abatement amount to reflect the amount of the tax imposed under fiscal disparities. The abatement does not directly enter into the fiscal disparities calculations.

How long does an abatement apply?

The political subdivision sets the length of the abatement. State law limits the duration to 15 years. The maximum term is extended to 20 years if only two of the three political subdivisions (city/town, county, and school district) grant an abatement.

How do the mechanics of abatement work?

The abatement resolution, approved by the political subdivision, specifies the duration and the amount of property taxes that will be abated. The political subdivision has considerable flexibility in setting the terms of the abatement; for example, it may set the abatement as a percentage of tax payable, a dollar amount, tax attributable to a portion of the parcel's market value, or in other ways. The local government adds the abatement to its property tax levy for the year. (The abatement levy is not subject to levy limits.) The owner pays property tax on a parcel and the political subdivision uses the payments as provided by the abatement resolution. For example, the abatement may be used to pay bonds or be given back to the property owner.

May abatements be used to pay bonds?

The abatement law authorizes the issuance of bonds to be paid back with the abatements. For example, bonds could be issued to construct public improvements or to pay for a site for a business. As the property owner pays the abated taxes, they are directed to pay off the bonds. These bonds can be general obligation bonds or revenue bonds. The abatement bond provisions parallel those in the TIF law: the abatement bonds are not subject to referendum approval and are excluded from debt limits.

How do abatements compare with TIF?

The legislature designed the abatement law to provide an alternative to and to supplement TIF. The two programs can be used for similar purposes and both rely upon property tax funding. Both programs have very similar bonding powers. However, abatement and TIF differ in many important respects. Some these differences include the following:

- TIF can be used for longer durations (up to 25 years in some cases) than abatements (typically 15 years)
- TIF requires approval only by the municipality (usually the city) to capture all local property taxes, while abatement requires each city/town, county, and school to approve to capture its taxes
- TIF use is subject to many more legal restrictions than abatement. These include a blight test for redevelopment districts, but-for findings, limits on what increments may be spent on, and so forth. Abatement is more flexible.

How widely has abatement been used?

The abatement law does not require reporting of abatements to the state. Property tax levy data reported to the Department of Revenue shows 50 cities provided abatements of $4.3 million of taxes for property taxes payable in 2006, and 21 counties provided $1.8 million in abatements. These amounts do not include abatements by cities with populations under 2,500 and by school districts.

For more information: Contact legislative analyst Joel Michael at 651-296-5057 or Karen Baker at 651-296-8959. Also see the House Research publication *Tax Increment Financing*, October 2006.

HOUSE RESEARCH | **Short Subjects**

Steve Hinze and Karen Baker

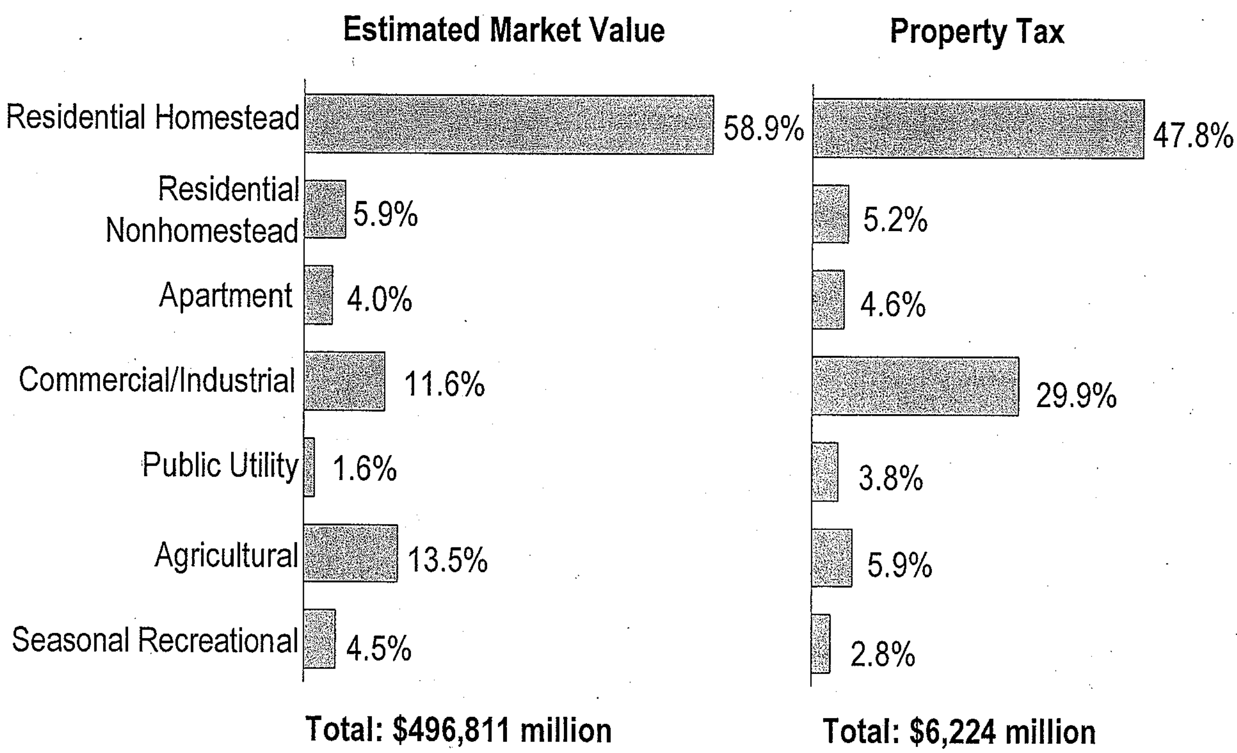
Updated: October 2006

Property Tax 101: Who Pays Property Taxes and Who Receives Them

Where property taxes come from

Total property taxes statewide were $6,224 million for calendar year 2006. The total amount of property value (excluding the value of exempt property) was $496,811 million. The graphs below show the breakdown of the state's total property tax base by market value and by taxes paid in 2006.

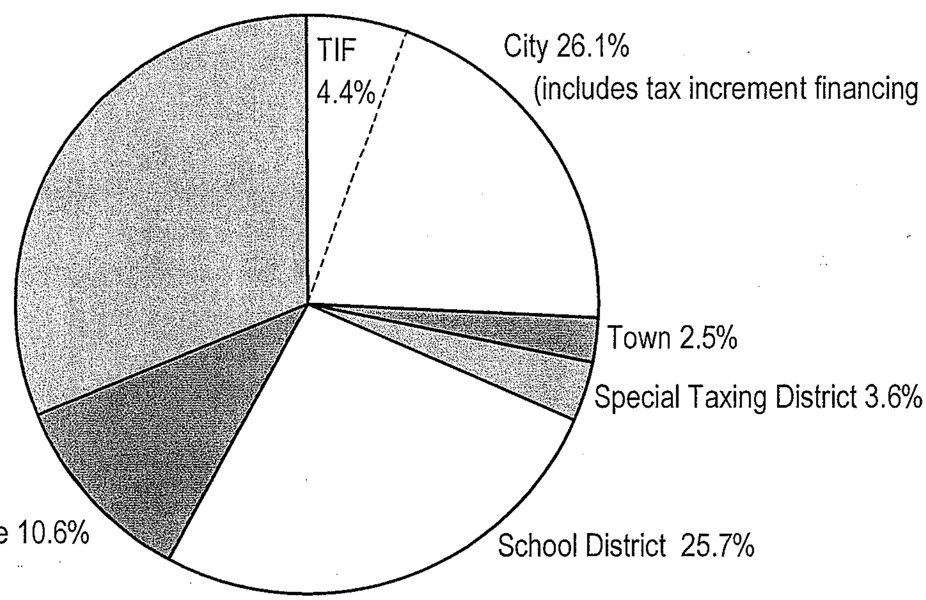
Statewide Shares of Market Value and Property Tax by Property Type (taxes payable 2006)



Where property taxes go

The total property tax burden in Minnesota was $6,224 million for calendar year 2006. The pie chart below shows the distribution of the tax among the various types of taxing jurisdictions.

Statewide Property Tax by Type of Government,*
Taxes Payable 2006
(Total: $6,224 million)



*Amounts shown are after allocation of property tax credits.

For more information: Contact legislative analyst Steve Hinze at 651-296-8956 or Karen Baker at 651-296-8959.

HOUSE RESEARCH | Short Subjects

Deborah A. Dyson
Revised: November 2006

"60-Day Rule"
Time Deadline for Agency Action

What is the "60-day rule"?

In 1995, the legislature enacted Minnesota Statutes, section 15.99, commonly referred to as "the 60-day rule." The 60-day rule requires governmental entities to approve or deny a written request for certain actions within 60 days or the request is approved.

More specifically, "failure of an agency to deny a request within 60 days is approval of the request. If an agency denies the request, it must state in writing the reasons for the denial at the time that it denies the request." Minn. Stat. § 15.99, subd. 2.

Who does it apply to?

The law applies to the following, all defined as "agencies" (Minn. Stat. § 15.99, subd. 1):

- a department, agency, board, commission, or other group in the executive branch of state government
- a statutory or home rule charter city, county, town, or school district
- any metropolitan agency or regional entity
- a watershed district or soil and water conservation district
- any other political subdivision of the state

What requests does it apply to?

It applies to "a written request relating to zoning, septic systems, watershed district review, soil and water conservation district review, or expansion of the metropolitan urban service area for a permit, license, or other governmental approval of an action." Minn. Stat. § 15.99, subd. 2.

A "request" is a written application on a form provided by the agency, if a form exists. A request not on an agency's form must include all information required by the agency and it must identify clearly on the first page the specific permit, license, or other governmental approval being sought.

Recently, the Minnesota Court of Appeals held that the rule does not apply to building permit requests. *Advantage Capital Mgmt. v. City of Northfield*, 664 N.W.2d 421 (Minn. App. 2003). The law does not apply to the subdivision regulation review process or the plat review process for requests made on or after June 1, 2003.

In an unpublished opinion (and therefore without precedential value), the Minnesota Court of Appeals determined that "other governmental action" did not apply to actions with a statewide effect, and therefore the 60-day rule did not apply. *In the matter of System Designation of Multi-Flo Wisconsin Aerobic Treatment Units*, CO-01-823, 2001 WL 1665410, 2001 Lexis 1425 (Minn. App., Dec. 21, 2001) (request for approval of a septic system as a standard under state agency rules).

When does the time begin to run?

The 60 days begins to run when the agency receives a complete application. The 60 days begins again upon receipt of a complete amended application. *Tollefson Dev. Co. v. City of Elk River*, 665 N.W.2d 554 (Minn. App. 2003). The application fee, if any, is one of the items that must be paid before an application is complete. The agency has 15 business days after receiving any part of an application to inform an applicant in writing that the application is missing some required element. Minn. Stat. § 15.99, subd. 3 (a). If more than one state agency in the executive branch must approve or deny the application, the 60 days begins to run when the first agency receives the complete application and it is up to that agency to make sure all other agencies get copies of the application. Minn. Stat. § 15.99, subd. 3 (b).

Are extensions allowed?

An agency may extend the review period by up to 60 days if it provides the applicant written notice of and reasons for the extension before the end of the initial 60 days. Minn. Stat. § 15.99, subd. (f). The notice of extension must be made after the complete application is submitted and the initial 60 days has begun to run. *American Tower, L.P. v. City of Grant*, 636 N.W.2d 309, 313 (Minn. 2001). An agency does not have to have extenuating circumstances to extend the review time; it is enough that the agency needs more time. *Id.* at 314.

The law also takes into account other proceedings or federal law requirements that may delay the beginning of the 60-day period. Minn. Stat. § 15.99, subd. 3 (d), (e).

An applicant may request an extension of time in writing.

What constitutes approval or denial of a request?

Approval. A request can be approved by the agency in its customary manner or by failing to deny the request within the 60-day period.

Denial by an agency with a multimember governing body. For requests made on or after June 1, 2003, a multimember governing body may deny a request by:

- adopting a resolution or motion to deny the request, or
- failing to adopt a resolution or motion to approve a request.

The governing body must provide its reason for denial on the record at the time of the vote on the resolution or motion. It must also provide a written statement of reasons for the denial to the applicant before the expiration of the time allowed for a decision. The written statement must be consistent with the reasons stated at the time of the decision.

Denial by other agencies. If an agency other than one with a multimember governing body denies a request, it must state in writing the reasons for the denial at the time it denies the request.

For more information: Contact legislative analyst Deborah A. Dyson at 651-296-8291.

Deborah A. Dyson

November 2006

Special Legislation and Local Approval

The Minnesota Constitution prohibits "special legislation" with the exception of certain special legislation relating to local governments.

Special legislation

Special legislation is legislation that applies to part of a class—a particular person, thing, or locale within a given class—and, in general, is prohibited under the state constitution. If a general law can be enacted, the legislature may not enact a special law, except a local law.

Whether a law is "special" is determined by the court on a case-by-case basis, applying general principles. In distinguishing permissible general legislation and unconstitutional special legislation, courts have said:

- A law is general when it is uniform in its operation even though it divides the subjects of its operation into classes and applies different rules to different classes;
- A law is special if it applies to particular members of a class.

In order to determine if a classification is justified and constitutional, courts have applied a three-part rational-basis test. A classification is proper if:

- the classification applies to and embraces all who are similarly situated;
- the distinctions are not manifestly arbitrary or fanciful but are genuine and substantial so as to provide a natural and reasonable basis justifying the distinction; and
- there is an evident connection between the distinctive needs peculiar to the class and the remedy or regulations in the law.

Prohibited special legislation

The Minnesota Constitution lists certain subjects that cannot be the subject of special legislation, whether they are local law or not:

- authorizing the laying out, opening, altering, vacating, or maintaining of roads, highways, streets, or alleys
- remitting fines, penalties, or forfeitures
- changing the names of persons, places, lakes, or rivers
- authorizing the adoption or legitimation of children
- changing the law of descent or succession
- conferring rights on minors
- declaring any named person of age
- giving effect to informal or invalid wills or deeds, or affecting the estates of minors or persons under disability
- granting divorces
- exempting property from taxation or regulating the rate of interest on money
- creating private corporations, or amending, renewing, or extending the charters thereof
- granting to any private corporation, association, or individual any special or exclusive privilege, immunity, or franchise whatever or authorizing public taxation for a private purpose

The constitution also prohibits special laws in the form of bills of attainder. A bill of attainder is special legislation that inflicts punishment or a penalty upon an individual.

Finally, the constitution requires taxes to be uniform on the same class of objects.

Legislative appropriations are not special legislation.

Local approval

As an exception to the prohibition on special legislation, the state constitution permits the legislature to enact special laws relating to local government units. A local law is effective only after approval by the affected local government unit, unless the general state law provides otherwise.

State statute requires approval by resolution adopted by a majority vote of all members of the governing body of the unit unless the particular special law specifies another method of approval. The chief clerical officer of a local government unit then files a certificate of local approval with the Secretary of State, including a copy of the resolution of approval or, if submitted to the voters, the number of votes cast for and against approval at the election. Generally, the law is effective after the local government files the required certificate with the Secretary of State.

If a local government unit fails to file a certificate of approval before the first day of the next regular session of the legislature, i.e., before the first Tuesday after the first Monday in January of odd-numbered years, the law is deemed to be disapproved by the local government unless otherwise provided in the special law. This has caught a few local governments that have then had to return to the legislature for enactment of the same special legislation.

Exceptions

The constitution permits the legislature to provide by general law exception to the local approval requirement. Currently, state statute provides three instances in which local approval is not required:

(1) The law enables one or more local government units to exercise authority not granted by general law. That is, the law is permissive, not mandatory.

(2) The law brings a local government unit within the general law by repealing a special law, by removing an exception to the applicability of a general statutory provision, by extending the applicability of a general statutory provision, or by reclassifying local government units.

(3) The law applies to a single unit or a group of units with a population of more than one million people.

Under all other circumstances, local approval is required. This includes legislation for a local government that is coded in Minnesota Statutes. Even if a law does not require local approval because it fits one of the exceptions above, if the specific legislation requires it, it is not effective until approved. Finally, whether or not the legislation expressly requires local approval, if the legislation is local law and none of the general law exceptions apply, the constitution requires local approval before the law is effective.

"Application clause"

The constitution also requires that special legislation for a local government name the local government unit or the counties, if more than one unit, are affected, whether or not local approval is required.

Usually the affected unit of government is named as a substantive part of the law and the application is apparent. With regard to the Metropolitan Council and the metropolitan agencies, although the unit of government is named in the substantive part of the law, it has become standard practice to add an "application clause," listing the counties included in the jurisdiction of the agency, to bills relating to metropolitan government.

For more information: See the House Research publication *Special Legislation*, September 2006.

HOUSE RESEARCH | Short Subjects

Steve Hinze and Karen Baker

Updated: November 2006

Property Tax 101: Property Tax Variation by Property Type

What causes property taxes to vary by type of property?

The primary cause of variation in property tax burdens is Minnesota's classified property tax system. In a classified system, each class of property is assigned one or more *class rates*. The property's taxable market value is multiplied by the class rate(s) to determine the property's tax base, technically called its *net tax capacity*.

Besides the class rates, variations in tax by type of property also occur because the state general tax and school district operating referendum levies apply to some types of property but not to others. (All voter-approved levies, except school district levies for bonded debt, are levied on referendum market value. School district levies for bonded debt are levied on the net tax capacity of all types of property.) The table below shows class rates and the applicability of taxes by type of property.

Class Rate Schedule for Taxes Payable in 2007

Class	Property Type (major property types only)	Class Rate	Subject to State Tax?	Subject to Referendum Levies?
1	**Homestead**			
1a	Residential homestead:			
	Up to $500,000	1.00%	No	Yes
	Over $500,000	1.25	No	Yes
2	**Agricultural**			
2a	Agricultural homestead:			
	House, garage & 1 acre – same as residential homestead			
	Agricultural land & buildings:			
	Up to $690,000	0.55	No	No
	Over $690,000	1.00	No	No
2b	Agricultural nonhomestead	1.00	No	No
3	**Commercial/Industrial/Public Utility**			
3a	Commercial/Industrial/Public Utility:			
	Up to $150,000	1.50	Yes*	Yes
	Over $150,000	2.00	Yes*	Yes
	Electric generation attached machinery	2.00	No	Yes
4	**Other residential**			
4a	Market-rate apartments (4 or more units)	1.25	No	Yes
4bb	Residential nonhomestead single unit:			
	Up to $500,000	1.00	No	Yes
	Over $500,000	1.25	No	Yes
4b	Residential nonhomestead 2-3 unit and undeveloped land	1.25	No	Yes
4c	Seasonal recreational residential (noncommercial):			
	Up to $500,000	1.00	Yes**	No
	Over $500,000	1.25	Yes**	No

* Subject to state general tax at commercial-industrial rate.
** Subject to state general tax at seasonal recreational rate.

What other factors cause property taxes to vary by type of property?

Variations also occur because certain types of property qualify for property tax credits that reduce the amount of tax that would otherwise be due. The two largest credit programs are the homestead market value credit and the agricultural market value credit, which apply to all residential homesteads and all agricultural homesteads. Other credits apply to property in some areas of the state but not to others.

Local variation also occurs because tax rates are determined separately for each taxing jurisdiction in the state, based on each jurisdiction's levy and tax base.

What is effective tax rate?

Effective tax rate is a measure of tax burden useful in making property tax comparisons. It is defined as net tax divided by market value (i.e., tax as a percent of market value). It allows comparison of tax burdens between properties of different values, different types, and different locations.

Comparison of Property Taxes on Various Types of Property, within the same taxing jurisdiction, each with a market value of $200,000 (Property taxes payable in 2007)

Property Type	Class Rate(s)	Net Tax Capacity	Property Tax*		Effective Tax Rate
			Gross	Net	
Agricultural homestead**	0.55/1.0%	$1,325	$1,400	$872	0.44%
Agricultural nonhomestead	1.0	2,000	2,000	2,000	1.00
Residential homestead	1.0	2,000	2,300	2,108	1.05
Seasonal recreational residential (i.e., cabin)	1.0	2,000	2,386	2,386	1.19
Residential nonhomestead (1 unit)	1.0	2,000	2,300	2,300	1.15
Residential nonhomestead (2-3 units)	1.25	2,500	2,875	2,875	1.44
Apartment	1.25	2,500	2,875	2,875	1.44
Commercial/Industrial	1.5/2.0	3,250	5,330	5,330	2.66
Commercial/Industrial @ $2,000,000***	1.5/2.0	40,250	66,010	66,010	3.30

* These examples assume a total local net tax capacity tax rate of 100 percent, a state commercial-industrial tax rate of 49 percent, and a state seasonal recreational tax rate of 25 percent, a total market value tax rate of 0.15 percent.
** The agricultural homestead is assumed to consist of a house valued at $50,000 and agricultural land and buildings valued at $150,000.
*** This property has a market value of $2,000,000 to show a typical effective tax rate on a larger commercial/industrial property.

For more information: Contact legislative analyst Steve Hinze at 651-296-8956 or Karen Baker at 651-296-8959.

Karen Baker and Steve Hinze

Updated: November 2006

Property Tax 101: Property Tax Administration

Who does what

Counties are responsible for property tax administration; the Department of Revenue provides assistance and oversight. The list below shows each county office's responsibilities for property tax administration. In some counties these offices are merged and one or two offices may perform the functions.

Assessor

- Values property
- Determines proper classification
- Sends valuation notices to taxpayers

Auditor

- Determines each taxing jurisdiction's total tax capacity (i.e., its tax base)
- Calculates proposed and final tax rates
- Prepares truth-in-taxation notices (based on proposed levies)

Treasurer

- Prepares and mails out property tax statements
- Collects property tax payments
- Distributes property tax receipts to each taxing jurisdiction

Property tax timeline

The process of calculating, imposing, and collecting Minnesota property taxes for a year actually spans two full calendar years. As shown on the reverse side, the two-year cycle begins with the January 2 statutory assessment date and extends all the way through the next calendar year until the property taxes have been paid. For example, for taxes payable in 2006, the cycle begins on January 2, 2005, and doesn't end until the final payments are made in October/November 2006.

Appeal process

If a property owner disagrees with the assessor's valuation (shown on the valuation notice), the taxpayer can seek relief directly from the assessor. This may resolve the matter, so that no further action is necessary. If it does not, there are two separate avenues of appeal:

1. A three-step appeal process, consisting of an appeal to:
   - the local board of review; if not satisfied, appeal to,
   - the county board of equalization; if not satisfied, appeal to,
   - the Minnesota tax court.
2. A single-step appeal to the Minnesota tax court. There are two divisions:
   - The regular division, which can be used for any property. Proceedings are formal (an attorney is recommended), and the decision may be appealed to the Minnesota Supreme Court; or
   - The small claims division, which can be used only for homesteads (regardless of value) and other property where the market value is under $300,000. Proceedings are less formal, and decisions are final.

Property Tax System Timeline			
		Assessment Year 2005 Taxes Payable 2006	**Assessment Year 2006 Taxes Payable 2007**
2005	January	Assessment date (2nd)	
	March	Valuation notices mailed	
	April	Local boards of appeal and equalization	
	June	County board of appeal and equalization; state board of equalization	
	July	Certification of state aid amounts	
	September	Truth-in-taxation levy certifications (15th, 30th)	
	November	Truth-in-taxation notices mailed	
	December	Truth-in-taxation hearings; final levy certifications (27th)	
2006	January	County auditors compute tax rates	Assessment date (2nd)
	March	Property tax statements mailed	Valuation notices mailed
	April		Local boards of appeal and equalization
	May	1st half tax payments due (15th)	
	June		County board of appeal and equalization; state board of equalization
	July	1st half state aid payments made (20th)	Certification of state aid amounts
	September		Truth-in-taxation levy certifications (15th, 30th)
	October	2nd half tax payments due – except on agricultural property (15th)	
	November	2nd half tax payments due – on agricultural property (15th)	Truth-in-taxation notices mailed
	December	2nd half state aid payments made (26th)	Truth-in-taxation hearings; final levy certifications (27th)
2007	January		County auditors compute tax rates
	March		Property tax statements mailed
	May		1st half tax payments due (15th)
	July		1st half state aid payments made (20th)
	October		2nd half tax payments due – except on agricultural property (15th)
	November		2nd half tax payments due – on agricultural property (15th)
	December		2nd half state aid payments made (26th)

For more information: Contact legislative analyst Karen Baker at 651-296-8959 or Steve Hinze at 651-296-8956.

Lynn Aves

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Child Care Licensing

To protect the health, safety, and welfare of children in child care settings, state law specifies certain requirements for the licensing of child care programs. Licensure of child care programs is governed by Minnesota Statutes, chapter 245A, and related rules.

Who must be licensed?

State law prohibits an individual, corporation, or other organization from providing child care services without a state license. Operating a child care program without a license is a misdemeanor. In general, both child care centers and family child care homes must be licensed, and specific licensing requirements apply to each type of program.

State law also specifies certain exceptions to the general requirement that child care providers must be licensed. Under these exceptions, the following types of child care are considered to be legal nonlicensed child care, for which a provider does not need a license:

- services provided to children who are related to the child care provider
- services provided to children from a single related family member who is not related to the child care provider
- programs operated by a public school for children 33 months or older
- services provided for children for periods of less than three hours a day while the child's parent is in the same or contiguous building
- recreation programs for children that are operated or approved by a park and recreation board
- child care programs operated by a school that provides child care to school-age children, if the program is approved by the district's school board
- Head Start nonresidential programs that operate for less than 45 days in a year
- services provided to children for a cumulative total of less than 30 days in any 12-month period
- programs for children such as scouting, boys clubs, girls clubs, sports and arts programs
- the religious instruction of school-age children
- Sabbath or Sunday schools, or congregate care of children of any age by a church, congregation, or religious society during the period the church, congregation, or religious society uses for its regular worship

What is the purpose of licensing?

The state's licensing process is designed to ensure that licensed child care programs meet certain health, safety, and supervision standards, child-to-staff ratios, and other requirements.

The licensing process also requires child care providers to pass a background study. If a background study reveals that an individual has committed certain crimes, maltreated a child or vulnerable adult, or engaged in certain conduct, the Commissioner of Human Services may disqualify the individual from direct contact with children served in the licensed child care program.

In addition, all licensed child care providers are mandated reporters under the state's Maltreatment of Minors Act. This means that a child care worker who knows or has reason to believe that a child is being neglected or abused must report the abuse or neglect to the local law enforcement, social services agency, or licensing agency. For additional information about child abuse reporting requirements, see *Overview of the Maltreatment of Minors Act*, House Research Department, September 2006.

What are the roles of state and local governments in the licensing process?

Both state and local government have a role in child care program licensing. The Minnesota Department of Human Services (DHS):

- issues licenses to all child care programs;
- conducts licensing inspections and investigates complaints and allegations of licensing violations or child maltreatment in child care centers; and
- conducts background studies of individuals who have direct contact with children served by licensed child care centers.

The local county social services or human services agency:

- performs specified licensing functions for family and group family child care homes under authority specified under Minnesota Statutes, section 245A.16;
- conducts licensing inspections and investigates complaints and allegations of licensing violations or child maltreatment in family and group family child care homes; and
- conducts background studies of individuals who have direct contact with children served by licensed family and group family child care homes.

Who should individuals call if they have questions?

Individuals who have questions about child care licensing should call the Licensing Division at DHS at 651-296-3971, or their local county agency.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi

Updated: November 2006

The Minnesota and Federal Dependent Care Tax Credits

What are the credits?

The Minnesota and federal dependent care credits partially offset the cost of child care for certain workers. The maximum Minnesota credit is $720 for one child and $1,440 for two or more children. The maximum federal credit is $1,050 for one child and $2,100 for two or more children.

Are the credits refundable?

The Minnesota credit is fully refundable. If an individual qualifies for a credit that is greater than his or her tax liability, the excess is paid as a refund. The federal credit is not refundable and may only be used to offset federal income tax liability.

Who is eligible for the credits?

Anyone who incurs expenses related to the care of a dependent and related household expenses may be eligible to claim the credits. The claimant must:

- maintain a household that includes the dependent;
- pay for care for a dependent under age 13, or a disabled spouse or adult dependent; and
- pay for care in order to work or look for work.

What are qualifying expenses?

Qualifying expenses are amounts paid for the care of a dependent under age 13, or a disabled spouse or adult dependent, but do not include:

- amounts paid to the claimant's spouse or another dependent, or
- amounts paid through a dependent care pre-tax account.

Qualifying expenses may not exceed the claimant's earned income (for married couples filing joint returns, expenses may not exceed the earned income of the lesser earning spouse).

How are the credits calculated?

The *federal credit* equals 35 percent of up to $3,000 of qualifying expenses for one child ($6,000 of qualifying expenses for two or more children). The maximum federal credit is $1,050 for one child and $2,100 for two or more children. The federal credit begins to phase down when income exceeds $15,000, with the credit percentage decreasing as income increases. Claimants with incomes over $43,000 qualify for the minimum federal credit equal to 20 percent of qualifying expenses, or up to $600 for one child and $1,200 for two or more children, depending on actual child care costs. For example, a claimant with $50,000 of income and $1,000 of expenses will qualify for a credit of $200 (20 percent of $1,000).

The *state credit* equals the lesser of the federal credit, or $720 for one child ($1,440 for two or more children). The state credit is calculated by reference to the federal credit for which the claimant is eligible, not the amount actually used to offset federal liability. For example, an individual with expenses of $2,000 and income below $15,000 is eligible for a federal credit of $700 (35 percent of $2,000). While this individual will probably not have any federal tax liability and thus will not benefit from the nonrefundable federal credit, he or she will still be eligible for a refundable state credit of $700.

The state credit is subject to a separate phaseout than the federal credit. In tax year 2007, the state phaseout begins when income exceeds $21,880, and the state credit is fully phased out when income exceeds $35,530. The income threshold for the phaseout is adjusted each year for inflation.

How do filers claim the credits?

Filers claim the credits when they file their federal and state income tax returns, by completing a separate schedule—Form 2441 for the federal credit and schedule M1CD for the state credit.

How many Minnesotans claim the credits?

In tax year 2004, 143,171 Minnesotans claimed the federal dependent care credit and 34,478 claimed the state credit. These claims represent 5.9 percent of all federal returns filed by Minnesotans, and 1.4 percent of all state returns filed.

Because the federal credit is nonrefundable and can only be used to offset tax liability, most of the federal credits are claimed by middle- and upper-income filers who have income over $43,000 and qualify for the minimum credit amount.

Because the state credit is refundable and in 2004 was only available to filers with incomes below $33,610, most of the state credits are claimed by low-income filers.

How much is paid out in credits?

In tax year 2004, Minnesotans claimed $62.9 million of federal dependent care credits. The average federal dependent care credit was $439.

In tax year 2004, Minnesotans claimed $12.4 million of state dependent care credits. The average state dependent care credit was $359.

How are the credits distributed geographically?

While about 44 percent of the returns claiming state credits came from the Twin Cities metropolitan area, these seven counties generated about 52 percent of all returns filed. Put another way, in 2004 nonmetro filers were more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 4.7 percent of all income tax returns claimed the federal dependent care credit, compared to 5.9 percent in Minnesota. Maryland had the highest percentage of returns claiming the federal credit, at 6.7 percent, and West Virginia had the lowest, at 2.3 percent. Minnesota's percentage of returns claiming the credit may be higher than national figures because Minnesota has a high proportion of two-worker households.

The average federal dependent care credit nationwide in 2004 was $522; it was $439 in Minnesota. The District of Columbia had the highest average credit, at $631, and Montana had the lowest, at $393. Minnesota's average credit amount may be lower than the national averages because state residents have above average incomes.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Minnesota and Federal Dependent Care Tax Credits*, February 2005.

Karen Baker and Nina Manzi **Updated: November 2006**

Targeting Property Tax Refund

What is targeting?

The "additional" or "special" property tax refund, generally referred to as "targeting," directs property tax relief to homeowners who have large property tax increases from one year to the next.

Who qualifies?

A homeowner qualifies if the property tax on the home has increased by more than 12 percent over the previous year's tax, and if the increase is over $100.

The homeowner must have owned and lived in the same home for both years. If any improvements were made to the home, that portion of the tax increase resulting from the improvements must be subtracted when determining the refund.

How does targeting work?

The refund equals 60 percent of the increase over the greater of (1) 12 percent or (2) $100. The maximum refund is $1,000. The following example shows how the refund is calculated.

Payable 2006 Property Tax Payable 2007 Property Tax	$1,400 2,000
2007 tax increase (over 2006) Taxpayer pays 1st 12% of increase, which must be at least $100 (12% x 1,400)	$600 168
Remaining increase eligible for relief ($600 - $168 = $432)	$432
State pays 60% of excess over 12% increase up to a $1,000 maximum (60% x $432 = $259)	$259
Amount of 2007 increase paid by taxpayer ($600 - $259)	$341

The taxpayer's $600 increase (i.e., 42.9 percent) is reduced to an out-of-pocket property tax increase of $341 (i.e., 24.4 percent) as a result of the $259 refund.

The taxpayer pays the full $2,000 amount of the 2007 property tax to the county, the first half in May and the second half in October. The taxpayer applies to the state for a targeting refund, which is paid at the same time the regular homeowner property tax refund ("circuit breaker") is paid.

Does targeting have any other restrictions?

No, unlike the regular property tax refund, the targeting refund is not tied to the taxpayer's household income. Under the regular homeowner property tax refund, the taxpayer's household income may not exceed a specified maximum and the amount of household income affects the amount of the refund.

However, the targeting refund does not use income as a factor, nor is there any limitation on the taxpayer's household income. Therefore, many higher income taxpayers who do not qualify for the regular property tax refund due to income restrictions are eligible for the targeting refund.

Is targeting a new program?

No, the first targeting program was enacted in 1980. With the exception of a few years in the 1980s, the program has been in effect for about 20 years, although miscellaneous changes have been made to the program during that time.

What are statewide amounts?

The amounts paid out for the targeting program have been low in recent years, but increased significantly from 2002 to 2003, then decreased in 2004 and 2005. Total refunds increased from $1.0 million in 2002 to $7.6 million in 2003, then fell to $3.7 million in 2004 and $4.3 million in 2005.

The table below shows the statewide amount, with a breakdown for the metro and the 80 nonmetro counties, for the past four years.

Targeting Refunds, 2002 – 2005 (dollars in thousands)

	Filed 2002	Filed 2003	Filed 2004	Filed 2005
Total Metro	$359	$6,335	$2,463	$2,636
Total Nonmetro	$674	$1,244	$1,241	$1,663
State	$1,033	$7,579	$3,704	$4,300

Some taxpayers (e.g., those who typically don't qualify for the regular property tax refund) may not be aware of the targeting program, resulting in lower total refunds statewide than would be the case if the program were more widely known.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue Schedule M1PR, the property tax refund form. There is a separate schedule on the back of the M1PR ("Schedule 1 – Special Refund") for the targeting program. The taxpayer files for this refund after receiving his or her property tax statement in February or March. Claims filed before August 15, 2007, will be paid beginning in late September 2007. The deadline for filing claims based on taxes payable in 2007 is August 15, 2008; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf.

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml. Also see the House Research Short Subject *Homeowner's Property Tax Refund Program*, November 2006, and the Information Brief *Targeting*, November 2006.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: November 2006

The Federal Earned Income Tax Credit and Minnesota Working Family Credit

What are the credits?

The federal earned income tax credit (EITC) and Minnesota working family credit (WFC) equal a percentage of the earnings of low-income individuals. The credits are refundable; if the credit exceeds a filer's tax liability, the rest is paid as a refund. Since these credits increase their recipients' earnings, they act as wage supplements and are thought to provide a work incentive.

Who is eligible for the credits?

Anyone with wages or self-employment income may be eligible to claim the EITC and the WFC. In tax year 2007, individuals with more than $2,900 in interest income, dividends, rental and royalty income, and capital gain income do not qualify.

How are the credits calculated?

The credits equal a percentage of earned income, up to a maximum credit amount, and are phased out when the claimant's total income exceeds a threshold. The maximum credit amounts and income levels at which the credits are phased out vary depending on the number of children in the household and whether the claimants are married. Both the maximum credit and the phaseout threshold are adjusted annually for inflation. In tax year 2007, the maximum credits, phaseout threshold, and income level at which the credits are no longer allowed are as follows:

	Maximum credit		**Phaseout threshold**		**Income at which credit fully phased out**	
	EITC	WFC	EITC	WFC	EITC	WFC
Unmarried claimants						
No children	$428	$107	$7,000	$7,000	$12,590	$12,600
1 child	$2,853	$854	$15,390	$18,290	$33,241	$33,198
2 or more children	$4,716	$1,651	$15,390	$21,700	$37,783	$37,729
Married claimants						
No children	$428	$107	$9,000	$9,000	$14,590	$14,600
1 child	$2,853	$854	$17,390	$20,290	$35,241	$35,198
2 or more children	$4,716	$1,651	$17,390	$23,700	$39,783	$39,724

How do filers claim the credits?

Filers claim the credits when they file their federal and state income tax returns, by completing a schedule or worksheet.

How many Minnesotans claim the credits?

In tax year 2004, 263,568 Minnesota returns claimed the EITC and 249,841 claimed the WFC. These claims represent 10.9 percent of all federal returns filed by Minnesotans, and 10.3 percent of all state returns filed.

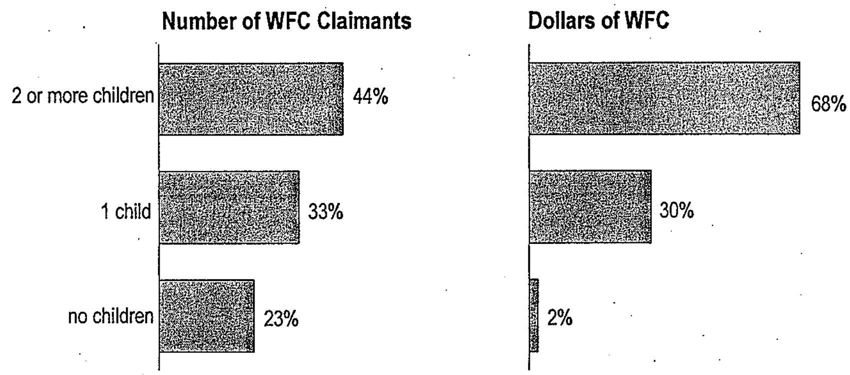
How much is paid out in credits?

In tax year 2004, Minnesotans claimed $412 million in EITC, of which $55 million offset tax liability and the remaining $357 million was paid as a refund. The average EITC was $1,562

Minnesotans claimed an additional $130 million in WFC, of which $24 million offset tax liability and the remaining $106 million was paid as a refund. The average WFC was $522.

How are the credits distributed among different types of families?

Seventy-seven percent of all earned income credits and working family credits went to families with one or more children. These families received about 98 percent of the total amount of credits paid in 2004. Individuals without children filed 23 percent of returns claiming credits, but received only 2 percent of the total amount of credits. Claimants with children received most of the total amount of credits because these families qualify for a higher maximum credit than do claimants without children.



How are the credits distributed geographically?

While over 46 percent of the returns claiming credits came from the Twin Cities metropolitan area, these seven counties generated about 52 percent of all returns filed. Put another way, in 2004 nonmetro filers were more likely to claim the credit than were metro area filers.

How does Minnesota compare with other states?

Nationwide, 16.8 percent of all income tax returns claimed the EITC, compared to 10.9 percent in Minnesota. The average EITC nationwide in 2004 was $1,816; it was $1,562 in Minnesota. Minnesota's number of recipients and credit amounts are lower than the national averages because state residents have above average incomes.

Eighteen other states and the District of Columbia provide a state version of the EITC. In most cases the state credit equals a percentage of the federal EITC.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Federal Earned Income Tax Credit and the Minnesota Working Family Credit*, February 2006.

HOUSE RESEARCH | **Short Subjects**

Nina Manzi and Karen Baker

Updated: November 2006

Renter's Property Tax Refund Program

What is the renter's property tax refund program?

The renter's property tax refund program (sometimes called the "renters' credit") is a state-paid refund that provides tax relief to renters whose rent and "implicit property taxes" are high relative to their incomes. "Rent constituting property taxes" is assumed to equal 19 percent of rent paid. If that rent constituting property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

What are the maximums?

For refund claims filed in 2007, based on rent paid in 2006 and 2006 household income, the maximum refund is $1,400. Renters whose income exceeds $49,160 are not eligible for refunds.

What is the average refund and total amount paid?

2005 Statewide Renter Property Tax Refunds
Filed in 2005 (based on 2004 incomes and payable 2004 taxes)

	Number of returns	Total amount	Average per return
Under 65 years old	192,064	$97.0 million	$505
Senior/disabled	77,678	$44.4 million	$572
Total: all renters	269,742	$141.4 million	$524

How are claims filed?

Refund claims are filed using Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2007, will be paid beginning in August 2007. The deadline for filing claims based on rent paid in 2006 is August 15, 2008; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf.

How do refunds vary depending upon the filer's income and rent constituting property taxes?

The following table shows the refund amount for two example families with different incomes—a married couple without dependents in the metro area, and a married couple without dependents in greater Minnesota (a single person living alone would qualify for the same refund amounts). Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average rent is higher in the metro area than in greater Minnesota. The metro area family paid monthly rent in 2006 of $725 the fair market rent for a one-bedroom apartment in the metro area. (19% of $725 x 12 = $1,653, which is their rent constituting property tax.) The family in greater Minnesota paid monthly rent in 2006 of $421, the fair market rent for a one-bedroom apartment in many greater Minnesota counties. (19% of $421 x 12 = $960, which is their rent constituting property tax.) Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple both under age 65, no dependents

		Metro area		**Greater Minnesota**	
		Taxpayer #1	**Taxpayer #2**	**Taxpayer #3**	**Taxpayer #4**
1	Gross income	$15,000	$30,000	$15,000	$30,000
2	Deduction for dependents	0	0	0	0
3	Household income (1 – 2 = 3)	$15,000	$30,000	$15,000	$30,000
4	Rent constituting property tax	$1,653	$1,653	$960	$960
5	Statutory threshold percentage	1.4%	2.6%	1.4%	2.6%
6	Threshold % x income (3 x 5 = 6)	$210	$780	$210	$780
7	Property tax over threshold (4 – 6 = 7)	$1,443	$873	$750	$0
8	Copay percentage	20%	35%	20%	35%
9	Taxpayer copay amount (7 x 8 = 9)	$289	$306	$150	$0
10	Remaining tax over threshold (7 – 9 = 10)	$1,154	$567	$600	$0
11	Maximum refund allowed	$1,400	$1,400	$1,400	$1,400
12	Net property tax refund	$1,154	$567	$600	$0

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml.

Karen Baker and Nina Manzi **Updated: November 2006**

Homeowner's Property Tax Refund Program

What is the property tax refund program?

The homeowner's property tax refund program (sometimes called the "circuit breaker" or the PTR) is a state-paid refund that provides tax relief to homeowners whose property taxes are high relative to their incomes. If property tax exceeds a threshold percentage of income, the refund equals a percentage of the tax over the threshold, up to a maximum amount. As income increases:

- the threshold percentage increases,
- the share of tax over the threshold that the taxpayer must pay increases, and
- the maximum refund decreases.

The program uses household income, a broad measure that includes most types of income. Deductions are allowed for dependents and for claimants who are over age 65 or disabled.

Has the program changed?

The 2001 tax law expanded the homeowner's property tax refund program, effective for refunds based on property taxes payable in 2002. The changes lowered the threshold for determining eligibility and increased the maximum refund allowed. The tax law also limited the amount of tax qualifying for the refund for farmers to the tax attributable to the house, garage, and first acre of property. (Previously the tax amount for farmers also included the tax on the first $600,000 of land and farm buildings.)

What are the maximums?

For refund claims filed in 2007, based on property taxes payable in 2007 and 2006 household income, the maximum refund is $1,700. Homeowners whose income exceeds $91,120 are not eligible for a refund.

How are claims filed?

Refund claims are filed using the Minnesota Department of Revenue (DOR) Schedule M1PR. Claims filed before August 15, 2007, will be paid beginning in late September 2007. The deadline for filing claims based on taxes payable in 2007 is August 15, 2008; taxpayers filing claims after that date will not receive a refund. Forms are available online at www.taxes.state.mn.us/taxes/forms/m1pr_print.pdf.

What is the average refund and total amount paid?

2005 Statewide Homeowner Property Tax Refunds Filed in 2005 (based on 2004 incomes and payable 2005 taxes)

	Number of returns	Total refund amount	Average per return
Under 65 years old	155,266	$91.4 million	$589
Senior/disabled	107,740	$64.0 million	$594
Total: all homeowners	263,006	$155.4 million	$591

How do refunds vary depending upon the filer's income and property tax?

The following table shows the refund amount for two example families with different incomes—one family in the metro area and one in greater Minnesota. Although the property tax refund threshold, copayment rates, and maximum refund amounts are the same statewide, the average residential homestead property tax in the metro area is higher than in greater Minnesota. The metro area family has payable 2007 property taxes of $2,959, the estimated average for the metro. The family in greater Minnesota has payable 2007 property taxes of $1,493, the estimated average for greater Minnesota. Taxpayers who are over age 65, disabled, or have dependents are allowed a subtraction from income in determining the refund.

Married couple both under age 65, two dependents

		Metro area		Greater Minnesota	
		Taxpayer #1	Taxpayer #2	Taxpayer #3	Taxpayer #4
1	Taxable market value of home	$271,500	$271,500	$152,500	$152,500
2	Gross income	$25,000	$50,000	$25,000	$50,000
3	Deduction for dependents	$8,910	$8,910	$8,910	$8,910
4	Household income (2 – 3 = 4)	$16,090	$41,090	$16,090	$41,090
5	Property tax	$2,959	$2,959	$1,493	$1,493
6	Statutory threshold percentage	2.0%	2.7%	2.0%	2.7%
7	Threshold % x income (4 x 6 = 7)	$322	$1,109	$322	$1,109
8	Property tax over threshold (5 – 7 = 8)	$2,637	$1,850	$1,171	$384
9	Statutory copay percentage	30%	40%	30%	40%
10	Taxpayer copay amount (8 x 9 = 10)	$791	$740	$351	$153
11	Remaining tax over threshold (8 – 10 = 11)	$1,846	$1,110	$820	$230
12	Maximum refund allowed	$1,420	$1,260	$1,420	$1,260
13	Net property tax refund	$1,420	$1,110	$820	$230

For more information: Claimants can check the status of their refund by calling DOR at (651) 296-4444 or online by clicking on "Where's My Refund" at www.taxes.state.mn.us/taxes/individ/index.shtml

Matt Burress

Updated: November 2006

Motor Vehicle Sales Tax

After a nearly ten-year hiatus, the legislature in 2000 again began dedicating revenues from the motor vehicle sales tax (MVST) to transportation-related purposes. A constitutional amendment passed by the voters in 2006 will result in 100 percent of MVST revenues going to transportation by fiscal year 2012.

MVST is the sales tax collected when cars are sold

The motor vehicle sales tax, or MVST, is a 6.5 percent tax applied to the sale of new and used motor vehicles. Minn. Stat. § 297B.02. It is imposed instead of the general sales tax and is based on the purchase price of the motor vehicle. A flat $10 tax applies to vehicles that are at least ten years old and have a resale value of less than $3,000. Certain collector's vehicles have a $90 flat tax. MVST is collected by auto dealers and when the vehicle is registered.

A brief history of MVST revenue

During the 1980s, the legislature dedicated MVST revenue to highways and transit, intending that the money supplement other transportation spending. The dedication was periodically changed and suspended, and it was abolished entirely beginning in fiscal year 1992.

Two recent changes in tax policy led to re-establishment of MVST revenue allocated to transportation purposes. First, the 2000 Legislature placed limits on registration taxes for passenger vehicles, which reduced the amount of revenue collected. Registration taxes are dedicated exclusively to streets and highways, and the legislature made up the losses to highway funds by transferring MVST revenue to highways. Second, the 2001 Legislature prohibited the use of property tax levies for metropolitan transit operations. It replaced property tax revenue with allocations from MVST for both metropolitan and greater Minnesota transit.

These MVST allocations to highways and transit were intended primarily to offset reductions in other taxes rather than provide new funding for transportation. One effect was to shift some of the funding from local to state sources.

2003 MVST allocation

In the 2003 session, the legislature increased the percentage of MVST revenue going to transit. The additional revenue for transit was partially to make up for reductions in general fund appropriations for bus service throughout Minnesota (which was largely due to overall budget cuts), and partly to reduce local responsibility for Hiawatha light rail transit operating costs.

The additional revenue effectively came from a reduction in the amount of MVST revenue going towards the state trunk highway system (from 32 percent to 30 percent until fiscal year 2008). MVST revenue dedicated to highways goes into the highway user tax distribution fund (HUTDF). The HUTDF receives money from multiple revenue sources and is constitutionally dedicated to the trunk highway fund, the county state-aid highway fund, and the municipal state-aid street fund.

MVST revenue allocated to the HUTDF was decreased and transferred to the metro area and greater Minnesota transit funds. The county state-aid highway fund and the municipal state-aid street fund received direct transfers from MVST revenue in order to offset the reduction of their portions of the HUTDF funding.

Current MVST allocation

Currently, 53.75 percent of MVST revenue goes towards transportation purposes, and 46.25 percent goes to the general fund. The distribution is as follows:

	FY 2004-07	FY 2008 and after
Highway user tax distribution fund (HUTDF)	30%	32%
County state-aid highway fund	0.65%	0%
Municipal state-aid highway fund	0.17%	0%
Metropolitan transit fund	21.5%	20.5%
Greater Minnesota transit fund	1.43%	1.25%
General fund	46.25%	46.25%

The MVST constitutional amendment

At the 2006 general election, the voters approved a constitutional amendment proposed by the 2005 Legislature to gradually dedicate all MVST revenue to transportation purposes by 2012.

The amendment specifies that 63.75 percent must be dedicated to transportation purposes in fiscal year 2008, growing by 10 percent in subsequent years until it reaches 100 percent in fiscal year 2012. It also requires that "no more than 60 percent" of the revenue go to the HUTDF, and "not less than 40 percent" go towards public transit assistance. Minn. Const. art. XIV, § 13. This distribution between the HUTDF and transit is referred to as the "60/40 split."

The constitutional language does not specify two elements that will need to be established in statute by the legislature:

- The percentage allocation of MVST revenue between the HUTDF and transit (within the 60/40 split limits)
- The allocation between metropolitan transit and greater Minnesota transit

The following table outlines MVST revenue allocation under one scenario, if the legislature dedicated 60 percent to highways and 40 percent to transit.

Additional Revenue from MVST Constitutional Amendment with 60/40 Split

(amounts in thousands)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Highway user tax distribution fund	$31,625	$64,068	$100,193	$141,135	$166,219
Transit purposes	18,975	40,533	64,508	91,665	108,339
General fund	(50,600)	(104,600)	(164,700)	(232,800)	(274,559)

Notes: Revenue is based on November 2006 forecast, and assumes a 2 percent growth rate starting in fiscal year 2012.

For more information: Contact legislative analyst Matt Burress at 651-296-5045.

Kathy Novak and Nina Manzi

Updated: December 2006

Economic Forecasts, Budget Surpluses, and Budget Shortfalls

When are economic forecasts prepared?

The commissioner of finance must prepare a forecast of state revenues and expenditures twice each year—in February and November.

What are the forecasts used for?

The November forecast in even-numbered years becomes the basis for the governor's budget recommendations to the legislature. The November 2006 forecast provides the revenue and expenditure projections that the governor will use in developing the budget for the fiscal year 2008-2009 biennium. The November 2006 forecast also tells if the state is on track to finish the fiscal year 2006-2007 biennium with a balanced budget.

The February forecast in odd-numbered years fine-tunes the preceding November's forecast with data that becomes available early in the calendar year. The February 2007 forecast provides the revenue and expenditure projections that the legislature will use in adopting a budget for the fiscal year 2008-2009 biennium. Following the February forecast the governor may submit modifications to the budget developed from the November forecast, which are called "supplemental budget recommendations." The February 2007 forecast also provides an update on the status of revenues and expenditures in the current biennium.

The November forecast in odd-numbered years and the February forecast in even-numbered years also provide updates on revenues and expenditures in the current biennium. Using the projections of the November 2007 forecast, the governor may make additional "supplemental budget recommendations" proposing changes to the fiscal year 2008-2009 budget during the 2008 legislative session. The legislature will use the projections in the February 2008 forecast to ensure that the fiscal year 2008-2009 biennium closes with a balanced budget.

What if a forecast shows a budget shortfall?

If a forecast shows a shortfall for the *general fund in the current biennium*, the commissioner of finance may reduce the budget reserve account as needed to balance revenues with expenditures. If there isn't enough money in the budget reserve to balance the general fund in the current biennium, the commissioner may also reduce outstanding appropriations, commonly referred to as "unalloting." Before reducing the budget reserve or unalloting appropriations, the commissioner must obtain the approval of the governor and must consult with the Legislative Advisory Commission. When the legislature is in session, the governor typically makes recommendations to the legislature on how to resolve the shortfall before approving use of the budget reserve or unalloting.

If a forecast shows a shortfall for *any other fund in the current biennium*, the commissioner of finance must reduce the affected agency's allotment to avoid a deficit. As with general fund shortfalls, if the legislature is in session the governor would typically make recommendations on how to resolve the shortfall.

If a forecast shows a shortfall for *the coming biennium*, the governor's budget recommendations must propose revenues and expenditures changes in order for the budget at the close of the coming biennium to be in balance.

What if the forecast shows a budget surplus?

If a forecast shows a surplus for the *general fund in the current biennium*, the commissioner of finance must allocate the surplus in priority order as follows:

- to the cash flow account, until it reaches $350 million
- to the budget reserve account, until it reaches $653 million
- to increase the school aid payment schedule to 90 percent
- to restore previous school aid reductions and reduce the property tax recognition shift accordingly

If, as became the case following the February 2006 forecast, all these priorities have been met, the remaining surplus is called a "positive unrestricted budgetary general fund balance."

If the *November forecast in an even-numbered year*, or the *February forecast in an odd-numbered year*, projects a positive unrestricted budgetary general fund balance at the close of the *current biennium* greater than one-half of 1 percent of total general fund revenues for the biennium, the commissioner must designate the entire balance as available for rebate. The commissioner excludes general fund carryforward amounts in calculating the one-half of 1 percent threshold amount. In the November 2006 forecast, the commissioner designated $1.038 billion as available for rebate.

If the projected surplus is less than one-half of 1 percent of total general fund revenues, the commissioner reports it in the forecast as an unrestricted budgetary general fund balance. If a biennium closes with a positive unrestricted general fund balance, the commissioner must transfer that amount to the tax relief account on the last day of the biennium.

If a forecast shows a surplus for *the coming biennium*, the governor's budget recommendations may propose revenue reductions and/or expenditure increases, as long as the proposed changes do not result in a projected budget shortfall.

What happens when a forecast shows an amount "available for rebate"?

If the commissioner designates an amount as "available for rebate," the governor must present a plan to the legislature for rebating the amount designated to the taxpayers. The plan must provide for payments to begin no later than August 15. The legislature must enact, modify, or reject the plan by April 15. Because the November 2006 forecast shows a positive unrestricted budgetary general fund balance greater than one-half of 1 percent of total general fund revenues, the governor must present a plan for rebate to the legislature during the 2007 session, providing for payments of the $1.038 billion designated for rebate to begin by August 15, 2007. The legislature has until April 15, 2007, to enact, modify, or reject the governor's plan.

For more information: Contact legislative analyst Kathy Novak at 651-296-9253 or Nina Manzi at 651-296-5204. Also see the House Research publication *Unallotment*, March 2002.

HOUSE RESEARCH | Short Subjects

Jeanne B. LeFevre

Updated: December 2006

Gift Ban Law and Rules for House Members and Employees

What does the gift ban law prohibit?

Public officials must not request or accept a gift from a lobbyist or principal, and lobbyists and principals must not give a gift to a public official or ask someone else to do so. Legislators and legislative employees are public officials under this law. Family members are not subject to the ban.

Who are lobbyists and principals?

A "lobbyist" is an individual registered with the board to lobby Minnesota state government. A "principal" is an entity that hires lobbyists and is registered with the Campaign Finance and Public Disclosure Board. Registered lobbyists and principals are listed on the board's web site at www.cfboard.state.mn.us. If an individual or entity is not listed on the web site, a member may call the board at 651-296-5148 to see if the web site is current. Members and staff may rely on the information provided by board staff on the issue of who is a lobbyist or principal. Examples of people who are not lobbyists include members of the media, local government officials, state employees, and representatives of foreign governments touring the Capitol.

What is the penalty for a violation?

There is no criminal penalty or civil fine. The board, which administers the law, takes the position that if possible, it will make a recipient return or pay for an improper gift. This has happened at least once. The practical effect of violating the law is that it would be embarrassing.

What is a gift?

A gift is something received without giving equal or greater value in return. If the House pays to send a member or employee to a conference sponsored by a principal, the conference is not a gift from the principal. The event was paid for. By express terms or board advisory opinions "gift" includes the following:

- a job offer made as a bribe
- discounts, loans, privileges, or access made available to legislators but not to the general public
- paying off a debt for a legislator
- honoraria
- travel expenses or lodging for a meeting
- donations to a legal defense fund to benefit public officials generally
- donations to a retirement party held for a public official who is in office or has taken a new office
- a contribution to a charity made at the request of a public official

Some of the advisory opinions involved legislators, but the reasoning would also apply to legislative staff.

The following are excluded from the gift ban by the statute or by board opinions:

- campaign contributions
- services to assist in performing official duties
- services of insignificant monetary value
- plaques or mementos recognizing services in a field of specialty or charitable cause
- trinkets or mementos costing $5 or less
- informational material of unexceptional value
- food and drink when asked to speak or answer questions at a program (eating lunch free when speaking at a legislative update program sponsored by a principal; not eating lunch free when touring a business that hires lobbyists). An advisory opinion lets a covered individual attend a party paid for by a principal if the individual (1) reimburses the principal for his or her fair share of the cost of the party; or (2) contributes to the party an item or items that equal or exceed the individual's share of the cost of the party.
- a gift received because of membership in a group, a majority of whom are not public officials, and everyone in the group gets a similar gift (a member may accept a gift from his or her spouse's employer that is a principal if the employer gives all spouses a similar gift and a majority of those spouses are not public officials)
- a gift from a lobbyist or principal who is a relative, unless the gift is given on behalf of someone outside the family
- referral of legal matters between attorneys
- a job offer in the normal course of career changes

What House rules apply to gifts?

House Rule 9.20 prohibits a member from accepting an honorarium (other than expense reimbursement) for services performed for an individual or organization with a direct interest in the business of the House, including, but not limited to, lobbyists and principals. The rule specifies that violations must be referred to the Ethics Committee. The rule does not mention employees. House Rule 9.21 prohibits members and employees from accepting travel or lodging from a business, union, lobbyist, association of lobbyists, or a foreign government. Both rules are stricter than the statute in restricting the sources from which members and employees may accept things.

For more information: Contact legislative analyst Jeanne LeFevre at 651-296-5043.

HOUSE RESEARCH | Short Subjects

Jim Cleary and Rebecca Pirius

Updated: December 2006

DWI and the B-Card: A Type of Restricted Driver's License for Repeat Offenders

The B-Card is a "restricted driver's license" with a no-alcohol/drug restriction. The B-Card provides a repeat DWI offender with an opportunity to become validly relicensed to drive, following chemical dependency treatment and a rehabilitation period described in law. However, any violation of that no-alcohol/drug restriction, irrespective of whether the violation involved driving, carries stiff consequences for the violator, including both administrative sanctions and criminal penalties. Thus with the B-Card, the repeat-DWI offender gets another chance to legally drive, but only if he or she remains chemically free.

What is a restricted driver's license?

Minnesota Statutes, section 171.09, authorizes the Department of Public Safety (DPS) to issue a driver's license to certain drivers, contingent upon the applicant's written agreement to certain restrictions deemed appropriate for public safety. Such a license is referred to as a "restricted driver's license."

What is a B-Card?

When a restricted driver's license is issued to a rehabilitated repeat-DWI offender, that person must absolutely abstain from alcohol and illicit drugs indefinitely—this license is commonly referred to as a "B-Card."

What are the restrictions of a B-Card?

Following a repeat DWI violation, a person must successfully complete chemical dependency treatment, as well as rehabilitation (following a third or subsequent violation), before he or she can be validly relicensed to drive—and then only with a B-Card. However, that B-Card license is contingent upon the person maintaining complete abstinence from alcohol and illegal drugs. The revoked driver must agree in writing to that restriction before being issued the B-Card.

Is the "no-alcohol" restriction permanent?

The "no alcohol/drugs" restriction of a B-Card applies continuously for the remainder of the person's life, and even prohibits small amounts of alcohol as would be consumed with wine in a religious ceremony, in certain cough medicine, in low-alcohol "near-beer," and so on. Furthermore, that restriction applies whether or not the person is or has been driving a motor vehicle. The restriction is quite absolute and exact: when a person agrees to the condition of a B-Card license, he or she is informed that the license is immediately canceled when he or she consumes alcohol or an illicit drug.

Can a B-Card be cancelled without the person getting another DWI?

DPS will cancel a person's B-Card if any police report or other authoritative information indicates that the person has consumed alcohol. Sometimes that information arises from a DWI arrest. More often, it stems from a traffic stop that involves alcohol but does not constitute impaired driving. Other times, the drinking is discovered by officers called to a domestic altercation or is reported by a spouse, neighbor, or other source. There does not need to be an arrest or conviction for any crime for a person's drinking to trigger cancellation of the B-Card. In fact, in *Ascher v. the Commissioner of Public Safety* (1994), the Minnesota Appeals Court ruled that even when the consumption information is obtained through an unconstitutional police stop, DPS may use it to cancel a person's B-Card.

What are the consequences for cancellation of a B-Card?

The consequences of a B-Card cancellation are quite severe, since before the person can again become validly licensed with a B-Card, he or she must again successfully complete chemical dependency treatment and rehabilitation. According to DPS rules, the rehabilitation process requires documented proof of alcohol/drug abstinence for a minimum period of:

- one year, for a person's first rehabilitation;
- three years, for the person's second rehabilitation; and
- six years, for the person's third or subsequent rehabilitation.

The law also provides for gross misdemeanor criminal penalties for violating the no-alcohol/drug restriction of the B-Card license while driving (Minn. Stat. § 171.09(b)(1)).

Must the "no alcohol" restriction stay on the plastic driver's license?

The 2005 Legislature enacted a temporary law that allowed B-Card licensees who had no repeat alcohol-related driving violations during the previous ten years to request a duplicate driver's license without the no-alcohol restriction showing on the card. This law expired on July 31, 2006. Duplicate licenses issued under that law remain in effect until renewal. However, all other B-Card licenses issued before and after the effective period of that law must continue to show the restriction. The restriction applies regardless of whether or not it appears on a person's driver's license.

How long does it stay on the driving record?

Since the "no alcohol" restriction of a B-Card lasts for the person's lifetime, it must remain permanently on the person's driving record, as maintained by DPS.

For more information: Contact legislative analyst Jim Cleary at 651-296-5053, or Rebecca Pirius at 651-296-5044. Also see the House Research publication *An Overview of Minnesota's DWI Laws*, December 2006.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2006

Minnesota's Individual Income Tax

How much are income tax revenues?

Minnesota's income tax revenues are projected to equal $7.3 billion in fiscal year 2007, approximately 43 percent of state tax collections and 37 percent of all state revenues.

What is the tax base used to calculate Minnesota's income tax?

Minnesota's income tax applies to a base of Minnesota taxable income (MTI). The starting point for calculating MTI is federal taxable income (FTI), which is the income measure used in determining federal income tax liability.

The calculation of MTI requires taxpayers to add the following to federal taxable income:

- bond interest from other states
- the capital gains portion of lump sum distributions
- all or part of their state income or sales tax deduction if they claimed itemized deductions at the federal level

Minnesota taxpayers are allowed several subtractions from federal taxable income:

- U.S. bond interest
- Railroad retirement benefits
- Income earned on a reservation by American Indians
- Certain K-12 education expenses of dependents
- 50 percent of charitable contributions in excess of $500, for taxpayers who don't itemize
- An elderly/disabled exclusion for qualifying low-income taxpayers
- Part of the gain on the sale of a farm for insolvent taxpayers
- $10,000 of expenses related to organ donation
- compensation for military active service outside Minnesota
- compensation for National Guard or reserve service in Minnesota if called up by the governor or president (generally for floods, airport security, etc.)

What are the income tax rates and brackets?

Minnesota's income tax is a graduated tax, with three rates: 5.35 percent, 7.05 percent, and 7.85 percent. The rates are applied to income brackets that vary by filing status. Married couples filing joint returns are allowed the most generous (widest) brackets, followed by head of household filers (single parents), and then by unmarried single filers.

The table shows the income tax brackets in effect for each rate in tax year 2007 (brackets for married separate taxpayers are half the width of the married joint brackets):

	Married joint	**Single**	**Head of Household**
5.35%	First $31,150	First $21,310	First $26,230
7.05%	$31,150 to $123,750	$21,310 to $69,990	$26,230 to $105,410
7.85%	All over $123,750	All over $69,990	All over $105,410

A married couple filing a joint return owes income tax equal to 5.35 percent of their first $31,150 of taxable income, 7.05 percent of income between $31,150 and $123,750, and 7.85 percent of taxable income over $123,750. The income tax brackets are adjusted each year for inflation.

What income tax credits does Minnesota allow?

Minnesota allows taxpayers to claim several credits against tax liability. Credits that may be used only to reduce liability, called nonrefundable credits, include the following:

- Marriage credit ($59.8 million in fiscal year 2007)
- Long-term care insurance credit ($8.4 million in fiscal year 2007)
- Credit for taxes paid to other states ($95.1 million in fiscal year 2007)

In addition, Minnesota allows three refundable credits, which are paid as refunds to taxpayers even if the credit amount is greater than their income tax liability:

- Dependent care credit ($11.9 million in fiscal year 2007)
- Working family (earned income) credit ($138.3 million in fiscal year 2007)
- K-12 education credit ($15.4 million in fiscal year 2007)

Credit amounts are from the Minnesota Department of Revenue's *Tax Expenditure Budget, Fiscal Years 2006-2009.*

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publications *The Minnesota Income Tax Marriage Credit*, September 2006; *The Minnesota and Federal Dependent Care Tax Credits*, February 2005; *The Federal Earned Income Credit and the Minnesota Working Family Credit,* February 2006; *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2006; *Income Tax Terms: Deductions and Credits*, July 2005.

HOUSE RESEARCH | Short Subjects

Nina Manzi

Updated: December 2006

Federal Taxable Income, the starting point for calculating Minnesota income tax

What is federal taxable income (FTI)?

Federal taxable income is the tax base used to calculate federal income tax liability. It is also the starting point for calculating Minnesota taxable income, the tax base used to calculate Minnesota income tax liability. Federal taxable income equals federal adjusted gross income after deductions and exemptions.

Federal adjusted gross income (FAGI)	–	Standard *or* Itemized deductions	–	Personal and Dependent exemptions	=	Federal taxable income (FTI)

What kinds of income are included in FTI?

Federal adjusted gross income includes most kinds of income: wages, salaries, and tips; taxable interest; dividends; alimony received by the taxpayer; business income or loss; capital gains or losses; other gains or losses; taxable IRA distributions; taxable pension and annuity distributions (*the taxable portion is typically determined by whether or not the contributions to the pension or annuity were included in federal adjusted gross income when they were made*); income from rental real estate, royalties, partnerships, S corporations, and trusts; farm income or loss; unemployment compensation; and taxable Social Security benefits (*the amount taxable depends on the individual's income level; at most, 85 percent of benefits are included in federal adjusted gross income*). FAGI does not include child support received by the taxpayer.

What kinds of income are excluded from FTI?

Federal adjusted gross income excludes: deductible IRA, SEP, and SIMPLE contributions; nontaxable employee fringe benefits; student loan interest payments; Health Savings Account contributions and investment income; moving expenses; one-half of self-employment tax; health insurance premiums (for self-employed taxpayers only); $250 of teacher classroom expenses; $4,000 of tuition expenses for higher education; penalty on early withdrawal of savings; and alimony paid by the taxpayer. FAGI does not exclude child support paid by the taxpayer.

What deductions are allowed from FTI?

Taxpayers may claim either the standard deduction or itemized deductions. In tax year 2004, the most recent year for which data is available, 57 percent of Minnesotans claimed the standard deduction and 43 percent itemized.

How much is the standard deduction?

In tax year 2007, the standard deduction is as follows:

- $10,700 for married couples filing joint returns
- $5,350 for married couples filing separate returns
- $7,850 for head of household filers
- $5,350 for single filers

What itemized deductions are allowed?

Itemized deductions are allowed for the following:

- State and local property and payments of income taxes
- Mortgage and interest
- Charitable contributions
- Medical expenses in excess of 7.5 percent of income
- Casualty and theft losses in excess of 10 percent of income
- Job expenses and miscellaneous expenses (most only allowed in excess of 2 percent of income)

What personal and dependent exemptions are allowed?

Taxpayers may claim one personal exemption each and one dependent exemption for each dependent claimed. For tax year 2007, the personal and dependent exemptions are $3,400 each. A family of four qualifies for four exemptions, totaling $13,600.

Are there limits on deductions and exemptions?

Itemized deductions are limited for taxpayers with incomes over a threshold. Taxpayers subject to the limitation must subtract from total itemized deductions the lesser of:

- 3 percent of income in excess of the threshold; or
- 80 percent of total itemized deductions, excluding deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses to the extent offset by gambling gains.

Personal and dependent exemptions are phased out for taxpayers with incomes over a threshold. Taxpayers subject to the phaseout lose 2 percent of their total exemption amount for each $2,500 of income over the threshold.

Tax year 2007	Itemized deduction limit begins at	Exemption phaseout begins at
Married joint filers	$155,000	$232,500
Married separate filers	$77,500	$116,250
Single filers	$155,000	$155,000
Head of household filers	$155,000	$193,750

The income thresholds for the itemized deduction limit and the personal exemption phaseout are adjusted annually for inflation.

The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 gradually phases out the limitation on itemized deductions and the phaseout of personal and dependent exemptions from 2006 to 2010. In tax year 2007, the limitation and the phaseout will be reduced by one-third. The general sunset of EGTRRA provisions would reinstate the full amount of the limitation of itemized deductions and the phaseout of exemptions beginning in tax year 2011.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publication *Income Tax Terms: Deductions and Credits*, July 2005.

House Research Department | 600 State Office Building | St. Paul, MN 55155 | 651-296-6753 | www.house.mn/hrd/hrd.htm

Nina Manzi

Updated: December 2006

Minnesota Taxable Income

What is Minnesota taxable income?

Minnesota taxable income (MTI) is the tax base used to calculate Minnesota income tax liability. Minnesota taxable income equals federal taxable income after Minnesota subtractions and additions.

Federal taxable income (FTI)	+	Minnesota additions	–	Minnesota subtractions	=	Minnesota taxable income (MTI)

What are Minnesota additions to taxable income?

Minnesota requires the following *additions* to federal taxable income:

- State income or sales tax deduction. Filers who claimed a federal itemized deduction for state income or sales taxes paid must add that amount back into Minnesota taxable income. Taxpayers making this addition are always allowed to claim at least the full standard deduction for the tax year.
- Bond interest and mutual fund interest dividends paid by non-Minnesota state and local governments. The federal government does not tax state and local bond interest. Minnesota does not tax Minnesota state and local bond interest, but does tax interest on bonds of other states and their local governments.
- Expenses relating to income not taxed by Minnesota. These are mainly expenses deducted at the federal level and attributable to U.S. bond interest income, which is excluded from Minnesota taxable income.
- Capital gain part of lump-sum distributions from qualified retirement plans.
- Teacher classroom expense deduction and higher education tuition deduction allowed at the federal level.

What subtractions does Minnesota allow from taxable income?

Minnesota allows the following *subtractions* from federal taxable income. The estimated cost of most subtractions is taken from the Department of Revenue's *Tax Expenditure Budget for 2006-2009*. Revenue estimates made during the 2007 legislative session differ from the *Tax Expenditure Budget* because they will be based on a more recent economic forecast.

- **State income tax refund** (filers who claimed federal itemized deductions only). The federal income tax allows a deduction for state income taxes. Minnesota requires filers to add back the amount deducted, and allows a subtraction for amounts refunded in order to avoid twice taxing the same income.
- **Subtractions required by federal law.** Federal law prohibits state taxation of these three types of income:

- U.S. bond interest
- Railroad retirement benefits
- On-reservation earnings of enrolled tribal members

- **K-12 dependent education expenses** ($15.8 million in fiscal year 2007). The deduction applies to school-related expenses, including tuition, textbooks, academic tutoring and camps, and instructional materials and supplies. The maximum deduction is $1,625 for each child in grades K-6 and $2,500 for each child in grades 7-12.
- **Compensation for military active service outside of Minnesota** ($6.2 million in fiscal year 2007).
- **50 percent of charitable contributions in excess of $500** ($5.5 million in fiscal year 2007). Allowed only for filers who do not claim federal itemized deductions—those who itemize have already deducted their charitable contributions in computing federal taxable income.
- **Minnesota elderly/disabled exclusion** ($1.4 million in fiscal year 2007). Equals up to $12,000 for low-income elderly and disabled filers with low amounts of Social Security and nontaxable pensions.
- **Job Opportunity Building Zone (JOBZ) income** ($1.4 million in fiscal year 2007). Allowed for net income from a qualified business in a JOBZ, for net income from renting property for use by a qualified business, and for gain from the sale of property used by a qualified business.
- **Organ donation expenses** ($100,000 in fiscal year 2007). Allowed for up to $10,000 of expenses related to organ donation by the taxpayer or a dependent, including lost wages.
- **Federal small ethanol producer credit** ($100,000 in fiscal year 2007). Producers with ethanol production capacity under 30 million gallons may claim a federal credit equal to 10 cents per gallon, but must include the credit in gross income. This subtraction prevents the credit from being included in Minnesota taxable income.
- **Compensation for National Guard and reserve active service in Minnesota** (less than $50,000 in fiscal year 2007). Allowed for state active service and federally funded state active service (generally floods, other disasters, and airport security) but not for drill pay.
- **Gain on sale of farm property for insolvent taxpayers** (less than $50,000 in fiscal year 2007). This subtraction is allowed for taxpayers who use the proceeds of the sale of a farm to pay off a mortgage, contract for deed, or lien on the property.
- **Foreign subnational income taxes.** Taxpayers subject to a foreign subnational income tax may subtract the amount of tax paid to the foreign governmental unit, to the extent the taxpayer did not use the subnational taxes to claim the federal foreign tax credit.

For more information: Contact legislative analysts Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publications *Income Tax Terms: Deductions and Credits*, July 2005; and *Minnesota's Elderly Exclusion* (web only) at www.house.mn/hrd/issinfo/tx_inc.htm.